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IN THE UNITED STATES DISTRICT COURT
DISTRICT OF UTAH, CENTRAL DIVISION

<p>SECURITIES AND EXCHANGE COMMISSION,</p> <p>PLAINTIFF,</p> <p>v.</p> <p>VESCOR CAPITAL CORP., a Nevada corporation, VESCOR CAPITAL, INC., a Nevada corporation, VESCORP CAPITAL, LLC, a Nevada limited liability company, VESCORP CAPITAL IV-A, LLC, a Nevada limited liability company, VESCORP CAPITAL IV-M, LLC, a Nevada limited liability company, a Nevada limited liability company, and VAL E SOUTHWICK,</p> <p>DEFENDANTS.</p>	<p>MEMORANDUM IN SUPPORT OF MOTION TO CLARIFY THE SCOPE OF THE STAY, AND, IF NECESSARY, TO LIFT THE STAY</p> <p>Civil No. 1:08cv00012</p> <p>Hon. Dee Benson</p>
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Heritage Capital Management, LLC, Covenant Bancorp, Inc., Covenant Capital, LLC, Heritage Orcas Partners, LP, Heritage Orcas VL Partners and Boundary Bay Capital, LLC (collectively, the “Covenant Group”) respectfully submit this memorandum of points and authorities in support of their Motion to Clarify the Scope of the Stay and, if Necessary, to Lift the Stay.

I. INTRODUCTION

The Covenant Group has various claims against entities and individuals in connection with secured loans in real estate development projects located in Nevada. In addition, certain Covenant Group entities have been elected the “Loan Manager” under loan management agreements relating to these secured loans. In its capacity as Loan Manager, the Covenant Group represents a large number of secured creditors holding roughly \$92 million in secured claims under roughly 462 fractional interests in the various deeds of trust on nine properties. As Loan Manager, the Covenant Group was in the process of foreclosing on these nine properties when this Court issued the Stay (as defined below). The value of these nine properties is substantially less than the secured loans on these properties and thus the secured lenders are being harmed every day the stay remains in effect.

The Covenant Group comes before this Court to clarify that they are free to continue the foreclosure action and to prosecute its tort claims against three individuals in the appropriate Nevada forum. To date, the Covenant Group has (1) initiated, as Loan Manager on each respective property, non-judicial foreclosures of real properties, in which the Covenant Group (and the other secured creditors) have liens based on recorded trust deeds (the “Nevada Foreclosures”) and (2) instituted a lawsuit in Nevada state court asserting contract and tort claims against various individuals and entities involved in the projects, *Heritage Capital Management, LLC v. Val E. Southwick, et al.*, Nevada District Court, Clark County, Case No. A525992 (the “Nevada Litigation”).

Subsequent to the initiation of these actions in Nevada, the Securities and Exchange Commission (“SEC”) brought this action pending before the Court. The SEC brought this action

against six named defendants: Vescor Capital Corp., Vescor Capital, Inc., Vescor Capital, LLC, Vescor Capital IV-A, LLC, Vescor Capital IV-M, LLC, and Val E. Southwick (collectively, the “Named Defendants”). None of the Named Defendants is the title holder of the property which is the subject of the Nevada Foreclosures. After the Court denied the SEC’s first motion to stay, the SEC then petitioned the Court to appoint a receiver and enter a stay. The Named Defendants did not oppose the petition and the Covenant Group and the many other affected third-party creditors of the Named Defendants were not given any notice of the proceeding. The Court issued an “Order Appointing Receiver” (“Receivership Order”). In a sweeping and expansive reading of the Receivership Order, the Receiver now contends that the stay entered in the Receivership Order (the “Stay”) applies to the Nevada Litigation, and even to claims against the individual defendants. By letter, the Receiver further implies that the Stay also applies to the Nevada Foreclosures. After receiving notice of the Stay, the Covenant Group dismissed the Named Defendants from the Nevada Litigation and has suspended the Nevada Foreclosures.

Application of the Stay to either the Nevada Litigation or the Nevada Foreclosures would be unnecessarily broad and over-reaching. The primary purpose of the Stay is to protect the assets of the receivership, and staying the actions in Nevada does not further this purpose. At this time, however, it is unnecessary for the Court to decide whether the entire Nevada Litigation should proceed against all of the defendants. The Covenant Group is immediately concerned only with proceeding on its tort claims against three individual defendants, Christopher D. Layton, William W. Plise and Douglas R. Malen, and has tailored its motion accordingly (without waiving any future rights).

