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UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

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

Defendants.

Case No. 12-cv-03237 EJD

MEMORANDUM OF POINTS AND AUTHORITIES TO DEFENDANTS MOTION FOR SUMMARY JUDGEMENT, OR FOR PARTIAL SUMMARY JUDGMENT, OR IN THE ALTERNATIVE FOR AN ORDER TREATING SPECIFIED FACTS AS ESTABLISHED

Ctrm: 4 - 5th Floor
Date: June 28, 2013
Judge: Hon. Edward J. Davila

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INTRODUCTION

This motion is brought by defendant Mark Feathers, who was the founder and CEO of Small Business Capital Corp., which is a named defendant, and who was the founder of the other named defendants in the lawsuit. These are Investors Prime Fund, LLC ("IPF") and SBC Portfolio Fund, LLC ("SPF"), ("the funds"). Plaintiff alleges that Feathers and SB Capital have committed securities fraud. Plaintiffs allegations are not supported by any evidence that Feathers and SB Capital failed to meet their disclosure requirements to the investors of IPF and SPF. Defendant will demonstrate these facts herein. For these reasons, the Court should grant summary judgment on defendant's request, or partial summary judgment, or for an order treat facts as established.

I. PLAINTIFFS CLAIMS AND THEIR ELEMENTS

SEC has failed to provide any level of specificity, or an evidentiary basis, to the allegations of its complaint. To prove fraud SEC has the burden of establishing that SB Capital or Feathers made false or reckless statements which they have not done. A close review of SEC's allegations will show that it has not come close to meeting this burden. SEC has even admitted that its own enforcement CPAs employed a faulty formula in their own pro forma tables of the defendant's outside CPA prepared financial information; the court must closely consider this as to raise significant credibility considerations, and the inherent bias of SEC's own CPA's in drawing his own "pro forma financial tables" (*Alameda Books, Inc. v City of Los Angeles* (9th Cir. 2011) 631 F3d 1031, 1042-1043)). Herein it will be demonstrated that SEC's allegations are not factually supported, and that it has failed to prove any elements of its fraud claims. A court should grant summary judgment when "the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c)(2). The "party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion,", but it does not have to produce evidence *negating* the opponent's claim." (*Celotex Corp. v. Catrett*

(1986) 477 U.S. 317, 325, 106 S.Ct. 2548, 2554). Rather, the moving party may discharge its burden by simply "showing – that is, pointing out…that there is an absence of evidence to support the nonmoving party's case." *Id.* at 325; *see also* Fed. R. Civ. P. 56(b) & (c)(2). In response, the nonmoving party bears "the burden of identifying with reasonable particularity the evidence that precludes summary judgment." *Siemers v. Wells Fargo & Co.*, 2007 WL 1456047, at *2 (N.D. Cal. May 17, 2007) (citation omitted). Only when "there is sufficient evidence for a reasonable finder of fact to return a verdict for the non-moving party" is there a "genuine dispute as to a material fact." *Id.*

II. ARGUMENTS TO PLAINTIFFS CLAIMS

A. SEC's STATEMENT THAT "THE FUNDS WERE PROHIBITED FROM MAKING LOANS, FOR THE MOST PART, TO SB CAPITAL"

SEC's statement is vague. It does not state a discreet fact. A party cannot create a "genuine" issue of "material" fact simply by making assertions in its legal memoranda. [*S.A. Empresa De Viacao Aerea Rio Grandendense v. Walter Kidde & Co.* (9th Cir. 1980) 690 F2d 1235, 1238; *Enzo Biocem, Inc. v. Gen-Probe, Inc.* (Fed. Cir. 2005) 424 F3d 1276, 1284 – "(a)ttorney argument is no substitute for evidence"].

The true fact is that allowances for manager loans were distinctly outlined in all fund offering document. SEC has not demonstrated that defendant made any kind of loans to manager other than those which were approved in the offering documents.

Supporting Evidence – See Exhibit A - "Offering Documents", and Exhibit B - "Offering Document References to Managers Loans"

B. AS TO SEC'S ALLEGATION THAT "SB CAPITAL DISCLOSED CERTAIN LIMITED CONFLICTS OF INTEREST".

SEC's statement is both vague and incorrect. The offering documents of the funds disclosed some combined two hundred and forty three or more references to conflicts of interest, and an index of conflicts of interest in each offering document. They also detailed narratives on

these matters. Additionally, citations to alert investors to the possibility of conflicts of interest immediately follow the section covering "Fiduciary Responsibilities", and investors were notified that they had not been prior represented. Example index:

Example narrative language:

Conflicts of Interest..... The Fund's business operations will be managed by the Manager, which has and will have certain conflicts of interest. (See "Conflicts of Interest.")

The Manager is subject to conflicts of interest.

There are several areas in which the interests of the Manager will conflict with those of the Fund, which should be carefully considered. (See "Conflicts of Interest.")

