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United States District Court,
C.D. California.

Securities and Exchange Commission
v.
Capital Cove Bancorp LLC et al.

Case No. SACV 15-980-JLS (JCx)
|
Signed 10/13/2015

**Attorneys and Law Firms**

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**PROCEEDINGS: (IN CHAMBERS) ORDER GRANTING RECEIVER'S MOTIONS FOR ORDER AUTHORIZING (1) SALE OF REAL PROPERTY BY PUBLIC AUCTION FREE AND CLEAR OF LIENS, CLAIMS, AND ENCUMBRANCES OR, IN THE ALTERNATIVE, ABANDONMENT OF OVER-ENCUMBERED PROPERTIES (Doc. 71), (2) ESTABLISHING CLAIMS BAR DATE, (3) APPROVING FORM AND MANNER OF NOTICE, (4) APPROVING PROOF OF CLAIM FORM AND SUMMARY PROCEDURES, (5) STAYING POST-RECEIVERSHIP INTEREST, AND (6) ESTABLISHING THE NET INVESTMENT METHOD FOR FIXING INVESTOR CLAIMS (Doc. 73)**

Honorable JOSEPHINE L. STATON, UNITED STATES DISTRICT JUDGE

***1** Before the Court are two Motions filed by Receiver Robert Mosier.[1] The Receiver filed a Motion for Entry of an Order Authorizing (1) Sale of Real Property by Public Auction Free and Clear of Liens, Claims, and Encumbrances, or (2) in the Alternative, Abandonment of Over–Encumbered Properties. (Sale Mot., Doc. 71.) The Receiver also filed a Motion for Entry of an Order (1) Establishing Claims Bar Date, (2) Approving Form and Manner of Notice, (3) Approving Proof of Claim Form and Summary Procedures, (4) Staying Post–Receivership Interest, and (5) Establishing the Net Investment Method for Fixing Investor Claims. (Claims Bar Mot., Doc. 73.) A number of interested parties opposed, (Docs.98, 99, 101, 104, 107, 116), the Receiver replied, (Docs.110, 111, 136), and two interested parties filed surreplies with leave of court, (Docs.140, 141). Having considered oral argument and the briefs taken under submission, the Court GRANTS the Receiver's Motions.

## I. *BACKGROUND*

On June 18, 2015, Plaintiff Securities and Exchange Commission filed suit against Defendants Christopher M. Lee (a.k.a. Rashid K. Khalfani) and Capital Cove Bancorp, LLC. (*See* Compl., Doc. 1.) The SEC's complaint alleges that Defendants have violated (1) the antifraud provisions of Section 17(a) of the Securities Act of 1993, 15 U.S.C. § 77q(a), (2) the antifraud provisions of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), (3) Rule 10b–5 of the Exchange Act, 17 C.F.R. § 240.10b–5, (4) the registration provisions of Section 5 of the Securities Act, 15 U.S.C. § 77e(a) and 77e(c), and (5) Sections 203 and 207 of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b–3, 80b–7. (Compl.¶¶ 10–12.)

On that same day, the Court entered a Temporary Restraining Order and Order to Show Cause Why Preliminary Injunction Should Not Be Granted pursuant to the SEC's Ex Parte Application. (TRO, Doc. 5.) The TRO ordered Defendants to comply with securities laws, prohibited the destruction of evidence, ordered Defendants to provide to the SEC an accounting of assets, and froze Defendants' assets. The TRO also appointed Robert Mosier as the temporary receiver over Defendants' assets. (Id. at 8.)

***2** On June 29 and 30, 2015, the Receiver filed his initial reports. (First Report, Doc. 35; First

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Supp. Report, Doc. 37.) The Receiver reported that CCB and its more than thirty related entities are financially insolvent, and that Defendants engaged in Ponzi-like activities by repaying existing investors with new investor monies. (First Report at 5–9; First Supp. Report at 2–4, Exs. 1–5.) The Receiver further reported the commingling of the entities' monies, the notable absence of corporate books and records, and a Morgan Stanley brokerage account statement that Khalfani admittedly altered "to show cash on hand." (First Report at 5–6, 9, Exs. A, D.) Investigations into CCB's books and records later revealed at least six other alterations to brokerage account statements since August 2013. (Supp. Pearson Decl. ¶¶ 5–6, 10–11, Exs. A–N, Doc. 77.)

The Receiver states that his work "reveals to a near certainty that the collective assets of Capital Cove will be insufficient to pay claimants 100% of the amounts claimed." (Mosier Decl. ¶ 5, Doc. 73.) The Receiver is aware of more than thirty real properties owned by Defendant CCB or its affiliates, [2] many with multiple encumbrances. (Mosier Decl. ¶¶ 5, 10–36, Exs. 1–26, Doc. 71.) Recorded liens against these thirty properties total approximately $17.8 million. (Second Supp. Report at 3, Doc. 48.) The Receiver proposes an initial sale of twenty-six properties, [3] and he estimates that the potential gross recovery from that sale may be in the range of $10.7 million to $12.3 million. (Third Supp. Report at 2, Doc. 85.) The total loan amounts of the first trust deeds on each of the twenty-six properties is approximately $9.5 million. (Third Supp. Report at 3.) The interest to be claimed by the first trust deed holders from the date of appointment through November 30, 2015, the likely date of closing sales, is approximately $1.1 million. (Third Supp. Report at 3.) The Receiver states that he received payoff demands from one of the secured lenders which, if left in place, would make the Defendants' estate insolvent "within a few months." (Claims Bar Mot. at 11; Mosier Decl. Ex. 3.)