The Covenant Group respectfully requests the Court to clarify that the Stay does not apply to either the Nevada Foreclosures or the tort claims against these three individual defendants in the Nevada Litigation. In the event the Court decides that the Stay does apply to either, the Covenant Group then respectfully requests the Court to lift the Stay with respect to the same. The Nevada Foreclosures should proceed because secured claims based on duly-recorded trust deeds take priority over any other claims and, since the collateral properties are already

over-encumbered, the Receiver has no economic interest in the collateral. Furthermore, the tort claims against individuals for their personal actions simply cannot be tied to the receivership assets, as any judgment against them would necessarily have to be satisfied from those individuals' personal assets. For these reasons, as detailed below, the Court should allow the Nevada Foreclosures and tort claims against the three individuals in the Nevada Litigation to proceed without any further interference from the Receiver

II. STATEMENT OF FACTS

A. The Covenant Loans

During 2000-2005, the Covenant Group loaned over \$66 million to entities related to Val E. Southwick. Some of these monies were loaned to certain of those entities, each of which offered, as discussed below, its respective titled interest in specific real properties, all located in or around Las Vegas, Nevada, as collateral for the loans (the "Covenant Loans"). Each loan was fully secured by its respective collateral through an assignment of a fractional share in a recorded deed of trust. Each assignment of a fractional interest was duly recorded in the official records of the Clark County Recorder. (Declaration of Jerry Smith ("Smith Decl."), which is attached as Exhibit A to this memorandum, at ¶¶ 2-3.) As a result, the Covenant Loans are doubly secured, as evidenced by two recorded instruments: (1) the underlying deed of trust and (2) the recorded assignment of a fractional interest in such deed of trust (the "Covenant Liens").

The Covenant Loans are tied to nine separate transactions and nine separate real properties. Because seven of the properties are contiguous, there are, for purposes of this motion, three distinct groups: (1) the Apex Property (which includes the seven contiguous properties), (2) the Sienna Vista Property, and (3) the Odyssey Property. A complete set of Covenant Liens was recorded on each respective property which was used as collateral for each respective Covenant Loan. (Smith Decl. at ¶ 4-6.) (Copies of the Covenant Liens, stamped by the Clark County Recorder, are attached as Exhibits 1-9 to the Smith Decl.)

B. Other Secured Loans and the Loan Management Agreements.

The Covenant Group is not the only secured lender. Based on similar loans, many other secured lenders recorded assignments of interests in the underlying trust deeds (collectively, with the Covenant Liens, the “Recorded Liens”). These other secured lenders have recorded liens and recorded assignments of fractional interests on the same nine properties. Concurrently with the making of the loans and recording of the associated liens, each secured lender entered into loan management agreements to facilitate management of the respective loans. One facet of the loan management agreement was naming a “loan manager” to manage the loan for the benefit of the numerous fractional interest holders. The various loan management agreements originally appointed a Southwick controlled-entity as the Loan Manager of the respective properties. Subsequent to defaults in loan payments and emerging information about Defendant Southwick, the Southwick entities were removed, and the Covenant Group was elected, by the respective groups of secured creditors, as the Loan Manager for each of the nine loans. (Smith Decl. at ¶ 7.)

C. The Nevada Foreclosures

The Nevada Foreclosures are non-judicial foreclosures on the Apex Property, the Sienna Vista Property, and the Odyssey Property. The Covenant Group, in its capacity as Loan Manager and on behalf of all the secured creditors under the loan management agreements, has instituted these non-judicial proceedings to foreclose the Recorded Liens associated with each respective property and sell the collateral under the terms of the various loans. Consequently, the Covenant Group represents all of the secured creditors, including many relatively small secured creditors, in prosecuting rights under the Recorded Liens. All of the deeds of trust, and assignments of interests in these deeds of trust, were properly recorded with the Clark County Recorder, and the Covenant Group, as Loan Manager, instituted non-judicial foreclosure proceedings, in the normal course of business and under the real property laws of Nevada. In accord with procedures established by Nevada law, “Notices of Default” were recorded for each respective deed of trust and the Covenant Group was prepared to schedule the foreclosures sales.

None of the Named Defendants in the SEC Action is the title holder of the property which is the subject of the Nevada Foreclosures. (Smith Decl. at ¶¶ 8-9.)

Subsequently, the secured creditors received notice of the Receivership Order, and the Covenant Group, to avoid any claim of violating a court order, has voluntarily delayed the Nevada sales until clarification of the Stay can be obtained. (Smith Decl. at ¶ 10.) The Covenant Group (and the other secured creditors it represents) is eager, however, to proceed with the foreclosure sales because the passage of time is having a negative impact on the amounts expected from the proceeds. The face value of the respective deeds of trust is currently substantially greater than estimated worth of the respective properties – meaning that there is no equity in the properties. In each case, the estimated value of the property is under 50% of the loan amounts secured by Recorded Liens. Property taxes continuously accrue. And because of current conditions in the Las Vegas commercial real estate market, the various properties are continuing to decline in value. (Smith Decl. at ¶¶ 11-12.)

The estimated current market value of the Apex Property is \$8,000,000.00. This is significantly less than the recorded liens on the property. The Covenant Loans associated with the Apex Property currently total \$10,995,833.00, and represent only 26.53 percent of the Recorded Liens on the Apex Property. When the loan balances of other secured creditors are included, the total amount subject to various recorded liens on the Apex Property is in excess of \$34,300,000. In contrast with an estimated market value of \$8,000,000.00, there clearly is not any equity in the Apex Property. (Smith Decl. at ¶¶ 13-15.)