Members of the Fund will have no claim to the fees payable to the Manager.

The Fund and its borrowers will pay certain fees and compensation to the Manager. (See "Compensation to Manager.") These fees will be owed as incurred. Even if the Fund is unsuccessful in generating sufficient income to cover its operations, it will have no claim against the Manager for a refund of such fees.

Investors have not been independently represented in the formation of the Fund.

Investors in the Fund have not been represented by independent counsel in its organization, and the attorneys who have performed services for the Fund have also represented the Manager. Thus, conflicts of interest between the Fund and the Manager may not have been addressed as vigorously as in an arms-length transaction. (See "Conflicts of Interest.")

Supporting Evidence – See Exhibit A - "Offering Documents", and Exhibit C - "Offering Document References to Conflicts of Interest"

C. SEC's STATEMENT THAT SB CAPITAL REPRESENTED THAT "THE FUNDS HAD CONSERVATIVE LENDING STANDARDS"

SEC's statement is a conclusory allegation. Nowhere does SEC show a statement in the offering documents such as "the funds have conservative lending standards". In fact, the funds were formed to invest in high yield mortgages, with the potential for substantial interest, premium, and loan servicing income. This meant making higher risk loans, with higher likelihoods of default, such as short term financing to borrowers with low amounts of loan documentation. It meant investing in junior position mortgage note investments. It meant providing financing to borrowers who might not qualify for institutional financing. The offering documents are replete with references as to the high risk nature of the loans that the funds would make; the offering documents disclosed the nature of the fund's lending businesses. Some citations:

> The purpose of the Fund is to invest in loans and, as such, it takes the risk of defaults by borrowers and other risks faced by lenders. Company loans may be made to some Borrowers who are unable to avail themselves of more traditional sources of financing, such as banks or savings and loans, either due to expedited funding requirements, credit or other underwriting issues. Some Fund loans may provide for monthly payments of interest only or will have long amortization schedules with short-term maturity dates. Thus, the borrower will have to make a large "balloon" payment of principal due at the end of the term. Many borrowers are unable to repay such loans out of their own funds and are compelled to refinance. Fluctuations in interest rates and the unavailability of mortgage funds could adversely affect the ability of borrowers to refinance their loans at maturity.
>
> **Special Considerations in Connection with Junior Encumbrances**
>
> In addition to the general considerations concerning trust deeds discussed above, there are certain additional considerations applicable to second deeds of trust (i.e., "junior encumbrances"). By its very nature, a junior encumbrance is less secure than more senior ones.
>
> Commercial and industrial loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans.
>
> The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.
>
> Company loans may be made to some Borrowers who are unable to avail themselves of more traditional sources of financing, such as banks or savings and loans, either due to expedited funding requirements, credit or other underwriting issues.

The Manager will seek to evaluate loans quickly in order to complete the underwriting process in one to two weeks. Many borrowers are willing to pay higher interest rates for a lender's ability to close quickly on such loans, which may not conform to an institutional lender's strict credit and income documentation guidelines, but which will meet Federal underlining guidelines to qualify for loan guarantees.

Supporting Evidence – See Exhibit A - "Offering Documents

D. SEC'S STATEMENT THAT SB CAPITAL REPRESENTED "FUND LOANS WERE SECURED, PERFORMING, AND CURRENT"

SEC's statement is vague and clearly overly broad. SEC's statement fails to reference "who" these representations were made to, with any level of detail or specificity, or when, or to present any factual evidence which is contrary to the offering documents of the funds. SEC fails to reference a specific period; even while the funds undeniably had some eleven years of combined operations between them at the time of injunction. SEC fails to define a reference to "performing". The funds provided detailed information on loan performance to their auditors, to investors, and to their regulators, such as the California Department of Corporations securities division, and the U.S. Small Business Administration. For example, in an email communication to the funds' auditors in late 2011, SB Capital acknowledges reference to a defaulted loan:

Subject: IPF Loan Collateral Analysis 12-31-11 on servicing portfolio.xlsx
From: "David Gruebele" <DG@secondangel.net>
Date: Thu, Mar 01, 2012 3:50 pm
To: <mae@sbcapital.com>, <jp@spiegelcorp.com>, <mark@sbcapital.com>, <CBerlin@SBCapital.com>
Attach: IPF Loan Collateral Analysis 12-31-11 on servicing portfolio.xlsx

Please see attacheded.

COLLATERAL / UNDERLYING LOAN REPORT
Small Business Capital
31-Dec-11

Loan Account	Name	Borrower Name	Payment Status
129	Four Brothers	Four Brothers Inns, LLC	Default

Communications to investors or to regulators typically included disclosures and disclaimer language that these were interim reports. The communications periodically suggest that all loans were not performing and current. Take a citation from a manager letter of Jan 2012 (Exhibit D):

> Commercial and residential real estate values, as you may know, continued to soften a bit in 2011. Most of our fund notes were financed over the past year, so this has no bearing on our portfolio. However, I would like to sell two of our notes which are not guaranteed (which we financed several years ago before our federal licensing) and replace these with guaranteed notes; the value of the collateral securing these notes may be less than the note amounts themselves.