The Receiver has identified approximately sixty-nine investors who seek recovery from the estate. (Third Supp. Report at 3.) A number of investors have subordinate trust deeds on the properties, and many have opted to release those deeds to assert a claim in the receivership estate. (Id.) The Receiver has informally estimated these claims to fall within $5 to $10 million. (Id.) A majority of investors have no recorded trust deed against any property, despite promises by CCB to the contrary. (Second Supp. Report at 3.) The investment amounts for those investors with no recorded trust deeds are "crudely estimated" to be $4 million. (Id.) The Receiver believes there will be sufficient equity to pay off the first trust deeds on each property, but he estimates that some second trust deeds–as well as most third, fourth, and fifth trust deeds–will be under-secured. (Id. at 3 n.2.)

***3** On September 1, 2015, the Court granted the SEC's Application for Preliminary Injunction and appointed Mosier as the permanent receiver. (PI Order, Doc. 96; Concurrent PI Order at 9, Doc. 97.) In relevant part, the permanent receivership appointment directs the Receiver to (1) take custody of any real or personal property owned or managed by Defendants, (2) have control of all accounts of the entities in receivership, (3) conduct investigations and discovery as may be necessary to locate and account for all the assets owned or managed by Defendants, (4) take any necessary actions to preserve and prevent the dissipation or concealment of those assets, (5) make an accounting of the assets and financial condition of Defendants, and (6) make any payments or disbursements as necessary in discharging his duties as temporary receiver. (Concurrent PI Order at 10–12.)

On August 14, 2015, the Receiver filed a Motion for Entry of an Order Authorizing (1) Sale of Real Property by Public Auction Free and Clear of Liens, Claims, and Encumbrances, or (2) in the Alternative, Abandonment of Over–Encumbered Properties. (Sale Mot., Doc. 71.) The Receiver also filed a Motion for Entry of an Order (1) Establishing Claims Bar Date, (2) Approving Form and Manner of Notice, (3) Approving Proof of Claim Form and Summary Procedures, (4) Staying Post–Receivership Interest, and (5) Establishing the Net Investment Method for Fixing Investor Claims. (Claims Bar Mot., Doc. 73.)

Interested parties filed oppositions to these Motions. [4] Dan Baer, Dennis Wesley, Joanne

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Wesley, and Creative Asset Management LLC, senior lienholders on four of the properties at issue (together "CAM"), oppose the Receiver's request to hold segregated sale proceeds pending resolution of lien issues and requests that it receive payment, interest, fees, charges, payment of certain commissions, and permission to credit bid during the proposed sale. (CAM Sale Opp. at 2–10, Doc. 98.) Center Street Lending Fund IV, LLC and Center Street Lending Fund V, LLC (together "CS Lending"), also senior lienholders, oppose the Receiver's request to hold a sale free and clear of liens with respect to the properties in which it has an interest. (CS Lending Opp. at 12–18, Doc. 104.) Investors Roman P. Mosqueda, Kristine Joy Mosqueda, and Ryan Christopher Mosqueda (together "Mosqueda") state they "have no opposition" to the Receiver's Motions as long as they are paid "before any unsecured creditors are paid therefrom." (Mosqueda Opp. ¶ 5, Doc. 91.) Jose Moreno, Antonio Moreno, Georgina Moreno, Mario Moreno, and Emilia Moreno (together "Moreno") request that the Court exclude the property located at 2222 W. Garvey Ave. from the proposed sale. (Moreno Opp. at 7–15, Doc. 101.) CAM and CS Lending also ask that the Court decline to stay the accrual of their default interest rates as of June 18, 2015. (CAM Interest Opp. at 8, Doc. 99; CS Lending Opp. at 14.)

***4** On September 22, 2015, CS Lending filed an Ex Parte Application to strike new arguments raised in the Receiver's reply briefs or, in the alternative, for leave to file a surreply addressing these arguments, and CAM filed a Joinder to this Application. (*See* App., Doc. 124; Joinder, Doc. 126.) The Receiver filed an Opposition, which the SEC joined. (Ex Parte Opp., Doc. 130; SEC Joinder, Doc. 132.) The Court granted leave for CS Lending and CAM to file a surreply brief, which they timely filed. (*See* Surreply Order, Doc. 135; CS Lending Surreply, Doc. 140; CAM Surreply, Doc. 141.)

## II. *LEGAL STANDARD*

"The power of a district court to impose a receivership or grant other forms of ancillary relief ... derives from the inherent power of a court of equity to fashion effective relief." *SEC v. Wencke,* 622 F.2d 1363, 1369 (9th Cir.1980). "[A] primary purpose of equity receiverships is to promote orderly and efficient administration of the estate by the district court for the benefit of creditors." *SEC v. Hardy,* 803 F.2d 1034, 1038 (9th Cir.1986). To that end, "[a] district court's power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad." *SEC v. Capital Consultants, LLC,* 397 F.3d 733, 738 (9th Cir.2005) (internal quotation marks and citation omitted). "The basis for this broad deference to the district court's supervisory role in equity receiverships arises out of the fact that most receiverships involve multiple parties and complex transactions." *Hardy,* 803 F.2d at 1037.

## III. *DISCUSSION*

The oppositions to the Receiver's Motions are limited to (1) the Receiver's proposed sale of properties "free and clear" of all liens, including his proposal to sell certain properties at a value less than the aggregate value of all existing liens and his proposal to hold sale proceeds in segregated accounts before distribution, (2) CAM's request as to certain fees, costs, and the opportunity to credit bid, (3) the Receiver's inclusion of the 2222 W. Garvey Ave. property in his proposed sale, and (4) the Receiver's request that the Court stay post-receivership default interest as to over-secured creditors. The Court addresses each issue in turn.