There is not any equity in the Sienna Vista Property either. The estimated current market value of the Sienna Vista Property is \$16,000,000.00. The current total of the Covenant Loans associated with the Sienna Vista Property is \$9,775,036.00 and represents only 20 percent of the Recorded Liens on the Sienna Vista Property. When the loan balances of other secured creditors are included, the total amount subject to various recorded liens on the Sienna Vista Property is in excess of \$40,000,000. In contrast with estimated market value of \$16,000,000.00, there clearly is not any equity in the Sienna Vista Property. (Smith Decl. at ¶¶ 16-18.)

Nor is there any equity in the Odyssey Property, the estimated current market value of which is \$9,000,000.00. The current total of the Covenant Loans associated with the Odyssey Property is \$3,939,521.00 and represents only 18.78 percent of the Recorded Liens on the Odyssey Property. When the loan balances of other secured creditors are included, the total amount subject to various recorded liens on the Odyssey Property is in excess of \$18,000,000. Compared to an estimated market value of \$9,000,000, it is clear that there is no equity in the Odyssey Property. (Smith Decl. at ¶¶ 19-21.)

D. The Nevada Litigation

The Nevada Litigation seeks damages from the various individuals and entities involved in the solicitation and receipt of the Covenant Loans.¹ When the suit was originally filed, it included claims against two Named Defendants: Val Southwick and Vescor Capital, Inc. Since receiving notice of the Receivership Order, the Covenant Group has voluntarily dismissed Defendants Vescor Capital, Inc. and Val E. Southwick. While the remaining entity defendants in the Nevada Litigation may include some entities related to Mr. Southwick, none is a Named Defendant. (Smith Decl. at ¶ 22.) Because of a fraudulent inflation of the real estate's actual worth and the subsequent decline in the commercial real estate market in Las Vegas, the Covenant Group is presently under-secured and, consequently, pursuing the Nevada Litigation to effectuate full recovery, including interest, penalties, costs and fees, on the Covenant Loans.

Severable and distinct aspects of the Nevada Litigation, however, are the tort claims against three natural-person defendants, Christopher D. Layton, William W. Plise and Douglas R. Malen, each of whom is a resident of Nevada (the "Individual Nevada Defendants"). The Covenant Group is suing each of the Individual Nevada Defendants for, among other claims,

¹ The defendants in the Nevada Litigation include: VESCOR DEVELOPMENT, LLC; SIENNA OFFICE PARK, LLC; SIENNA OFFICE PARK 2, LLC; SIENNA OFFICE PARK 3, LLC; SOP 871, LLC; ONE MORTGAGE LTD., INC.; VDC COMMERCIAL MORTGAGE, LLC, dba PARTNERS CAPITAL; APEX HOLDINGS 1, LLC; APEX HOLDINGS 2, LLC; APEX HOLDINGS 3, LLC; APEX HOLDINGS 4, LLC; APEX HOLDINGS 5, LLC; APEX HOLDINGS 6, LLC; APEX HOLDINGS 23, LLC; CHRISTOPHER D. LAYTON; WILLIAM W. PLISE, DOUGLAS R. MALAN; SV ASSETS, LLC; ODYSSEY EQUITY, LLC.

fraud, breach of fiduciary duty, deceptive trade practices, and fraudulent conveyance. The core of these tort claims is tied to a fraudulent transfer of property which has substantially harmed the Covenant Group. The Individual Nevada Defendants engineered and carried out a fraudulent transfer which wrongfully removed and released the Covenant Group's recorded liens on certain property. Because the liens were fraudulently released, the Covenant Group, and the other secured lenders, cannot pursue a non-judicial foreclosure against that property.² (Smith Decl. at ¶ 23.)

The claims against the Individual Nevada Defendants have separate and distinct importance because of the personal character of the claims and the possibility of recovering against the personal assets of Plise, Malen and Layton. In addition to their involvement in the fraudulent transfer of the trust deed securing a Covenant loan, the Individual Nevada Defendants have separately defrauded the Covenant Group by knowingly and willfully making false and misleading representations to the Covenant Group. Consequently, the Covenant Group seeks a full recovery *directly* from the Individual Nevada Defendants (and their personal assets) for all of the money owed and, separately, seeks punitive damages for their personal breaches of fiduciary duty and treble damages for personally making knowing and willfully false and misleading representations.

E. The SEC Action and the Original Motion to Stay

On February 6, 2008, the SEC filed a complaint against the Named Defendants, thereby initiating this action. On February 26, 2008, the SEC filed a Motion to Stay Litigation ("SEC's Original Motion to Stay"). The SEC's motion papers did not even attempt to make an evidentiary showing in support of its request for a 90 day stay. Instead, only a couple, sparse statements were offered to show why a stay was needed. On April 11, 2008, the Court denied the SEC's Original Motion to Stay.