Fund offering documents which cover the claim period made specific reference to non-performing loans and/or foreclosures. From IFP's 2009 offering circular:

> In 2008, the Fund foreclosed on two loans in the aggregate principal amount of $933,500; however, both properties were sold by the Fund at no loss each for a sales price in excess of the aggregate principal, accrued interest and fees and costs payable on such properties through their date of sale.

SB Capital would advise investors directly on the status of loan portfolios with their requests for information, and discuss the business model of the funds.

> Subject: RE: SB Capital Portfolio
> From: Vahid Sotoudeh <vsotoudeh@sbcglobal.net>
> Date: Mon, June 21, 2010 10:54 am
> To: mark@sbcapital.com
> Cc: Mark@primefund.com, jeff@sbcapital.com
>
> Hi Mark,
>
> I hope all is well. Would you send me an update on the status of the two non-conforming loans mentioned in tl emails below last month? Also, do you see any new such loans in the horizon?
>
> > From: mark@sbcapital.com <mark@sbcapital.com>
> > Subject: RE: SB Capital Portfolio
> > To: "Vahid Sotoudeh" <vsotoudeh@sbcglobal.net>
> > Cc: Mark@primefund.com, jeff@sbcapital.com
> > Date: Tuesday, May 11, 2010, 8:13 PM
> >
> > We count on about 20% of these loans being in a non-payment status, as we can charge higher rates once they are in default. These are confirming private money loans, both on income properties. The dollar amount of the fund in these loans is about 20% currently. All of our loan docs have a default interest rate, as well as provisions for the payment of attorney fees by the borrower. For both of these loans, the rents, or potential rents, would exceed the amount of payments due on the 1st mortgage. Based upon my conversations with the 1st mortgage lenders, they would like accomodate our requests to reinstate the loans while the properties are sold, if that becomes necessary. We do not typically accept payments on loans which are in default. In some cases we may step in and collect rents, as are allowed to do so by California statute.

Fund offering documents offered to provide financial statements to investors which had information on investments (Feathers declaration). The funds' primary focus was on SBA lending during the last half of the claim period. Whereas SEC appears to offer to cast doubt on the defendant's business entities, another federal agency, SBA, who supervised the loan product that constituted the majority of the fund's portfolios (SBA loans) offered differing conclusions. SEC initiated their enforcement review in December 2011, which is a date just weeks after Feathers

received the results of an on-site Safety and Soundness exam from SBA. After a review of one hundred percent of the SBA 7(a) loans in the portfolios at that time, and the financial statements, lending, loan portfolio, and servicing operations of Small Business Capital, LLC, which was wholly owned by IPF, and SBA's review of the management of Small Business Capital, which was the same management as SB Capital, the SBA provided its own assessment. Its conclusions are worth looking at. There can be no argument by SEC that the operations were "still new", and the results of this federal agency safety and soundness exam are not relevant. This exam was more than one year into fund licensing, was conducted in the second half of 2011. SB Capital's management had two decades of SBA lending experience behind them, so the exam results were not "beginner's luck". Through the date of the injunction, the fund's SBA portfolios doubled; SBA loans were 90% or more of fund assets. SBA's comments are valid, because they were given in close proximity to SEC's review and the injunction, and they are from a regulatory agency with decades of lender examination experience.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

December 9, 2011

Mark Feathers, President
Small Business Capital, LLC
419 S. San Antonio Road, Suite 213
Los Altos, CA 94022

Dear Mr. Feathers:

Enclosed please find three copies of the Report of Examination (ROE) of Small Business Capital, LLC (SBC) for the July 11-15, 2011 safety and soundness examination conducted by the Fuentes-Fernandez & Company on behalf of the U.S. Small Business Administration (SBA).

MANAGEMENT

Management has generally maintained safe and sound operations and provided adequate direction to staff. The business planning and internal control process are currently sufficient for the size and scope of operations of the newly formed firm and its parent.

LOAN PORTFOLIO MANAGEMENT

Portfolio management practices were effective to date. In the ten months between June 2010 and March of 2011, SBC originated thirteen loans with a gross principal balance of over $15

million.

Portfolio Concentrations

SBC appropriately managed concentration risk since it did not have large concentrations by industry and it had strategies in place to manage its geographic concentrations. The majority of its loans were concentrated in California at 82.5 percent. The industry concentrations were diversified since all industries were well below 15 percent of the portfolio as illustrated in the table below.

SBA Loan Performance

Compared to both their peer group and all 7(a) lenders, SBC met or exceeded all key portfolio risk measures as illustrated in the table below.

