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 8 THOMAS A. SEAMAN

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

12 SECURITIES AND EXCHANGE
 COMMISSION,

13 Plaintiff,

14 vs.

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

18 Defendants.

Case No. CV12-03237

**MOTION FOR ADMINISTRATIVE
 RELIEF UNDER CIVIL L.R. 7-11;
 REQUEST FOR AUTHORITY TO ACCEPT
 PAYOFF OF CONSTRUCTION LOAN**

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

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1 Pursuant to Civil L.R. 7-11, Thomas A. Seaman ("Receiver"), receiver for Small Business
 2 Capital Corp. ("SB Capital"), Investors Prime Fund, LLC, SBC Portfolio Fund, LLC ("SPF"), and
 3 their subsidiaries and affiliates (collectively, "Receivership Entities"), hereby moves for
 4 administrative relief in the form of an order authorizing him to accept a payoff of the construction
 5 loan issued to 349 First Street, LLC ("Borrower") by SPF ("Loan").¹

6 I. INTRODUCTION

7 As discussed in the Receiver's Fourth Interim Report (Dkt. No. 167, pp. 8-10), there were
 8 significant deficiencies in the administration of the Loan prior to the Receiver's appointment,
 9 including missing construction and architect contracts, lack of documents supporting the budget,
 10 lack of required city approvals, no written profit sharing agreement, missing financial statements
 11 for the borrower and guarantor, and missing lien waivers. The Receiver worked diligently with
 12 Borrower to remedy these deficiencies, but ultimately Borrower was unable to satisfy essential
 13 documentary and insurance requirements and cure other deficiencies. Moreover, a construction
 14 loan that goes into default has potential costs and liabilities for the lender not associated with other
 15 loans, including the costs of completing construction and potential construction defect liability.
 16 Under these circumstances, the risks associated with funding the remainder of the Loan were
 17 unreasonably great in relation to the potential economic benefits.

18 Accordingly, the Receiver and Borrower negotiated the proposed Loan Payoff and Release
 19 Agreement ("Agreement"), a copy of which is attached as Exhibit A to the Declaration of Thomas
 20 Seaman filed herewith ("Seaman Declaration"). Under the Agreement, Borrower will pay
 21 \$1,247,702.64 in cash, the full outstanding principal and accrued interest as of July 1, 2012, in full
 22 satisfaction of the Loan. The Receiver will forego payment of \$84,741.68 in accrued interest.
 23 Borrower and Ian Carney ("Guarantor") will release all claims against the Receivership Entities.

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 27 ¹ Accepting a loan payoff is something done in the ordinary course of SPF's lending/servicing
 28 business, and therefore is within the Receiver's existing authority under the Preliminary
 Injunction Order. Dkt. No. 34, Part VII. Nevertheless, the Loan has been the subject of a
 motion filed by Defendant Feathers and has been discussed at prior hearings. Accordingly, in
 an abundance of caution, the Receiver seeks authority to accept the proposed payoff.

1 The proposed payoff eliminates the risk of nonpayment for a loan currently in default. The
 2 Agreement also eliminates costs associated with foreclosure, holding and selling the property, as
 3 well as the market risk associated with selling undeveloped land. Accordingly, the Receiver
 4 believes the Agreement is in the best interests of the receivership estate and requests authority to
 5 execute the Agreement and accept the payoff provided therein in full satisfaction of the Loan.

6 II. BACKGROUND FACTS

7 In December 2010, SPF made a loan to Borrower of \$940,000 for the acquisition of two lots
 8 located at 731 and 733 Bay Road, Menlo Park, California ("Acquisition Loan"). From the
 9 Acquisition Loan, \$840,000 was used to purchase the property from SB Capital.² At that time,
 10 \$50,000 was paid to Borrower as a developer fee and \$50,000 was paid to SB Capital as a loan
 11 origination fee. The Property originally included an 11-room boarding house which was in poor
 12 condition. Seaman Declaration, ¶ 2.