### A. *The Proposed Sale of Properties "Free and Clear" of All Liens*

The Court first addresses CAM and CS Lending's opposition to the Receiver's proposed sale of properties "free and clear" of all liens. Both CAM and CS Lending argue that upon the Receiver's sale of properties in which they have an interest, the Receiver should pay them immediately rather than have their liens attach to the proceeds.

Pursuant to the provisions of 28 U.S.C. § 2001, this Court may authorize the Receiver to sell acquired assets by public sale. Moreover, "it has long been recognized that under appropriate circumstances, a federal court presiding over a receivership may authorize the assets of the receivership to be sold free and clear of liens and related claims." *Pennant*

*Mgmt., Inc. v. First Farmers Fin., LLC,* No. 14–CV–7581, 2015 WL 4511337, at *4 (N.D.Ill. July 24, 2015) (quoting *Regions Bank v. Egyptian Concrete Co.,* No. 09–cv–1260, 2009 WL 4431133, at *7 (E.D.Mo. Dec. 1, 2009)). *See also Mellen v. Moline Malleable Iron Works,* 131 U.S. 352, 357 (1889) ("[T]he removal of alleged liens or incumbrances [sic] upon property, the closing up of affairs of insolvent corporations, and the administration and distribution of trust funds are subjects over which courts of equity have general jurisdiction.").

The Receiver argues that this case is an appropriate circumstance for authorizing such a sale. (Sale Reply at 13, Doc. 110.) Because Local Rule 66–8 directs a receiver to "administer the estate as nearly as possible in accordance with the practice in the administration of estates in bankruptcy [,]" the Court looks to the Bankruptcy Code for guidance. C.D. Cal. R. 66–8. Section 363(f) of the Bankruptcy Code empowers the trustee of an estate to sell the estate's property "free and clear of any interest in such property of an entity" if any one of the following five conditions is present: (1) an applicable non-bankruptcy law permits such a sale, (2) the entity at issue consents, (3) the interest is a lien and the property's selling price is greater than the aggregate value of all liens on such property, (4) the interest is in a bona fide dispute, or (5) the entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. 11 U.S.C. § 363(f). Because Section 363(f) is written in the disjunctive, satisfaction of any one condition is sufficient to sell the property "free and clear of any interest." *Id.*; *In re Elliot,* 94 B.R. 343, 345 (Bankr.E.D.Pa.1988) ("[I]f any of the five conditions of § 363(f) are met, the Trustee has authority to conduct the sale free and clear of all liens.").

***5** The Receiver argues that a sale "free and clear" of interests is proper under Sections 363(f)(3) and 363(f)(4). First, the Receiver intends to sell a majority of the identified properties at a price "sufficient to pay the liens then existing." (Sale Mot. at 7.) The multiple interests on these properties are liens.[5] For those properties that will obtain a selling price greater than the aggregate value of all liens on the properties, Section 363(f)(3) weighs in favor of authorizing a sale "free and clear" of interests. Second, the Receiver's counsel noted at the hearing that a handful of properties are unlikely to sell at a price greater than the aggregate value of all existing liens. The Receiver argues he should have the authority to sell those properties at a lower price because the relevant senior liens, those of senior lenders CAM and CS Lending, are in a bona fide dispute under Section 363(f)(4). (*See* Sale Reply at 14–15.)

To establish a "bona fide dispute" under Section 363(f)(4), the moving party must "provide some factual grounds to show some objective basis for the dispute." *See In re Kellogg–Taxe,* No. 2:12–BK–51208–RN, 2014 WL 1016045, at *6 (Bankr.C.D.Cal. Mar. 17, 2014) (citing *In re Gaylord Grain LLC,* 306 B.R. 624, 627 (B.A.P. 8th Cir.2004)). "[A] court need not determine the probable outcome of the dispute, but merely whether one exists." *Id.* (internal quotation marks and citation omitted). "However, not any alleged dispute satisfies [Section 363(f)(4) ]. It clearly entails some sort of meritorious, existing conflict." *In re Taylor,* 198 B.R. 142, 162 (Bankr.D.S.C.1996) (citing *In re Atlas Machine & Iron Works v. Bethlehem Steel,* 986 F.2d 709 (4th Cir.1993)).

The Receiver argues that the disputed liens are voidable under the Uniform Voidable Transfer Act,[6] which states in relevant part:

> (a) A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows:
>
> > (1) With actual intent to hinder, delay, or defraud any creditor of the debtor.

Cal. Civ.Code § 3439.04(a), *as amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B.161). "The purpose of [the UVTA] is to permit the receiver to collect those assets that can actually be located and recovered in the wake of a Ponzi scheme, and to ratably distribute those assets among all participants, including the many investors who lost everything." *Donell v. Kowell,* 533 F.3d 762, 779

(9th Cir.2008). Moreover, the "mere existence of a Ponzi scheme, which could be established by circumstantial evidence, has been found to fulfill the requirement of actual intent on the part of the debtor." *In re Agric. Research and Tech. Grp.,* 916 F.2d 528, 536 (9th Cir.1990). *See also In re Cohen,* 199 B.R. 709, 717 (B.A.P. 9th Cir.1996) ("Proof of a Ponzi scheme is sufficient to establish the Ponzi operator's actual intent to hinder, delay, or defraud....").[7]

First, the Court addresses whether the disputed liens in question may be voidable under the UVTA. The UVTA defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money ... and *creation of a lien* or other encumbrance." Cal. Civ.Code § 3439.01(i) (emphasis added). The Receiver may therefore seek to void a lien under the UVTA.