SBA Lender Portal Data as of 3/31/2011	SBC	7(a) Peer Group	Portfolio
Past Due Rate	0.0%	1.6%	1.7%
Delinquency Rate	4.5%	1.5%	1.8%
12-month Purchase Rate	0.0%	4.5%	5.9%
SBPS Score Average	204.2	181.1	182.2
6-month Liquidation Rate	0.0%	5.2%	5.7%
Projected Purchase Rate	2.6%	5.4%	5.3%
Dollar Weighted Average FBS	1,331.5	1,194.5	1,189.9
6 Month Net Flow Indicator	1	0	
PLP Percent	0%	60.0%	59.3%
SBA Express Percent	0%	8.5%	7.5%

FINANCIAL CONDITION AND PERFORMANCE

Capital

SBC is well capitalized with a Capital/Unguaranteed Loans Serviced ratio of 141 percent. This ratio is above the minimum capital requirement set forth in SBA Regulation 13CFR §120.471(a).

E. SEC'S STATEMENT THAT "SB CAPITAL CAUSED SPF TO SELL EIGHT MORTGAGE LOANS AT A PREMIUM OVER THEIR BALANCE"

SB Capital arranged for the funds to sell mortgage loans at a premium over their balance in accordance with the express provisions of the offering documents of the funds. These sales were accompanied by a manager's economic analysis (Exhibit E) to demonstrate a fair and reasonable purchase price in the best interest of the buying fund and the selling fund. SEC has not demonstrated in its pleadings that SB Capital was not allowed to sell loans at a premium over their balance.

7. Purchase of Loans from Affiliates. Existing loans funded or acquired by the Manager or its affiliates may be purchased by the Fund. The Fund may also purchase loans from third parties. All loans purchased by the Fund must satisfy the lending guidelines described above. Generally, the purchase price to the Fund for any such loan will not exceed the par value of the note or its fair market value, whichever is lower, but the Manager may purchase loans for a premium if the Manager believes the total purchase price is fair and reasonable and in the best interest of the Fund.

F. SEC's STATEMENT THAT SB CAPITAL "CAUSED SPF TO PAY OVER $570,000 IN MANAGEMENT FEES TO SB CAPITAL"

SEC is vague in its reference to "management fees" throughout its complaint. SEC fails to illustrate what these numbers signified in any relative terms to some measure of comparison. SEC fails to demonstrate in its pleadings that any of these payments were outside of the allowances of the fund offering documents. The offering documents have indexes outlining manager's compensation, and they are replete with references to same. There are some fifty references in each offering document to various forms of manager's compensation. These included loan fees, premiums, loan points, broker fees, packaging fees, profit participation, etc.

Origination and Loan Documentation Fees

The Manager and its affiliates will receive origination and loan sale premiums payable by the borrowers and other investors on Fund loans arranged by the Manager and its affiliates. The Manager and its affiliates may also be entitled to receive loan processing, servicing and documentation fees associated with loans arranged by Manager and its affiliates. Such fees will payable by the borrowers on Fund loans at prevailing industry rates depending on market conditions.

The offering documents of the funds, per SB Capital's directives in their preparation, state with what must be recognized as high levels of disclosure and candor. They even state that the fund manager may be motivated to earn compensation by using fund money on risky loans "not" in the best interests of investors:

> be motivated to close loans using Fund monies that are risky or otherwise not in the best interests of the Fund, in order to earn its loan points, especially if the profits earned by the Fund are insufficient to pay the Manager a substantial profits interest and such commissions become the Manager's primary or sole

G. SEC'S STATEMENT THAT "THE FUNDS FAILED TO DISCLOSE THE CONFLICTS OF INTEREST ARISING FROM INTER-COMPANY TRANSACTIONS"

As discussed prior, there are more than two hundred and forty reference to conflict of interest in fund offering documents. A mere assertion of "fiduciary duty" of the fund manager, such as SEC makes in its pleadings, with no details or standard of comparison provided, is not a sufficient evidentiary basis to overcome the extent of the disclosures references of the funds in their offering documents. A specific allowance for inter-company loan sale transactions was fully disclosed in fund all fund offering documents.

> 7. **Purchase of Loans from Affiliates**. The Manager is an active mortgage loan broker and existing loans funded or acquired by the Manager or its affiliates may be purchased by the Fund.

H. SEC'S STATEMENT THAT THAT THE FUNDS "WOULD USE BE BETWEEN 96% AND 98% OF OFFERING PROCEEDS TO MAKE OR TO INVEST IN MORTGAGES"

This guidance was subject to a fully subscribed offering. Other references in the offering documents clearly indicate that offering proceeds were calculated "before deducting organizational and offering expenses".