² Consequently, this property is not a subject of the present motion, despite the Covenant Group's ongoing and legitimate interest in it.

F. The Receivership Order

After the Court denied the SEC's Original Motion to Stay, the SEC filed its Stipulated Motion to Appoint Receiver on May 2, 2008 ("Stipulated Motion"), to which the Named Defendants offered no opposition. Again, as with the SEC's Original Motion, the SEC provided no evidentiary support for why a stay involving non-parties and the property of non-parties was necessary. Again, it offered only a single self-serving rationale, simply concluding that a "stay is necessary to allow the commission to prepare an accounting, to evaluate Southwick's assets and to determine whether the appointment of a receiver or other relief is necessary or appropriate." (SEC's May 2, 2008 Memorandum of Points and Authorities in Support of Motion to Appoint Receiver at 4.)

On May 5, 2008, the Court issued the Receivership Order, which appointed Robert G. Wing of Prince Yeats & Geldzahler as receiver (the "Receiver"). The Receivership Order identified, as the receivership entities, "Defendants Vescor Capital, Corp., Vescor Capital, Inc., Vescorp Capital, LLC, Vescorp Capital IV-A, LLC and *all affiliated* limited partnerships, corporations or other business entities (*collectively*, the 'Companies')." (Receivership Order at 2 (emphasis added).) Section VI of the Receivership Order, provides that certain "acts are stayed pending further order of this Court." (Receivership Order at 7.) Included are "any act to collect, assess or recover any claims related to the Companies, or against property held by the Companies." (*Id.* at 8).

The SEC's moving papers provide no guidance nor limitation as to the nature or scope of what comprised an "affiliated business entity." Nor do they provide guidance or limitation as to the nature or scope of what claims comprise "claims related to the Companies."³

G. The Stay of the Nevada Litigation

³ Read liberally, the Receivership Order is potentially so broad that, on its face, it enjoins two pending bankruptcy matters, *In re Vescor Dev., LLC*, Bankruptcy Petition No. 07-1521-mku (Bankr. Nev. 2007) and *In re Vescor Capital Inc.*, Bankruptcy Petition No. 07-22435 (Bankr. Utah 2007).

On June 10, 2008, the Receiver filed a “Notice of Order Staying Proceeding and Request for Notice in the Nevada Litigation.” (“Notice of Stay.”) Concurrently with the Notice of Stay, the Receiver’s counsel sent a letter to counsel for the Covenant Group, the stated purpose of which was to give counsel and clients notice that the Nevada Litigation has been stayed in its entirety. Notably, the letter stated that

[i]t is the Receiver’s position that the Order stays all claims asserted in the Nevada Litigation, because such claims are actions against receivership companies, actions to recover money or property from Val Southwick, or, in the case of non-receivership – company defendants, are claims that are “related to” receivership companies If you disagree with the Receiver’s assessment of the stay’s impact in the Nevada Litigation, you should file a motion asking Judge Benson, in the Federal District Court for the District of Utah, to determine the scope of the stay.

(Letter dated June 9, 2008, from Andrew B. Clawson, attached as Exhibit A (emphasis added).)

Given the unduly broad scope of the Receiver’s interpretation of the stay, counsel for the Covenant Group wrote to the Receiver’s counsel seeking among other things,

[c]larification about what “affiliated” means as used in the Receivership Order for purposes of determining if an entity appropriately should be treated as one of the receivership “Companies,” the source of authority supporting the stay of claims “related” to the Companies, and the criteria used to assess whether a claim is sufficiently “related” to the “Companies” to warrant enjoining state court proceedings.

(Letter dated June 12, 2008, from Kevin J. Leichter, attached as Exhibit B.) The Receiver’s counsel has not responded in any fashion. On June 30, 2008, the Honorable Michelle Leavitt, Judge presiding over the Nevada Litigation, stayed proceedings pending further resolution of the scope and application of the Receivership Order.

As detailed in the Argument below, the Covenant Group, as Loan Manager, should be entitled to complete the Nevada Foreclosures, regardless of the fact that Vescor-related entities may hold bare legal title. Likewise, the Covenant Group should be entitled to proceed in the Nevada Litigation against all current defendants. However, the Covenant Group is not now

seeking to proceed against any of the entities in the Nevada Litigation. With respect to the Nevada Litigation, the Covenant Group is seeking only to proceed against the three Individual Nevada Defendants (Plise, Malen and Layton).

III. ARGUMENT

A. In Clarifying the Receivership Order, the Court Should Confirm that Neither the Nevada Foreclosures or the Nevada Litigation Is Stayed.