***6** Next, the Court turns to whether the Receiver has demonstrated a sufficient, objective basis for a dispute under the UVTA. In the Receiver's Reports to the Court, he provides evidence that Defendants engaged in a Ponzi scheme. CCB claimed to be a real estate and investment services firm focused primarily on real estate-owned properties. (Ma Decl. Exs. 42, 44, 74, Doc. 13.) But Khalfani made material misrepresentations to investors, promising first or second trust deeds on properties while recording third, fourth, or fifth trust deeds, or recording none at all, in exchange for their investments. (First Supp. Report at 2–4; Second Supp. Report at 7.) CCB primarily used one bank account for all its current entities, which resulted in the commingling of investor dollars and operating funds. (First Report at 5, Doc. 35.) Tracing of investor funds reveals that Defendants paid earlier investors and covered CCB operating costs with new investor money. (First Supp. Report at 2–4, Exs. 1–5; Second Supp. at 3.) "Distributing funds to earlier investors from the receipt of monies from later investors is the hallmark of Ponzi schemes." *In re Agric. Research,* 916 F.2d 528, 536 (9th Cir.1990). The real properties in Defendants' estate therefore constituted a key component of Defendant's alleged Ponzi scheme. Negotiating senior liens on these properties facilitated Defendants' purchase of the properties, and the circumstances demonstrate that Defendants pursued such liens in furtherance of the alleged Ponzi scheme.

The Court therefore finds that the Receiver has demonstrated a sufficient, objective basis to support the existence of a Ponzi scheme furthered by the disputed liens. However, a good faith defense exists under the UVTA. A transfer is not voidable under Section 3439.04(a)(1) against a person who "took in good faith and for a reasonably equivalent value...." Cal. Civ.Code § 3439.08(a). "The issue of good faith under [the UVTA] is a defensive matter as to which the [parties] asserting the existence of good faith have the burden of proof." *See In re Cohen,* 199 B.R. at 719; *see also* Cal. Civ.Code §§ 3439.08(a), 3439.08(f)(1), *as amended by* 2015 Cal. Legis. Serv. Ch. 44 (S.B.161). "One lacks the good faith that is essential to the [UVTA] if possessed of enough knowledge of the actual facts to induce a reasonable person to inquire further about the transaction." *In re Cohen,* 199 B.R. at 719. "Such inquiry notice suffices on the rationale that some facts suggest the presence of others to which a transferee may not safely turn a blind eye." *Id.* Courts therefore "look to what the [creditor] objectively 'knew or should have known' in questions of good faith, rather than examining what the [creditor] actually knew from a subjective standpoint." *In re Agric. Research,* 916 F.2d at 535–36.

The Court first addresses whether CS Lending is entitled to the good faith defense. CS Lending has made 88 loans to Defendants totaling approximately $19.6 million, and it argues that it performed its due diligence by (1) completing a background check on Khalfani and (2) reviewing CCB's Articles of Organization. (Couig Decl. ¶¶ 9, 16, 17, Doc. 104–1.) However, the Receiver's evidence demonstrates that almost immediately after initiating the lending relationship, Defendants were late in making their required payments. (Mosier Decl. ¶ 14, Exs. 1–2, Doc. 110.) At least 63 loans were in default at some point during the lending relationship, and Defendants defaulted on as many as twenty loans in a given month. (Mosier Decl. ¶¶ 13, 14, Exs. 1–2, Doc. 110.)

Moreover, CS Lending was aware of the SEC's investigation before it entered into several new loan transactions with Defendants. (Mosier Decl. ¶ 17, Ex. 3, Doc. 110.) This evidence suggests that CS Lending "possessed [ ] enough knowledge ... to induce a reasonable person to inquire further about the transaction[s]." *In re Cohen,* 199 B.R. at 719. The evidence therefore demonstrates there is a bona fide dispute as to the voidability of CS Lending's liens under the UVTA.

The Court then turns to CAM. CAM has made eight loans to Defendants, and it similarly argues that it performed its due diligence before agreeing to make these loans. (*See* Baer Decl. ¶ 19, Doc. 100.) CAM states it personally inspected each property and examined comparable sales to determine whether the property value was adequate to protect each loan. (Baer Decl. ¶¶ 5, 7, 9, 11, 13, 15, 17.) CAM also notes that Defendants timely made all payments on four loans, (id.¶¶ 6, 8, 10, 12), and that all payments were current on the four remaining loans prior to the Receiver's appointment, (id.¶¶ 12, 14, 16, 18). However, CAM admits that in early June 2015, it "began to become concerned that Capital Cove may be having cash flow problems stemming from delay in closing several acquisitions." (Baer Decl. ¶ 21). The Receiver states he "[is] advised" that CAM agreed to make four loans to CCB in February 2015, but that three loans were delayed for a period of months because CCB "could not raise sufficient capital to acquire new properties." (Mosier Decl. ¶ 21, Doc. 110.) CAM emailed Khalfani on June 11, 2015, requesting to meet regarding Khalfani's inability to close escrow on one such property. The email states:

> ***7** You have not signed the loan documents, an additional $146,503.53 is required to close escrow, the deadline to close is tomorrow, June 12, 2015, the Seller, and Seller's agent are very worried and deeply concerned, and no one has heard from you. I realize that you are having cash flow problems, but you can't treat people like "mushrooms" (i.e., keeping them in the dark and feeding them a load of manure). I want to work with you, R.K., but you have got to help me to help you.

(Mosier Decl. Ex. 4, Doc. 110.) CAM states that Khalfani assured it he was in the process of funding the escrow at issue, and Khalfani fully funded and closed the escrow within two business days after the email exchange. (Baer Decl. ¶ 21.) Around this time, Defendants closed the sale of one property and the acquisition of two others in which CAM had an interest. (Id.) CAM states that "[a]t that point, [it] felt reassured by Capital Cove's continuing performance that nothing was amiss." (Id.)