> **USE OF PROCEEDS**
>
> The proceeds from the sale of Units offered hereby will be used approximately as set forth below. The figures set forth below are only estimates, and actual use of proceeds will vary.
>
> Net proceeds to the Fund is calculated before deducting organizational and offering expenses, including without limitation legal and accounting expenses, printing costs and selling expenses. (See "Use of Proceeds.")

The offering documents clearly show that at any given time the funds might also occasionally have periods where they were heavy on cash and would make investments in other than mortgage note from new investor subscription and loan payoffs:

> There may be a delay between the time a subscription is submitted by a prospective investors and the time the Fund accepts such subscription and the investor becomes a Member. There may also be a delay between acceptance into the Operating Account and funding a loan. During these periods of delay, the proceeds may be invested in interest bearing accounts, short-term certificates of deposit, money-market funds or other liquid assets which will not yield as high a return as the anticipated return to be earned on Fund loans. The length of these delays may adversely affect the overall investment return to Members.

I. SEC'S STATEMENT "THAT DEFENDANTS REPRESENTED THAT THE FUNDS WOULD PAY MEMBER RETURNS OF 7.5%"

SEC fails to state a period of reference, and it fails to distinguish what the word "pay" means. Did it mean to pay income? Did it mean to make distributions? SEC's wording in the complaint is vague throughout. The funds would "distribute" monies to investor, which could be earnings, capital, or a combination. When read as a whole, which the offering documents recommended that investors do, the funds could not even assure profitability. Offering documents clearly show the possibility of "losses" as opposed to "income":

"Summary of Operating Agreement – Profits and Losses" and "- Cash Distributions."

1.23 "Preferred Return" shall mean an amount equal to a compounded simple return on the balance of each Member's Capital Account outstanding from time to time at a rate equal to the greater of: (i) 7.5% per annum; or (ii) the applicable Prime Rate. The Preferred Return shall accrue during each Fiscal Year only to the extent the Company has Profits in such Fiscal Year,

Distribution and shall not create a debt of the Company or the Manager to any Member to the extent that such Profits or case are not available for allocation or distribution, nor shall such

payments constitute "guaranteed payments" within the meaning of Code Section 707(c).

1.25 "Profits" and "Losses" shall mean, for each Fiscal Year or other period, an amount equal to the Company's taxable income or loss for such Fiscal Year or period,

Offering documents clearly show the possibility of a return of capital:

Distributions of Income

To the extent cash distributions exceed the current and accumulated earnings and profits of the Fund, they will constitute a return of capital, and each Member will be required to reduce the tax basis of his Units by the amount of such distributions and to use such adjusted basis in computing gain or loss, if any, realized upon the sale of Units. Such distributions will not be taxable to Members as ordinary income or capital gain until there is no remaining tax basis, and, thereafter, will be taxable as gain from the sale or exchange of the Units.

Investors who become Members in the Fund in the manner set forth herein will not be responsible for the obligations of the Fund and will be liable only to the extent of their agreed upon capital contributions. Members may be liable for any return of capital plus interest if necessary to discharge liabilities existing at the time of such return. Any cash distributed to Members may constitute, wholly or in part, return of capital.

The funds even outlined with clarity that "new member" capital might be used as a source of capital for fund distributions:

Withdrawal.....	Investors have no right to demand withdrawals from the Fund for twelve (12) months after investment; thereafter, investors have a limited right to withdraw from the Fund. The Fund may utilize money from new subscriptions to fund withdrawals. (See "Summary of Operating Agreement – Withdrawal from Fund" and "Risk Factors – Risks Related to Ownership of Units.") The Manager shall have the right to redeem a Member's Units, at its sole discretion, if it believes it is in the Fund's best interest.

Company marketing clearly showed that the funds had "not" always earned the target 7.5% return (from SB Capital Powerpoint presentation to investors, Exhibit F):

SB CAPITAL [redacted]

Investors Prime Fund – California only

2006 (June 30-Dec. 31)	8.60%
2007	8.25%
2008	8.63%
2009	6.50%
2010	7.50%
2011 (January 1-August 30)	7.50%

IPF offering documents also show an entirely different member distribution, which was conditional upon variables which included a Prime Rate reference index, and fund profitability. SEC's representation is far off from the true fund return model for investors:

Member Preferred Return	Fund profits will first be allocated entirely to the Members each year up to the amount of the Member Preferred Return, which is the greater of 7.5% per annum or the prime rate, which is adjusted monthly. Any profits exceeding the Member Preferred Return may be retained by the Manager. (See "Terms of the Offering – Member Preferred Return.")