A plausible reading of the Receivership Order confirms that neither of the Nevada actions is embraced by the Stay. As a threshold matter, the SEC has not established that jurisdiction lies over the implicated entities and individuals. Even assuming jurisdiction can be established, imposing a stay against secured creditors, like the Covenant Group, is unwarranted in these circumstances. Applying the Stay to (1) non-judicial foreclosures, based on secured claims and recorded liens on real properties located entirely in the state of Nevada, and/or (2) claims against natural persons, who are each residents of Nevada, would stretch the Receivership Order well beyond its plain and ordinary meaning.

The core of the Receiver's position is that the Nevada Litigation is stayed because it represents "any act to collect, assess or recover any claims related to the Companies, or against property held by the Companies." (Receivership Order at 8.) This reliance is necessarily hinged on the definition of "Company" which is expressed as "Defendants Vescor Capital, Corp., Vescor Capital, Inc., Vescorp Capital, LLC, Vescorp Capital IV-A, LLC and *all affiliated* limited partnerships, corporations or other business entities (*collectively*, the 'Companies')." (*Id.* at 2 (emphasis added).) Even though this reading is over-broad, its assertion is not the primary subject of this motion. In the interest of economy, the Covenant Group will not immediately contest the full breadth of the Receiver's position and application of the Stay to the entities named in the Nevada Litigation (except that the Receiver should be required to establish that the jurisdiction has been properly asserted). The real subject of dispute is the extraordinary breadth of the Stay suggested in the Receiver's Letter. The Receiver's broad position implies that the Stay also applies to the Nevada Foreclosures, and the

Receiver also contends that the Individual Nevada Defendants fall within the scope of the Stay because they are “related to the Companies.”

The fundamental question posed by this Motion is the exact meaning of the language in the Order relied on by the Receiver, namely what constitutes “any act to collect, assess or recover any claims related to the Companies, or against property held by the Companies.” In addressing this question, it is important to consider the standards employed in originally issuing the Stay. In the present circumstances, where the SEC failed to provide notice to the Covenant Group and similarly situated parties (thereby denying them the opportunity to brief the issues and present their arguments to the Court), it is especially important to keep these standards in mind.

The Covenant Group does not dispute that the Court has discretion in deciding whether to enter a stay. This discretion is tempered, however, by the need to consider and weigh the interests of parties that may be adversely affected by a stay. As a general proposition, the Supreme Court has expressly directed that the “proponent of a stay bears the burden of establishing its need.” *Clinton v. Jones*, 520 U.S. 681, 708 (1997). Stated more fully by the Tenth Circuit, the party requesting a stay “must make a strong showing of necessity because the relief would severely affect the rights of others.” *Commodity Futures Trading Com'n v. Chilcott Portfolio Mgmt., Inc.*, 713 F.2d 1477, 1484 (10th Cir. 1983) (reversing district court for having abused discretion by granting stay to protect receiver). Against the purported need for a stay, the Court will balance the interests of other affected parties. As recognized in this District, “[i]n exercising its judgment, the Court must weigh competing interests and consider the effects of the stay on the Court’s docket, on counsel, and on the litigants.” *Utah v. Eli Lilly and Co.*, 509 F.Supp.2d 1016, 1019 (D. Utah 2007) (quoting *Crown Cent. Petroleum Corp. v. Dept. of Energy*, 102 F.R.D. 95, 98-99 (D. Md.1984)).

As a practical matter, the need to balance interests imposes an evidentiary burden upon the party seeking a stay, because “[w]hen applying for a stay, a party must demonstrate ‘a clear case of hardship or inequity’ if ‘even a fair possibility’ exists that the stay would damage

another party.” *Ben Ezra, Weinstein, and Company, Inc. v. America Online Inc.*, 206 F.3d 980, 987 (10th Cir. 2000) (quoting *Span-Eng Assocs. v. Weidner*, 771 F.2d 464, 468 (10th Cir.1985)). See also *Clinton v. Jones*, 520 U.S. 681, 708 (1997) (finding that district court abused discretion in deferring trial where record lacked any basis to conclude whether stay of civil trial against President would be warranted); *Coastal Bermuda Ltd. v. E.W. Saybolt & Co., Inc.*, 761 F.2d 198, 204 (5th Cir. 1985) (“[T]he moving party bears a heavy burden to show why a stay should be granted absent statutory authorization and a court should tailor its stay so as to not prejudice other litigants unduly.”). This burden is aptly summarized in *Aventis Pharma Deutschland GMBH v. Lupin, Ltd.*, 403 F. Supp. 2d 484, 489 (E.D. Va. 2005).

A Motion to Stay Proceedings is not expressly provided for by the Federal Rules or by statute, although a district court has the inherent discretion to recognize such a motion under its general equity powers. *Williford v. Armstrong World Indus., Inc.*, 715 F.2d 124, 127 (4th Cir.1983). While recognizing this power, the United States Court of Appeals for the Fourth Circuit has observed that “it is not, however, without limitation.” *Id.* “[P]roper use of this authority,” the Court of Appeals explained, “calls for the exercise of judgment which must weigh competing interests and maintain an even balance.” *Id.* (quoting *Landis v. North American Co.*, 299 U.S. 248, 254-55, 57 S.Ct. 163, 166, 81 L.Ed. 153 (1936)). A party seeking a stay “must justify it by clear and convincing circumstances,” and these circumstances must weigh more heavily than the potential harm to the party against whom the stay applies. *Id.* Accordingly, the applicant for a stay “must make out a clear case of hardship or inequity in being required to go forward....” *Id.* Otherwise, a stay is not merited.