It is critical here that for the purposes of Bankruptcy Code Section 363(f)(4), the Court "need not determine the probable outcome of the dispute, but merely whether one exists." *In re Kellogg–Taxe,* 2014 WL 1016045, at *6. The circumstances surrounding CAM's latter three loans indicate that Defendants were suffering cash flow problems that delayed several real estate acquisitions underlying those loans. Although Khalfani appeared to later remedy his money shortfalls, the initial delays were noteworthy enough to cause growing concern. (*See* Baer Decl. ¶ 21.) Moreover, the evidence suggests that Defendants obscured or failed to disclose their situation when engaging in real estate transactions. A mere day before escrow closed on the above property, Khalfani told CAM he was "in the process of funding the [ ] escrow." (Baer Decl. ¶ 21.) Funds necessary to close the escrow were lacking on the eve of the closing deadline, the seller and seller's agent were "very worried and deeply concerned," and yet "no one" working with Khalfani on the real estate transaction "ha[d] heard from [him]" until CAM sent the above-referenced email. (Mosier Decl. Ex. 4, Doc. 110.) The evidence provides some objective basis that CAM "possessed [ ] enough knowledge ... to induce a reasonable person to inquire further about the transaction." *In re Cohen,* 199 B.R. at 719. The Court therefore finds there is a bona fide dispute as to the voidability of CAM's liens under the UVTA. [8]

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Because the Court finds the liens of CS Lending and CAM are in a bona fide dispute under Section 363(f)(4), it may authorize the Receiver to approve the highest auction bidding price for those affected properties even if that price is insufficient to cover the aggregate value of all existing liens. However, CS Lending argues the Court should nevertheless decline to do so because (1) the Receiver improperly raised this request in a reply brief, (2) the relief would violate CS Lending's due process rights, and (3) the Receiver has not provided any justification for this relief. (CS Lending Surreply at 4–10, Doc. 140.)

***8** CS Lending correctly notes "[i]t is improper for a moving party to introduce new facts or different legal arguments in the reply brief than those presented in the moving papers." *U.S. ex rel. Giles v. Sardie,* 191 F.Supp.2d 1117, 1127 (C.D.Cal.2000) (citing *Lujan v. Nat'l Wildlife Fed'n,* 497 U.S. 871, 894–95 (1990)). However, the Court granted leave for CS Lending and CAM to file surreplies addressing new matters raised in the Receiver's reply briefs. (*See* Doc. 134.) CAM and CS Lending were therefore provided "notice and an adequate opportunity to reflect and to respond[,]" thereby satisfying their due process rights. *See In re Loloee,* 241 B.R. 655, 662 (B.A.P. 9th Cir.1999). At the hearing, CS Lending requested another opportunity to respond to the Receiver's arguments. Because the Court already provided an opportunity to file a surreply, it declines to grant this request.

Moreover, CS Lending is also protected by the adequate assurance requirement for sales pursuant to Section 363(f). 11 U.S.C. § 363(e). "The concept of adequate protection finds its basis in the Fifth Amendment's protection of property interests." *In* re DeSardi, 340 B.R. 790, 797 (Bankr.S.D.Tex.2006) (citing H.R.Rep. No. 95–595, 338–40 (1977), as reprinted in 1978 U.S.C.C.A.N. 6294–6297.). "Most often, adequate protection in connection with a sale free and clear of other interests will be to have those interests attach to the proceeds of the sale." S. Rep. 95–989, at 56 (1978). "Typically, the proceeds of sale are held subject to the disputed interest and then distributed as dictated by the resolution of the dispute; such procedure preserves all parties' rights by simply transferring interests from property to dollars that represent its value." *In re Clark*, 266 B.R. 163, 171 (B.A.P. 9th Cir.2001). In this case, liens will attach to the proceeds of the sale "with those liens, claims, and encumbrances to maintain the same force, effect, and priority against the sales proceeds as existed at the time of the closing of the sale." (See Proposed Order ¶ 5, Doc. 155–1.) The Court therefore finds that adequate assurance exists in this case.

Finally, the Court addresses CS Lending's concern that the Receiver has not explained how this relief is in the best interests of the receivership estate. The Receiver has provided compelling evidence of (1) the large number of unsecured and junior creditors who were defrauded and await recovery in this case, and (2) the Receiver's expected inability to pay the full amount of each claim from the pooled assets of Defendants' estate. It is therefore in the best interest of the receivership estate to sell the affected properties at the highest possible market price, even if that price falls below the aggregate value of existing liens, rather than abandoning those properties.

Accordingly, the Court authorizes the Receiver to sell the identified properties through public auction. For those properties affected by the bona fide dispute as to CAM and CS Lending's liens, the Receiver may approve the highest bidding price even if it is insufficient to cover the aggregate value of all existing liens. For all other properties, the Receiver may only approve a sale price sufficient to cover the aggregate value of all existing liens. To promote the equitable distribution of Defendants' assets, and given the bona fide dispute at issue here, the Court approves the Receiver's request to hold sale proceeds in segregated accounts in lieu of immediate distribution.[9] (*See* Proposed Order ¶ 5, Doc. 155–1.) Should the Receiver seek to void the liens of CAM or CS Lending, he must initiate this process **within 28 days** of this Order.

**B.** ***CAM's Request for Various Fees, Commissions, and Permission to Credit Bid***

***9** Next, the Court addresses CAM's request for various fees, charges, and commissions. CAM first argues that any order authorizing the sale should require payment of "attorneys' fees and other charges to which [CAM is] lawfully entitled under their promissory notes, deeds of trust and California law." (CAM Sale Opp. at 8, Doc. 98.) CAM then requests permission to credit bid for any properties in which it holds a security interest. (Id. at 8–9.) Finally, CAM argues that broker Hamilton Cove Realty, Inc. is entitled to a 2.5% commission for the sale of five identified properties. (Id. at 910.)