J. SEC'S STATEMENT THAT "SB CAPITAL USED THE MONEY TO PAY ITS OPERATING EXPENSES, INCLUDING OVER $485,850 PAID TO FEATHERS AND COMPANIES HE CONTROLS"

There were no restrictions on such matters; SEC has not offered in its complaint references that would show any restrictions in the offering documents of the funds, including restrictions on payments of any salaries, wages, and benefits to Feathers. It is a fact that IPF and SPF offering documents made specific allowances for the manager to be reimbursed for all organizational and syndication expenses:

> 10.4 Reimbursement of Manager for Certain Expenses. The Manager shall be reimbursed by the Company for all organizational syndication and operating expenses incurred on behalf of the Company, including without limitation, out of pocket general and administrative expenses of the Company, accounting and audit fees, legal fees and expenses, postage, and preparation of reports to Members.

K. SEC's ALLEGATION THAT DEFENDANT FEATHERS AND SB CAPITAL WERE NOT PROPERLY REGISTERED AS BROKER-DEALERS

Issuers such as SB Capital are offered clear exemptions from broker-dealer registration requirements when (1) they are issuers only for their own funds; SB Capital made no trade in other securities, and it did not operate in the securities industry, (2) and both funds had specific guidance from their counsel that they were exempt from registration requirements with the SEC, who was not the fund's regulator, nor the issuer of their permit (for IPF). IPF was a California permitted offering, which SEC does not deny. The exception to regulatory oversight of the SEC by the funds is:

> THE SALE OF UNITS COVERED BY THIS OFFERING CIRCULAR HAS NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), IN RELIANCE UPON THE EXEMPTIONS FROM SUCH REGISTRATION REQUIREMENTS PROVIDED FOR UNDER SECTION 3(a)(11) OF THE ACT AND RULE 147 THEREUNDER RELATING TO INTRASTATE OFFERINGS.

SPF was an SEC exempt fund also:

THE SALE OF UNITS COVERED BY THIS MEMORANDUM HAS NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), IN RELIANCE UPON THE EXEMPTIONS FROM SUCH REGISTRATION REQUIREMENTS PROVIDED FOR UNDER SECTION 4(2) OF THE ACT, AND REGULATION D THEREUNDER RELATING TO CERTAIN LIMITED OR PRIVATE OFFERINGS. THESE UNITS CANNOT BE RESOLD WITHOUT REGISTRATION UNDER THE ACT OR PURSUANT TO AN EXEMPTION THEREFROM.

L. SEC's STATEMENT THAT THE RECEIVABLES "REPRESENTED MORE THAN 14% OF TOTAL COMBINED ASSETS"

SEC offers a statement, but presents no indication that any guidance of the offering documents was violated. These clearly indicate the amount of the receivable might be as high as $5,000,000 for IPF.

> Through prior member approval changes to the Fund's operating agreement, the Manager can convert a portion of organizational and syndication accruals from Fund expenses to a note receivable from the Manager. Those prior marketing, syndication and organizational costs which were accrued prior to 2010, or certain new marketing and syndication expenses incurred in 2011, up to 1% of the Fund's maximum capitalization of $500,000,000 or up to $5,000,000, which may represent more than 1% of the Fund's capital depending upon total capitalization at any given time, may be converted from a current Fund expense or capitalized asset to a

Additionally, the funds were lawfully separate and distinct entities. For SEC to make a statement as to the fund's "combined assets", when they had different owners, operating agreements, financial statements, etc., is analogous to SEC combining elements of the balance sheets of entirely unrelated public entities and making references in a lawsuit against one entity that combined information for both entities. There is no specificity in SEC's statement, and no measure of bearing. SEC regulated companies are routinely provided with a15% guidance for expenses (Exhibit G); SEC offers no explanation why the funds would not be allowed the same consideration:

> O&O Expenses
>
> Rule 2810 limits the amount of O&O expenses for an Investment Program to 15 percent of the gross proceeds of the offering. O&O expenses have three components: (1) issuer expenses that are reimbursed or paid for with offering proceeds; (2) underwriting compensation; and (3) due diligence expenses. Each of these items is discussed below.

M. SEC STATES "THAT SB CAPITAL BORROWED ADDITION MONEY FROM IPF TO MAKE INTEREST PAYMENTS ON THESE RECEIVABLES"

SEC's statement has several obvious flaws. The first is that there were no express restrictions, nor implied restrictions, that the interest accrual payments on the receivables could not be considered as organization expenses. Interest expenses are "an organization's expense". Of additional consideration, SB Capital earned substantial amounts of commercial mortgage brokering income every year. SEC has not offered any evidentiary basis to demonstrate that the payments on the line were not from other business income. It is not the defendant's burden of proof to show this matter, it is SEC's.

N. SEC'S STATEMENT "THE FUNDS WERE NOT ABLE TO ASSESS THE COLLECTABILITY OF THESE RECEIVABLES"

SEC offers no evidence to the Court that SB Capital or the funds ever represented to existing or prospective investors that the collectability of the receivable would be assessed by SB Capital or outside parties. The offering documents themselves make no statements that the fund's financial statements would reflect the collectability of the receivable.