Aventis, 403 F. Supp. at 489 (finding that pharmaceutical patent owner was not entitled to stay of second infringement action, absent clear and convincing showing of hardship or inequity).

When balancing these interests, the Court is charged to proceed cautiously, because “[t]he right to proceed in court should not be denied except under the most extreme circumstances.” *Commodity Futures*, 713 F.2d at 1484 (quoting *Klein v. Adams & Peck*, 436 F.2d 337, 339 (2d Cir.1971)). And in the present circumstances, where the Receiver is asserting application of the Stay in another jurisdiction, the imposition of a stay should be made sparingly because “these precautions are of particular importance where, as here, restraints on other courts are contemplated.” *Span-Eng Assocs. v. Weidner*, 771 F.2d 464, 468 (10th Cir.1985) (quoting

Commodity Futures, 713 F.2d at 1484). Indeed, “considerations of comity require more than the usual measure of restraint, and such injunctions should be granted only in the most unusual cases.” *Commodity Futures*, 713 F.2d at 1484 (quoting *Bergh v. Washington*, 535 F.2d 505, 507 (9th Cir. 1976)). See also *Auerbach v. Frank*, 685 A.2d 404, 406-09 (D.C. 1996) (discussing general hesitation amongst state courts in issuing anti-suit injunctions affecting other jurisdiction). When the affected jurisdiction is a state court, as is the case in the present controversy, this concern is further heightened because “the underlying policy of preserving the independence of a state’s judicial system must be carefully weighed in considering whether to stay a state court proceeding.” *Commodity Futures*, 713 F.2d at 1484, n. 5.

When the Stay was first entered, the defendants apparently consented to the entry of the Receivership Order. Furthermore, the SEC failed to provide notice to the Covenant Group and other affected parties. Consequently, there was no adverse party to challenge the SEC and push it to make the necessary evidentiary showing. Now that the Covenant Group has received notice, and has asked the Court to clarify the meaning of “affiliated” business entities, the SEC must now meet its evidentiary burden. Because there is a fair possibility that a broad definition of “affiliated” business entities, and other expansive interpretation of the Stay, will harm the Covenant Group and other innocent parties, the SEC “must demonstrate ‘a clear case of hardship or inequity.’” *Ben Ezra*, 206 F.3d at 987.

1. The SEC Has Not Established Jurisdiction Over the Implicated Business Entities

Before the Receiver can lay claim to an entity or an entity’s assets, certain fundamental elements of due process must be satisfied. The Ninth Circuit has specifically considered whether a receiver appointed in an action instituted by the SEC can include a non-party legal entity. *In re San Vicente*, 962 F.2d 1402, 1406 (9th Cir. 1992) (“By including the property of San Vicente in its receivership order, the court exercised control over the property of a legal entity not before the court.”). The court spelled out the due process considerations as follows:

In sum, a district court has the power to include the property of a non-party limited partnership in an SEC receivership order as long as the non-party meets

the minimum contacts standard set out in *International Shoe* and receives actual notice and an opportunity for a hearing.

Id. at 1408. *See also SEC v. Elmas*, 620 F. Supp. 231, 233-34 (D. Nev. 1985) (relying on, after appropriate analysis of the evidence, the alter ego doctrine to avoid the due process concerns in exerting receiver control over non-party entities).

Because the SEC failed to provide notice of the proposed stay, the due process rights of the implicated entities have not even been addressed. Before considering the due process rights of the affected entities, however, it would be extremely helpful if the SEC at least identified the entities it proposes should be included in the receivership. Based on the SEC filings, it is unclear which entities are implicated.⁴ After the SEC has identified the entities it proposes should be included in the receivership, the SEC must then show that each and every such entity has received actual notice and an opportunity for a hearing. As a threshold matter, before even considering the propriety of the Stay, the SEC must show that the Court has jurisdiction over entities involved in the Nevada Litigation and Nevada Foreclosures. If the SEC can establish jurisdiction, then the subject entities and other affected parties, such as the Covenant Group, should then be able to challenge, in a separate motion, the necessity and propriety of the Stay as applied to those entities.

2. The SEC Cannot Meet Its Burden With Regard to the Nevada Foreclosures

The Nevada Foreclosures are not sufficiently “related” to the present proceedings to justify a stay. The SEC must show “a clear case of hardship or inequity” to warrant a stay of the Nevada Foreclosures. Because the Receiver cannot make a defensible claim of any value to the completely encumbered real property subject to the Nevada Foreclosures, staying those non-judicial proceedings is an unduly broad application for the Receivership Order.