The Receiver argues that because there is a bona fide dispute as to CAM's liens, ordering the payment of attorneys' fees and charges is premature. (Sale Reply at 3.) 11 U.S.C. § 506(b) provides that the holder of "an allowed secured claim [that] is secured by property the value of which ... is greater than the amount of such claim" is entitled to "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose." 11 U.S.C. § 506(b). However, if CAM's liens are voidable under the UVTA, CAM will not have "an allowed secured claim" giving rise to the "reasonable fees, costs, or charges" provided by this statute. *See* id. Accordingly, in light of the Court's finding that a bona fide dispute exists as to CAM's liens, the Court declines to order the payment of CAM's fees and costs at this time.

The Court then turns to CAM's request to credit bid on the properties in which it has an alleged interest. Although secured creditors may credit bid under 11 U.S.C. § 363(k), courts may deny this opportunity "for cause." *See* 11 U.S.C. § 363(k). "Intrinsically, acting 'for cause' looks to the court's equity powers that allow the court to balance the interests of the debtor, its creditors, and the other parties of interests in order to achieve the maximization of the estate and an equitable distribution to all creditors." *In re RML Dev., Inc.*, 528 B.R. 150, 155 (Bankr.W.D.Tenn.2014) (citing *Florida Dept. of Revenue v. Picadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008); *NLRB v. Bildisco and Bildisco,* 465 U.S. 513, 527 (1984); *Katchen v. Landy,* 382 U.S. 323, 336 (1966)).

A number of equitable considerations justify the denial of CAM's request to credit bid. The Court takes note of the SEC's prima facie case of Defendants' securities fraud, the Receiver's evidence of a Ponzi scheme, the numerous investors and creditors that were defrauded by Defendants, the Receiver's finding that Defendants' collective assets will be insufficient to pay 100% of all amounts claimed, and the Receiver's intent to equitably distribute recovery among all those who were harmed. Allowing CAM to credit bid would harm the many unsecured and junior creditors who also await recovery. This conclusion is further supported by the Court's finding that a bona fide dispute exists as to CAM's liens against the properties at issue. Accordingly, the Court finds it has justifiable "cause" to deny CAM's request to credit bid.

Finally, the Court addresses CAM's argument that Hamilton Cove Realty is entitled to a 2.5% commission due upon the sale of applicable property. In the bankruptcy context, a broker has only a "general unsecured claim" for brokerage commissions if he fully performed his brokerage services before the petition was filed. *See In re Moskovic,* 77 B.R. 421, 423 (Bankr.S.D.N.Y.1987); *In re Godwin Bevers Co., Inc.*, 575 F.2d 805, 807–08 (10th Cir.1978). Here, HCR fully performed its brokerage services before this proceeding began. (*See* CAM Sale Opp. at 9; Baer Decl. Ex. 9 ¶ 10.) HCR does receive its commission upon completion of the property's sale, but the timing of the sale–namely, the Court's authorization that the sale take place during this proceeding–does not elevate HCR's claim beyond its "general, unsecured" status. *See In re Godwin Bevers Co.*, 575 F.2d at 808. Accordingly, the Court declines to order the immediate payment of HCR's commission at the expense of other claimants. To the extent HCR believes it has a claim against the estate, it must file a claim along with the other unsecured claimants in this case.

### C. *Sale of Property at 2222 W. Garvey Ave.*

***10** The Court turns to Moreno's request that the Court exclude the 2222 W. Garvey Ave. property from the Receiver's proposed sale. On August 25, 2015, Moreno filed an action in state court alleging


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(1) declaratory relief, (2) quiet title, (3) partition, (4) breach of contract, (5) common counts, (6) fraud, and (7) intentional interference with prospective economic advantage with respect to this property. (Moreno Opp. at 6–7; Skovholt Decl. ¶ 4, Ex. A, Doc. 103.) Moreno therefore requests that the Court exclude the property from the proposed sale so the interested parties may continue with their state court action. (Moreno Opp. at 15–16.)

However, Moreno provides no legal basis for why the Court should do so. In fact, it is well established that "the court first assuming jurisdiction over property may exercise that jurisdiction to the exclusion of other courts." *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 818 (1976); *see also* *Sexton v. NDEX West,* LLC, 713 F.3d 533, 536 (9th Cir.2013) ("[I]f a state or federal court has taken possession of property, or by its procedure has obtained jurisdiction over the same, then the property under that court's jurisdiction is withdrawn from the jurisdiction of the courts of the other authority as effectually as if the property had been entirely removed to the territory of another sovereign."). The SEC's Complaint was filed in the instant action on June 18, 2015, and the 2222 Garvey Ave. property was first identified by the Receiver as a part of Defendants' estate in his First Receiver's Report on June 29, 2015. (First Report, Ex. B at 3, Doc. 35.) The Court's Temporary Restraining Order, filed on June 18, 2015, "immediately authorized, empowered and directed" the Receiver to "take custody, control, possession, and charge" of all assets managed by CCB, including all real property "wherever located." (TRO at 8–9.) Moreno filed a complaint in state court on August 25, 2015, nearly two months later. (Skovholt Decl. ¶ 4, Ex. A, Doc. 103.)