O. SEC's STATEMENT: "SINCE AT LEAST 2010 FOR IPF AND SINCE 2011 FOR SPF, FEATHERS AND SB CAPITAL HAVE PAID RETURNS TO INVESTORS IN EXCESS OF NET PROFITS OF THE FUNDS, IN A "PONZI-LIKE SCHEME IN WHICH THE RETURNS WERE PARTIALLY FUNDED WITH MONEY FROM NEW INVESTORS"

SEC's statement is a conclusory allegation. Although SEC's statement is not accurate, defendant asks "What is the definition of "Ponzi-like""? SEC itself even has no policy on when it can call an entity "Ponzi-like" (Exhibit H). The term is vague and offers no specificity or absolute measures of reference or comparison. SEC fails to show that fund disclosures regarding

distributions were violated. SEC has produced its own "pro forma" tables, which also by definition are unreliable, and which it has already admitted to be unreliable (Court Docket 160 "SEC Reply").

> The Commission does not dispute that in calculating member returns in the Complaint, it added together the line items "distributions" and "re-invested distributions" to arrive at the total distributions alleged in the Compliant. In his motion, Feathers claims that adding these two amounts was incorrect because the "distributions" amount already included the "re-invested distributions" amount. It may well be that the line item "distributions" includes "re-invested distributions," so that Feathers' lower number will ultimately be shown to be correct.

The word "paid" is vague. Is it a reference to distributions of income, or income and capital, or capital, or all? The offering documents make reference to the allowances for distributions for all of these possibilities. The financial illustrations in SEC's complaint are not reliable, by their own admission (Court Docket 160). SEC's Enforcement CPA himself only attests to his "good faith" efforts, and makes no representations to the accuracy of his work:

> 5. As part of my work, I calculated what I believed in good faith to be the total amount of distributions to investors from each of the Funds for 2010, 2011 and the first quarter of 2012. I and others at the Commission analyzed financial statements produced by defendants from their QuickBooks system, which, among other things, included separate entries for "re-invested distributions" and for "distributions" in the category "Liabilities & Equity." (*See, e.g.*,

In his statement the CPA makes reference to the "Quickbooks" of the defendants, which appears to bypass a reliance on the audited financial statements of the funds, or their CPA prepared tax returns, with no explanation why the fund's CPA prepared fund financial information is not used.

SEC shows similar vagueness in its employment of the word "returns". SEC offers no definition of what "returns" are, and no specificity. The funds' primary references for monies that would go to investors would be either "distributions" or "withdrawals". This is further compounded by SEC's employment of some nine different references and phrases related to their

undefined use of the word "return" in the complaint. SEC's complaint makes references to: "Member return", "Monthly return", "Member preferred return", "Paid returns", "Pay returns", "Membership returns", "Investor Returns", "The returns", and "Returns paid". Additionally, the funds, as funds like this do, made disclosures in the offering documents that investor distributions might include some return of principal:

Distributions of Income

To the extent cash distributions exceed the current and accumulated earnings and profits of the Fund, they will constitute a return of capital, and each Member will be required to reduce the tax basis of his Units

P. SEC's STATEMENT THAT "DEFENDANT'S DISCLOSURES TO INVESTORS WERE FALSE AND MISLEADING BECAUSE THEY FAILED TO DISCLOSE THAT SB CAPITAL HAD IMPROPERLY TAKEN $6 MILLIONS FROM THE FUNDS, THAT DEFENDANTS CAUSED THE FUNDS TO RECORD THE AMOUNTS TAKEN AS ASSETS IN THE FORM OF RECEIVABLES"

SEC's statement is a conclusory allegation. SEC provides no demonstration that monies used by SB Capital were not for reimbursement of expenses, or for monies to be spent for expenses. SB Capital caused the receivable to be reflected on fund financial statements as a "receivable" (Exhibit G) , and in accordance with the disclosures of the offering documents (Exhibit A).

Q. SEC's STATEMENT THAT "THE FUNDS WERE NOT ABLE TO ASSESS THE COLLECTABILITY OF THESE RECEIVABLES BECAUSE OF THE UNCERTAINTY OF SB CAPITAL'S CASH FLOW"

SECs statement is vague. "Cash flow" by definition is a broad term. Loan proceeds are reflected by generally accepted accounting principles (GAAP) on a company's "Sources and Use of Cash Statement". SB Capital did in fact have assurance of cash flow by the very approval, fully disclosed, of the fund manager notes. Additionally, SB Capital, and the funds, never did represent to investors that they would be assessing the collectability of the receivables. The funds offered their financial statements for investors to review. The offering documents make express references

to the fact that investors might lose a large portion of their investment, and should not invest if they could not afford to lose this.