All of the properties in the Nevada Foreclosures are subject to the Recorded Liens, which are secured liens evidenced by duly-recorded deeds of trust and separately recorded assignments

⁴ A list of entities was included with the SEC’s Original Stay Motion – but that motion was denied. As a list was available, the SEC’s decision not to include it in the later motion is somewhat unsettling.

of interests in the same, including the recorded interests of the Covenant Group. As set forth in the Declaration of Jerry Smith, the value of these properties is insufficient to pay the secured claims. Therefore, the Receiver cannot hope to include such properties as distributable assets in the Receivership. Without a defensible interest in the subject properties, there is no basis for the Receiver to interrupt and frustrate the Nevada Foreclosures. Every day the injunction remains in place, the secured creditors are harmed. If the foreclosures are further delayed, the Covenant Group, and the other secured creditors they represent, lose not only the time value of money, but will also ultimately recover less in the eventual foreclosure sales. The values of the respective properties are diminishing. Substantial property taxes remain unpaid and continuously accumulate, and the commercial real estate market in Las Vegas continues to decline. Together, these developments are eating away at the value of the already over-encumbered properties.

The Covenant Group, as Loan Manager, will certainly be allowed to proceed with the Nevada Foreclosures *eventually* – as validity of the Recorded Liens is undisputed. But if sales are delayed by an expansive reading of the Stay, the Covenant Group and the other secured creditors will realize fewer proceeds. (Smith Decl. at ¶ 12.) The Court should not allow such inequity to result from an overly-broad interpretation of the Receivership Order.

Because there is no equity to which the Receiver can ever lay claim, The SEC cannot show “a clear case of hardship or inequity” in allowing the Nevada Foreclosures to proceed. The Court should clarify that the Nevada Foreclosures are not sufficiently “related” to the purpose and goals of the receivership and that, therefore, the Receivership Order does not stay these non-judicial proceedings.

3. The SEC Cannot Justify a Stay Embracing the Individual Nevada Defendants

The Receiver’s attempt to include the three individuals, Plise, Malen, and Layton, in the Receivership Order stretches the words of the Court beyond credible limits. Recognizing the impossibility of including these individuals as affiliated entities, the Receiver attempts and end-around and argues that because the Individual Nevada Defendants are “related” to the Southwick

fraud, claims against them are stayed. Against the backdrop of the SEC's burden to show "a clear case of hardship or inequity," this interpretation is entirely indefensible.

The Covenant Group has tort claims against Plise, Malen, and Layton for, among other things, those individuals' personal wrongdoings and tortious conduct. Any judgment against the Individual Nevada Defendants would necessarily have to be satisfied from the personal assets of Plise, Malen, and/or Layton, respectively. The fundamental purpose of the Receivership Order and the Stay is to protect the assets of the receivership, with the expectation of making an equitable distribution sometime in the future. To justify a stay against the Individual Nevada Defendants, it is then logically necessary that the Individual Nevada Defendants (and their assets) are included within the receivership. Even the Receiver does not make so bold a claim. Consequently, stretching the use of the word, "related," as it is used in the Receivership Order, to effectuate a Stay against the Individual Nevada Defendants is entirely unwarranted.

If the Receiver believes the assets of the Individual Nevada Defendants should be included in the receivership, then the Receiver should tackle the issue head-on and openly move the Court to name it as a receiver for the Individual Nevada Defendants. At which time, it and the SEC must make a showing that such inclusion is appropriate and necessary despite the obvious harm caused to the Covenant Group and other similarly-situated parties.

At this time, and for the purpose of this Motion, however, the Court should clarify that the Stay does not apply to the Individual Nevada Defendants.

B. In the Event the Court Determines the Receivership Order Applies to the Nevada Actions, then the Stay Should be Lifted as to Those Actions.

Alternatively, the Covenant Group respectfully requests the Court to lift the Stay, to the greatest extent possible, as it applies to the Nevada Foreclosures and the Nevada Litigation. While the Tenth Circuit has not tackled this precise issue, the Ninth Circuit has specifically addressed what circumstances justify the lifting of a stay issued in conjunction with a SEC receivership. It has developed a test, followed by many courts, to determine whether a stay should be lifted. The test contemplates three factors:

(1) whether refusing to lift the stay genuinely preserves the status quo or whether the moving party will suffer substantial injury if not permitted to proceed; (2) the time in the course of the receivership at which the motion for relief from the stay is made; and (3) the merit of the moving party's underlying claim.

SEC v. Universal Financial, 760 F.2d 1034, 1038 (9th Cir. 1985) (citing *SEC v. Wencke*, 742 F.2d 1230, 1231 (9th Cir. 1984)). Application of these three factors to the situation at hand demonstrates that the stay against the Covenant Group should be lifted.