13 On May 30, 2012, SPF refinanced the \$940,000 loan with the Loan in the amount of
 14 \$2,360,000. From the Loan, \$1,144,085 was used to pay off the Acquisition Loan. SB Capital was
 15 paid another loan fee of \$47,200 and an interest reserve of \$151,913 was established. The interest
 16 on the amount advanced has been paid current from the interest reserve. A total of \$1,011,148.12 is
 17 shown on the closing statements as "undisbursed" and available. The undisbursed funds were to be
 18 used for construction of four single-family condominiums. Borrower demolished the boarding
 19 house in late 2012. Seaman Declaration, ¶ 3.

20 The Receiver obtained an appraisal of the property in its "as is" condition and as a
 21 completed project. According to the appraisal, which is dated as of September 2012, the "as is"
 22 value of the land is \$1,240,000, and the value of the finished condominiums is \$2,520,000 if sold in
 23 bulk, or \$3,000,000 if sold individually. Seaman Declaration, ¶ 4.

24 The Receiver evaluated the Loan, the project, and the extent to which the conditions for
 25 making construction disbursements have been satisfied. In that regard, the Receiver engaged a
 26 construction specialist to assist with, among other things, a review of the project, including (i) a
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28 ² SB Capital previously obtained the property from a prior borrower via foreclosure.

1 review of the current plans and specifications for the project, which Borrower advised have not
2 been finally approved by the City of Menlo Park, (ii) review of the updated budget received from
3 Borrower, which reflected cost overruns resulting in an overall budget in excess of the loan
4 proceeds available for disbursement, and (iii) review of the hard and soft construction costs set forth
5 in the updated budget and time to complete construction. At the conclusion of her review, the
6 construction specialist provided the Receiver with a list of deficiencies and unanswered questions
7 needing to be addressed prior to further funding. Seaman Declaration, ¶ 5.

8 The Receiver worked with Borrower to obtain proper documentation in order to administer
9 the Loan and secure the profit sharing agreement. Through this process, the Receiver discovered
10 significant deficiencies in the administration of the Loan prior to his appointment, including:

- 11 a. No contract in place with the general contractor and no assignment of that contract.
- 12 b. The architect's agreement was missing and Borrower could not produce a copy.
- 13 c. No bids or supporting documentation for the budget.
- 14 d. No formal profit sharing agreement, which Borrower indicated was a verbal agreement.

15 Without a written agreement, the profit sharing agreement is not secured by the collateral.

16 e. Developer fees were paid in advance, rather than with each draw or as work was
17 completed.

18 f. No financial statements for Borrower or Guarantor. Borrower only provided financial
19 statements for Carney Construction Consulting which is neither the borrower nor the guarantor.

20 g. SB Capital never requested lien waivers for any prior draws.

21 h. Draw requests were informal and did not include sufficient supporting documentation.

22 Seaman Declaration, ¶ 6.

23 The Receiver worked diligently with Borrower to remedy these deficiencies. Borrower was
24 generally cooperative, but contended that it had been damaged by the delay in funding the
25 remainder of the Loan. Ultimately, Borrower was unable to satisfy essential documentary and
26 insurance requirements under the Loan documents. The Borrower also has not obtained city
27 approvals and permits for the project, a requirement of further funding under the loan documents.
28 Moreover, the loan-to-value ratio, assuming a value of \$2,520,000, is very high (about 94%).

1 Finally, once construction is started, the expenses and potential liability associated with
 2 enforcement of the loan in the event of a default (foreclosure, completion of construction, potential
 3 additional cost overruns, and potential construction defect liability) increase significantly. Under
 4 these circumstances, the Receiver determined that the risks associated with funding the remainder
 5 of the Loan were unacceptably great in relation to the potential economic benefits. Accordingly,
 6 the Receiver issued a notice of default and demanded full payment of the Loan. The Receiver and
 7 Borrower then negotiated the Agreement. Seaman Declaration, ¶ 7.