> ***The Units bear risks and if you cannot afford to lose some or a large portion of your investment, you should not invest.***
>
> Prospective investors should be aware that the Units bear risk, and are suitable only for investors of adequate financial means. If you cannot afford to lose your investment, you should not invest in the Units. If the Fund accepts an investment, you should not assume that the Units are a suitable and appropriate investment for you.

R. SEC'S STATEMENT THAT "BY RECORDING THE $6M AS RECEIVABLES ON THE FUND'S FINANCIAL STATEMENTS, DEFENDANTS CONCEALED THAT THE MONEY WAS USED TO PAY SB CAPITAL'S EXPENSES RATHER THAN TO INVEST IN MORTGAGE LOANS"

SEC's statement is a conclusory allegation. SEC does not even show its source document(s) for its $6M allegation. SB Capital did not represent, nor do offering documents make representation, that any proceeds from the managers note would be used to invest in mortgage loans. Nor did SB Capital represent that all investor capital would be used for mortgage investments. SEC makes a generalized comment about "concealment" but does not specify who these matters were concealed from. Its logic is flawed. By recording the receivables on fund financial statements, always available to investors, who were always provided offering documents, these matters were disclosed.

III DEFENDANTS RELIANCE ON EXTERNAL PROFESSIONALS

The offering documents of the funds, submitted by SEC to the Court with its complaint, make clear reference that these were prepared by outside professionals for the funds.

The audited financial statements and tax returns of the funds, submitted by SEC to the Court with its complaint, make clear reference that these were prepared by external licensed certified public accountants (see Court Dockets 9 through 9-7).

IV SEC'S CLAIM FOR INJUNCTIVE RELIEF IS BARRED BECAUSE, *inter alia*, THERE WAS NO VIOLATION OF THE SECURITIES AND EXCHANGE ACT AND BECAUSE THERE WAS NO REASONABLE LIKLIHOOD THAT ANY VIOLATION WILL BE REPEATED. THE SEC'S CLAIM FOR INJUNCTIVE RELIEF IS FURTHER BARRED BECAUSE THE ADVERSE AFFECTS OF THE INJUNCTION FAR OUTWEIGHT ANY BENEFIT

Defendants discontinued selling member units of ownership in defendants IPF and SPF prior to the date of injunction; SEC has not demonstrated otherwise. The evidence offered in support of this motion establishes every essential element of the defendant's defense. Defendant is not required to provide evidence to disprove SEC's claims, for which it has the burden of proof at trial [*Celetox Corp. v. Catrett* (1986) 477 US 317, 323, 106 S.Ct. 2548, 2553; *Crawford v. Countrywide Home Loans, Inc.* (7 Cir. 2011) 647 F3d 642, 648)].

The audited financial statements of the funds, as well as SEC's own acknowledgement, demonstrate that SB Capital and Feathers have financial obligations to the funds. The investors of the funds will suffer substantial economic damages which far outweigh any benefit to SEC of injunctive relief.

V THE SEC'S CLAIM FOR DISGORGEMENT IS BARRED BECAUSE, *inter alia*, FEATHERS DID NOT RECEIVE ANY ILL-GOTTEN PROFITS OR ECONOMIC GAINS AS A RESULT OF ANY OF THE ACTIONS IN THE COMPLAINT

SEC has not referenced any ill-gotten profits or economic gains of the defendant. It has alleged profits or gains in its complaint. This motion demonstrates that all SB Capital and Feathers gains, compensation, profits, etc., were within the express provisions of the offering documents.

VI SEC'S CLAIM FOR PENALTIES IS BARRED BECAUSE, *inter alia*, ANY VIOLATION WAS ISOLATED OR UNINTENTIONAL

In its complaint and pleadings, SEC has not demonstrated how defendants' actions were willful, negligent, reckless, or intentional. Feathers and SB Capital were held in good regards prior to the complaint by their regulators, investors, and the general public. SEC has not demonstrated any basis to assert otherwise.

VII SEC'S COMPLAINT FAILS TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED

Demonstrations in this Memorandum of Points and Understanding lead to a clearly drawn conclusion that SEC's complaint fails to state a claim upon which relief can be granted.

CONCLUSION

It is clear that in their offering documents and financial statements the Defendants offered to investors disclosure on SEC's allegations. The SEC will not be able to meet its burden of proof as to its allegations at trial. To survive summary judgment, however, plaintiffs now must come forward with evidence to support their claims against the defendants. Plaintiff can no longer rely solely on their pleadings for support.

Plaintiffs do not have evidence that the defendants violated the terms of their offering documents. Plaintiffs will be unable to point to a genuine issue of material fact to support their allegations and this lack "sufficient evidence for a reasonable finder of fact" to find in their favor. (*Seimers,* 2007 WL 1456047, at *2). Because plaintiffs will be unable to prove that the defendants violated the terms of their offering documents, defendant respectfully requests summary judgment for the defendants against the allegations of the plaintiff.

Date: 5-13-13

Mark Feathers, *Pro Se* defendant