Next, the Court turns to Moreno's request to exclude the Garvey Ave. property from the sale so they may trace and reclaim the property under theories of equitable relief. The Court finds that the Moreno's proffered theories of equitable relief do not justify the exclusion of the Garvey Ave. property. "Courts have favored pro rata distribution of assets where, as here, the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders." *SEC v. Credit Bancorp. Ltd.*, 290 F.3d 80, 88–89 (2d Cir.2002). Equitable relief such as constructive trusts may be "useful to work out equity between a wrongdoer and a victim; but, when the fund with which the wrongdoer is dealing is wholly made up of the fruits of the frauds perpetrated against a myriad of victims, the case is different." *Cunningham v. Brown,* 265 U.S. 1, 13 (1924). As the Eleventh Circuit explained:

> To allow any individual to elevate his position over that of other investors similarly 'victimized' by asserting claims for restitution and/or reclamation of specific assets based upon equitable theories of relief such as fraud, misrepresentation, theft, etc. would create inequitable results, in that certain investors would recoup 100% of their investment while others should receive substantially less.... In the context of this receivership the remedy of restitution to various investors seeking to trace and reclaim specific assets as originating with them is disallowed as an inappropriate equitable remedy.

*SEC v. Elliot, 953 F.2d 1560, 1569 (11th Cir.1992)* (citation omitted) (affirming the district court's decision to disallow tracing). See also *In re North Am. Coin & Currency, Ltd.*, 767 F.2d 1573, 1575 (9th Cir.1985) ("We necessarily act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors, for ratable distribution among all creditors is one of the strongest policies behind the bankruptcy laws.").

***11** Here, Defendants perpetrated fraud against a myriad of victims whose funds are commingled. Allowing various investors to "trace and reclaim

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specific assets ... is [therefore] disallowed as an inappropriate equitable remedy." *Elliot,* 953 F.2d at 1569. Accordingly, the Court declines to exclude the Garvey Ave. property from the Receiver's proposed sale.

### D. *Stay of Post–Receivership Interest*

Both CAM and CS Lending also challenge the Receiver's proposed stay of post-receivership default interest of their senior liens.[10] (*See* CAM Interest Opp. at 5–8; CS Lending Opp. at 16.)

As noted above, receivers should "administer the estate as nearly as possible in accordance with the practice in the administration of estates in bankruptcy." C.D. Cal. R. 66–8. The Bankruptcy Code permits interest on secured creditor's claims only to the extent the value of the secured property exceeds the amount of the claim. *See* 11 U.S.C. § 506(b). CAM, CS Lending, and the Receiver disagree whether the value of the properties is sufficient to satisfy the principal of CAM and CS Lending's claims. Even assuming that the property values exceed the contested claims, however, the Court finds it may stay post-receivership default interest under equitable considerations.

In the bankruptcy context, courts have found that a secured creditor's entitlement to default interest under 11 U.S.C. § 506(b) is subject to equitable considerations, including whether the application of default interest will harm junior or unsecured creditors. *See, e.g., Gen. Elec. Capital Corp. v. Future Media Prods. Inc.*, 547 F.3d 956, 960 (9th Cir.2008) (noting that a party's default interest is "subject ... to reduction based upon any equities involved."); *In re 785 Partners LLC,* 470 B.R. 126, 134 (Bankr.S.D.N.Y.2012) (stating that post-petition default interest may not be allowed where "the application of the contractual interest rate would harm the unsecured creditors."); *In re Jack Kline Co. Inc.*, 440 B.R. 712, 747 (Bankr.S.D.Tex.2010) (applying a "balancing of the equities test" to determine whether to apply post-petition default interest); *In re DWS Invs., Inc.*, 121 B.R. 845, 849–50 (Bankr.C.D.Cal.1990) (refusing to apply a post-petition default interest rate in part because "[t]he estate is insolvent and the unsecured creditors are unlikely to receive a distribution" if the rate is applied). In fact, courts have recognized that this consideration of whether junior or unsecured creditors will be harmed "has special significance." *In re Jack Kline Co.*, 440 B.R. at 747 (finding that "this factor weighs heavily against allowing any default interest rate charged by Central Bank.").

***12** The Receiver argues "[i]t cannot seriously be disputed" that the accrual and imposition of post-receivership default interest will harm junior and unsecured creditors. (Claims Bar Reply at 6, Doc. 111.) Because the Receiver provides substantial evidence that Defendants' collective assets will be insufficient to pay all claimants 100% of the amounts claimed, and that many unsecured and junior creditors are most at risk for losing their potential recoveries, the Court finds that ongoing default interest rates would directly harm junior and unsecured creditors. "It is manifest that the touchstone of each decision on allowance of interest in ... receivership ... has been a balance of equities between creditor and creditor or between creditors and the debtor." *Green,* 329 U.S. at 165. As a result, the Court finds that staying all post-receivership default interest satisfies the "primary purpose" of receiverships, which is "to promote orderly and efficient administration of the estate" for the benefit of all creditors. *See Hardy,* 803 F.2d at 1038.

## IV. *CONCLUSION*

For the foregoing reasons, the Court GRANTS the Receiver's Motions. The Court enters two concurrently-filed Orders.

### All Citations

Not Reported in F.Supp.3d, 2015 WL 9701154

Footnotes

1 The Court notes that the Receiver's 39–page Motion for Entry of an Order Authorizing the Sale of Real Property far exceeds the 25–page limit imposed by the Local Rules and the Court's Standing Order. C.D. Cal. R. 11–6. *See also* Initial Standing Order ¶ 10(c), Doc. 18. In addition, Local Rule 11–8 requires any

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memorandum of points and authorities over 10 pages in length to contain a table of contents and table of authorities. C.D. Cal. R. 11–8. The Receiver also failed to comply with this local rule. The Court may – and typically does – strike any motion that fails to comply with the Local Rules. *See Christian v. Mattel, Inc.,* 286 F.3d 1118, 1129 (9th Cir.2002). Here, the Court addresses the merits of the Receiver's Motions. However, counsel for the Receiver is ordered to carefully review the applicable rules before filing any other documents in this Court, and any future filings that fail to comply with the Local Rules or the Court's Standing Order will result in (1) the striking of the non-compliant filing and/or (2) sanctions.