8 III. ARGUMENT

9 A. Broad Equitable Powers of the Court

10 "The power of a district court to impose a receivership or grant other forms of ancillary
 11 relief does not in the first instance depend on a statutory grant of power from the securities laws.
 12 Rather, the authority derives from the inherent power of a court of equity to fashion effective
 13 relief." *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir. 1980). The "primary purpose of equity
 14 receiverships is to promote orderly and efficient administration of the estate by the district court for
 15 the benefit of creditors." *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir 1986).

16 District courts have the broad power of a court of equity to determine the appropriate action
 17 in the administration and supervision of an equity receivership. *See SEC v. Capital*
 18 *Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005). The Ninth Circuit explained:

19 A district court's power to supervise an equity receivership and to determine the
 20 appropriate action to be taken in the administration of the receivership is extremely
 21 broad. The district court has broad powers and wide discretion to determine the
 22 appropriate relief in an equity receivership. The basis for this broad deference to the
 23 district court's supervisory role in equity receiverships arises out of the fact that most
 receiverships involve multiple parties and complex transactions. A district court's
 decision concerning the supervision of an equitable receivership is reviewed for abuse
 of discretion.

24 *Id.* (citations omitted); *see also Commodities Futures Trading Comm'n. v. Topworth Int'l, Ltd.*,
 25 205 F.3d 1107, 1115 (9th Cir. 1999). Accordingly, the Court has broad equitable powers and
 26 discretion in the administration of the receivership estate and disposition of receivership assets.

27 Here, the Loan is in default and Borrower has failed to remedy fundamental deficiencies,
 28 including the lack of a construction contract, the lack of required city approvals, and inadequate

1 insurance and bonding for the property and the project. These and other deficiencies, as well as the
 2 potential costs and liabilities associated with a defaulted construction loan, make the risks
 3 associated with funding the remainder of the Loan unreasonably great in relation to the potential
 4 economic benefits, *i.e.*, the interest that would accrue during the remaining term of the Loan.

5 Under the Agreement, Borrower will pay \$1,247,702.64 in cash in full satisfaction of the
 6 Loan. This amount covers the full outstanding principal and interest accrued as of July 1, 2012.
 7 The Receiver will forego \$84,237.06 in interest that has accrued since July 1, 2012. As noted
 8 above, Borrower contends it has been damaged as a result of the delay in funding. The Receiver
 9 believes this claim has no merit. Nevertheless, Borrower and Guarantor will release all claims
 10 against the Receivership Entities and the Receiver.

11 The proposed payoff eliminates the risk of nonpayment of a defaulted loan. It also
 12 eliminates costs associated with foreclosure, holding and selling the property, as well as the market
 13 risk associated with selling undeveloped land. If SPF were to take the property via foreclosure and
 14 sell it to a third party, the recovery would almost certainly be lower than the proposed payoff. Per
 15 the appraisal, the "as is" value of the property is \$1,240,000. The costs of foreclosure, insurance,
 16 taxes and sale (broker, title, escrow, etc.) would have to be paid from the sale proceeds.

17 Finally, the Guarantor has failed to provide any financial statements. His ability to satisfy
 18 any significant portion of the Loan (principal or accrued interest) is unknown. Under these
 19 circumstances, the proposed payoff is in the best interests of the receivership estate.

20 IV. CONCLUSION

21 WHEREFORE, the Receiver requests an order authorizing him to execute the Agreement
 22 and accept the proposed payoff from Borrower in full satisfaction of the Loan.

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 24 Dated: March 22, 2013

ALLEN MATKINS LECK GAMBLE
 MALLORY & NATSIS LLP

25 By: /s/ Ted Fates

26 TED FATES
 27 Attorneys for Receiver
 THOMAS A. SEAMAN