First, as discussed above, the Covenant Group would suffer substantial injury if this Court refuses to lift the Stay. Preventing a party from pursuing its rightful claims against wrongdoers necessarily causes harm. This harm alone justifies lifting the Stay. In the present circumstances, however, imposition of a stay causes substantial additional harm to the Covenant Group, and a stay certainly does not protect the status quo. The potentially extraordinary harm to the Covenant Group especially justifies lifting the Stay.

With each passing day that the Nevada Foreclosures are delayed, the Covenant Group is increasingly harmed. As previously discussed, delay not only robs the Covenant Group of the time value of their money, but, because of declining property values, also results in further diminishing the amounts which will be recovered under the secured claims. Due to the fraud that intentionally inflated the value of the collateral properties beyond their actual worth, the Covenant Group is already under-secured. Accruing property taxes and a struggling market exacerbate the problem; the Covenant Group, and the other secured creditors who they represent, will receive less money from a sale if foreclosure is stalled by the Receiver.

In addition, delaying the Covenant Group's ability to pursue claims against Plise, Malen, and Layton is troublesome. Personal assets can be dissipated or intentionally hidden, to the frustration of creditors who establish rights later in time. Furthermore, these individuals have

participated in numerous, substantial frauds, and these risks may be more pressing in the present circumstances. For these reasons, time is of the essence to make recovery against these individuals. And the Receiver's interference reduces the Covenant Group's prospects of making a full recovery against the Individual Nevada Defendants.

Second, given the secured nature of the claims, the present duration of the stay should be given little weight. The SEC and the Receiver (and any other interested party) do not need substantial time to review the official records of the Clark County Recorder. If there are any concerns or objections about the validity of the Recorded Liens, those objections should be made immediately. Even if weight were given to this second factor, it should support lifting the Stay. As the Court is well aware, Southwick has been under the spotlight for sometime. He has been the subject of various governmental investigations for years, and an initial accounting was done over 18 months ago. Indeed, the Court denied the SEC's Original Motion to Stay, partly because the SEC had already had sufficient time to make its investigation. And the Receiver has now been in place for almost 90 days, giving him adequate time to perform an investigation.

Finally, the third factor also weighs in favor of the Covenant Group. *Wencke* unequivocally stated that where the receiver is unlikely to realistically prevail on a claim, "a blanket stay should not be used to prejudice the rights which innocent and legitimate creditors may have against the receivership entities." 622 F.2d at 1373; *see also Universal Financial*, 760 F.2d at 1039 (stating that this factor weighed in favor of party likely to "prevail in future litigation"). In regards to the Apex Property, the Sienna Vista Property, and the Odyssey Property, the Covenant Group is properly secured by Recorded Liens and the Receiver thus has no economic interest in the properties. In addition, the Receiver, by definition, has no interest in the personal assets of the Individual Nevada Defendants and thus the Covenant Group is almost

certain to prevail against the Receiver as to the extent of the Stay.

The Covenant Group will complete the Nevada Foreclosures. And, for the reasons discussed above, the Receiver has no claim to the proceeds of a foreclosure. Unlike other Southwick investors, who were simply swayed by promises of high returns, the Covenant Group, and the other secured creditors they represent as Loan Manager, made loans with the protection of recorded trust deeds on real property and exerted appropriate diligence to make sure that instruments documenting the liens were properly recorded. Not surprisingly, the secured creditors have a high expectation of recovering monies loaned through the Nevada Foreclosures. The Receiver (assuming that the titled-entities are within the receivership), on the other hand, has only a minimal expectation of successfully drawing any value from the subject real estate. The properties are over-encumbered, and there is no equity to which the Receiver can lay claim. With or without a stay, the Receiver will take nothing from this property. Consequently, the Receiver's legitimate interest in staying the Nevada Foreclosures is minimal (at most).

Lifting the Stay with regard to Plise, Malen, and Layton is especially warranted. Because recorded liens on real property were improperly released, and it is undisputed that the Individual Nevada Defendants were involved, the Covenant Group will almost certainly succeed in proving its tort claims against these individuals.

Notwithstanding the fact that the Covenant Group's claims are much stronger, a Stay to simply benefit the Receiver vis-à-vis a similarly-situated creditor is entirely inappropriate. The Receiver cannot claim an interest in the assets of Individual Nevada Defendants unless and until the Court includes the same within the receivership. The Receiver must attempt to recover against these individuals in the same manner and with the same tools as any other litigant.

The Receiver and the Covenant Group should be on equal footing, and a stay would

unfairly benefit one creditor to the detriment of the other. As discussed above, if the Receiver wishes to have a legitimate advantage, it may make a motion to the Court to include Plise, Malen, and Layton in the receivership. Until such a motion is granted, any stay implicating an action against the Individual Nevada Defendants should be lifted.

CONCLUSION

For the reasons stated above, the Court should grant the Covenant Group's motion.

DATED this 31st day of July, 2008.

/s/ Peter W. Billings _____
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Timothy K. Clark
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