2 The Receiver has found that the following companies are affiliates of CCB: Capital Cove International, Inc., Capital Cove Asset Management, Inc., Capital Cove Financial, Capital Cove Financial Services, Inc., Capital Cove Asset Management, Capital Cove Real Estate, Capital Cove Real Estate Advisors, Capital Cove Realty Group, Capital Cove REO Opportunities Fund LLC, Capital Cove REO Opportunities Fund II, Capital Cove REO Opportunities Fund III, Capital Cove REO Opportunities Fund IV, REO Multi Asset Fund Holdings, Inc., Capital Cove Investment Management, Inc., Capital Cove Advisory, Capital Cove Financial Advisory Services LLC, Rittenhouse Square Trust LLC, Rittenhouse Square Advisory LLC, Aspyration Capital Advisors, Inc., Aspyration Financial Group, Inc., Nepenthe Capital Management Inc., Diversified Realty and Financial Services, Inc., Portovelo Management Group LLC, Portovelo Financial, Portovelo Development, Portovelo Wealth Management, First Asian Bancorp LLC, First Asian Management. (*See* Mosier Decl. ¶ 4, Doc. 73 at 16–17.)

3 The Court has already authorized the Receiver to sell the following properties free and clear of liens, claims, and encumbrances: 520 N. Valley Center Ave., Glendora, CA 91741; 9564 Delmar Ave., Hesperia, CA 92345; 2136 W. 20th Street, Los Angeles, CA 90018; 1447 E. Pumalo Ave., San Bernardino, CA 92404; 2979 West Birch Street, San Bernardino, CA 92376; 945 West 2nd Street, Rialto, CA 92376; 842 Sheffield Way, Perris, CA 92571; 6926 Eastwood Ave., Rancho Cucamonga, CA 91701 (Ex Parte Order Re: Assorted Properties, Doc. 43; Ex Parte Order Re: Eastwood, Doc. 53.)

4 A number of beneficiaries who invested through Cervenka & Lukes Capital Partners also jointly opposed the proposed stay of post-receivership non-default interest. (C & L Opp., Doc. 107.) The Receiver reached a settlement with C & L and the C & L Beneficiaries on the issues raised in their Opposition, (Claims Bar Reply at 3 n.1, Doc. 111), and the C & L Beneficiaries indicated they would formally withdraw their Opposition upon court approval of their settlement, (Notice of Withdrawal, Doc. 151). Because the Court approved the terms of this settlement agreement on September 30, 2015, the Court considers the C & L Opposition withdrawn and it does not address the issues raised in the Opposition. (*See* Ex Parte Order, Doc. 149). Another interested party, German Centeno, initially requested that the Court exclude the property located at 1350 Hollencrest Drive from the proposed sale. (Centeno Opp. at 4–9, Doc. 116.) At the hearing, counsel for the Receiver and Centeno stated they had reached a settlement agreement in principal and that they request that the Court remove the Hollencrest property from the list of properties to be sold. The Court therefore considers Centeno's Opposition withdrawn and does not address the issues raised in this Opposition.

5 Under the Bankruptcy Code, a lien is a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37). This definition generally includes "inchoate liens," "judicial liens, security interests, and statutory liens." *See* S.Rep. No. 95–989, at 25 (1978).

6 The UVTA amended and superseded the Uniform Fraudulent Transfer Act. *See* 2015 Cal. Legis. Serv. Ch. 44 (S.B.161).

7 Courts have found that whether fraudulent transfers are made "with actual intent" to hinder, delay, or defraud creditors is the same under the Bankruptcy Code and the UVTA. *See, e.g., In re Cohen,* 199 B.R. at 717.

8 CAM and CS Lending note the Receiver has yet to bring an action to avoid the disputed liens. (CAM Surreply at 2, Doc. 141; CS Lending Surreply at 5, Doc. 140.) However, the disputed liens "need not be the subject of an immediate or concurrent adversary proceeding" to raise a bona fide dispute under Section 363(f)(4). *See In re Kellogg–Taxe,* 2014 WL 1016045, at *6 (citing *In re Gaylord Grain LLC,* 306 B.R. at 627).

9 Mosqueda states they have no opposition to the Receiver's motion "provided that the proceeds from the auction sale thereon are held in a segregated account, subject to payment of their liens-claims thereon before any unsecured creditors are paid therefrom." (Mosqueda Opp. at 2.) The proceeds from the auction sale will be held in segregated accounts, and liens will attach to the proceeds of the sale "with those liens, claims, and encumbrances to ... maintain the same force, effect, and priority against the sales proceeds as existed at the time of the closing of the sale." (*See* Proposed Order ¶ 5, Doc. 155–1.)

10 The Receiver also requests a stay of “all post-receivership interest as to all investor and unsecured and under-secured creditor claims.” (Proposed Order ¶ 10, Doc. 75–1.) Although there is no opposition to this request, the Court notes that 11 U.S.C. § 502(b)(2) disallows the recovery of unmatured interest by unsecured and under-secured creditors as of the petition date. 11 U.S.C. § 502(b)(2). Interest is considered “ 'unmatured' when it was not yet due and payable at the time the debtor filed its bankruptcy petition.” *Thrifty Oil Co. v. Bank of Am. Nat'l Trust and Sav. Ass'n,* 322 F.3d 1039, 1046 (9th Cir.2002). “As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds.” *Vanston Bondholders Protective Comm. v. Green,* 329 U.S. 156, 163 (1946). This general rule “achieve[s] fairness and administrative efficiency” because “denying post-petition interest ensures that no party realizes a gain or suffers a loss due to the delays inherent in liquidation and distribution of the estate.” *Thrifty Oil Co.*, 322 F.3d at 1047.

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