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Hon. Edward J. Davila
United States District Judge
United States Courthouse, San Jose
280 South First Street
San Jose, CA 95113

Re: *SEC v. Small Business Capital Corp., et al.*, Case No. 5:12-CV-03237-ELD

Dear Judge Davila:

Plaintiff Securities and Exchange Commission ("Commission") respectfully submits this letter brief in opposition to the August 3, 2012 letter brief filed by counsel for defendant Mark Feathers ("Letter"). In the Letter, Feathers asks for an initial payment of $375,000, exclusive of costs, to fund his personal defense. Feathers proposes that this payment come from assets he does not own, and specifically that it should be made from funds held by the Receiver which belong to, and have been frozen for the benefit of, the defrauded investors. In addition, the $375,000 initial payment does not include the costs of hiring expert witnesses and future legal fees. (*See* Letter at pp. 8-10.).

The Commission respectfully requests that the Court deny defendant's application because substantial precedent establishes that Feathers does not have any right to use other people's assets for his personal legal defense. In addition, defendant has not made the required showing to justify releasing any of his own assets from the asset freeze to which he consented, and he has not identified any of his own assets in any event. Moreover, defendant's request for a substantial advance payment for his personal legal fees is unreasonable. For these reasons, and the reasons stated below, defendant's request should be denied.

## I. INTRODUCTION

The assets Feathers proposes to use to fund his legal defense are not his assets. Rather, they are the assets of the Receivership Entities: defendant Small Business Capital Corp. ("SB Capital"); the three funds it managed, defendant SBC Portfolio Fund, LLC ("SPF), SBC Commercial Mortgage Fund, LLC ("CMF"), defendant Investors Prime Fund, LLC ("IPF"); and IPF's subsidiary, Small

Business Capital, LLC ("SBC LLC"). Feathers' personal assets are not held by the Receiver. Feathers' personal assets remain in his custody and control, subject to the continuing asset freeze to which he consented.

The Commission does not dispute that this Court has the discretion to release a defendant's own assets from an asset freeze to pay the defendant's personal legal fees, as well as the discretion to limit, or forbid, payment of a defendant's personal attorney fees out of that defendant's own frozen assets. However, the Commission opposes Feathers' request because defendant is applying to use other people's money – specifically the assets of the Receivership Entities, frozen and held for the benefit of the defrauded investors by the Receiver. A substantial body of precedent holds that a defendant in a civil enforcement action has no right to use another person's funds to pay the defendant's personal legal expenses. Moreover, it would be manifestly unfair to the defrauded investors to permit Feathers to use their limited remaining funds to pay his personal legal fees, thus increasing the loss each investor suffers from Feathers' fraud. Accordingly, the Commission urges the Court to exercise its discretion to deny Feathers' application to use the frozen assets of the Receivership Entities for his personal benefit.

The Commission also questions the reasonableness of defendant's request for the Receivership Entities to pay what is essentially a large retainer for legal work that has yet to be performed. Counsel for Feathers concedes that it did not seek or obtain any retainer from Feathers before entering an appearance in this matter, but fails to explain why the Receivership Entities should now be forced to pay in advance for Feathers' personal defense. Indeed, Feathers has not attempted to make any showing to the Court that he does not have other assets that could be used to pay his personal legal fees, or why he cannot earn money to pay his legal fees. If counsel is convinced that Feathers has meritorious defenses, then when Feathers prevails at the conclusion of the case, Feathers can pay his counsel from his assets according to the terms of their agreement. This will conserve the resources of the Court and the parties, thus providing for more efficient administration of this case.

## II. ARGUMENT

In the Letter, Feathers challenges the preliminary injunctive relief that he already consented to, and then asserts, without any legal basis, that he has a legal right to use assets he does not own to pay his legal defense. Defendant's contentions are without merit. Moreover, to the extent Feathers may be asking to fund his defense with his own assets, Feathers has not made the requisite showing to justify modification of the Court's asset freeze.

### A. Feathers' Challenges to The Merits of The Case Are Baseless

Feathers argues that, based on counsel's "limited review of the evidence," Feathers' conduct "(a) was proper on the merits, (b) sanctioned by trained professionals and/or another government agency, and (c) in no way warranted the SEC's resort to an *ex parte* TRO seizing his assets." (Letter at p. 2.) Feathers does not explain why he did not assert these arguments before consenting to a

Preliminary Injunction, or how these arguments will advance the resolution of this matter. In fact, defendant's arguments either mischaracterize the evidence or are based on speculation.

**1. The Court Found that the Commission made a Prima *Facie Case* Against Feathers, and Feathers Consented to a Preliminary Injunction and Continued Freeze of his Personal Assets**

Feathers repeatedly asserts that "no findings" have been made against him in this case. (*E.g.*, Letter at pp. 2, 4, 5, 7.) That is simply not true. The Court specifically found that the Commission "made a *prima facie* case" that defendants had violated, and were violating, the federal securities laws. *See* June 26, 2012 Temporary Restraining Order (Docket No. 16) ("TRO"), at p. 1 ¶ B.

Feathers seeks the initial payment of legal fees so that his counsel can marshal evidence to challenge the Preliminary Injunction (Docket No. 34) ("PI") that is already in place. (Letter at p. 10.) This proposal completely ignores the fact that, while represented by counsel, Feathers chose not to contest the Court's findings pursuant to the Order to Show Cause that was issued as part of the TRO. With advice of counsel, Feathers consented to the PI. Moreover, as of the date of the fee application, Feathers has not placed in issue any of the allegations against him, so the Court can only speculate as to the matters at issue and the reasonableness of any request for legal fees.

**2. Defendant's Claims that the Emergency *Ex Parte* Action was "Not Warranted" are Baseless**

This case is about the fraud committed by Feathers and the entity defendants, but in an effort to point the finger at his accuser, Feathers repeatedly makes the baseless assertions that the Commission's emergency *ex parte* action was "not warranted," and somehow the Commission violated its "Wells process." (Letter at pp. 1, 2, 4, 7.) As a preliminary matter, the facts support the Commission's decision to seek emergency relief. Indeed, the day the TRO was issued, Feathers caused a $100,000 cashier's check, drawn on the account of one of the Receivership Entities, to be issued payable to himself for his personal expenses. *See* Receiver's First Status Report and Inventory (Docket No. 30) at p. 6 ll. 5-8. Moreover, the fraud was ongoing and Feathers was continuing to raise money from investors: the defendants received a $45,000 check from an investor just one day before the PI was entered. (*See* Declaration of John B. Bulgozdy ("Bulgozdy Dec.") ¶ 4.)

Feathers speculates that the Commission did not provide defendants with a Wells notice in a tactical effort to deprive defendants of "the opportunity to engage counsel."[1] (Letter at p. 7.) However, the fact is that Feathers and the entity defendants were represented throughout the Commission's investigation by the law firm of DLA Piper, and specifically the West Coast Chair of

[1] *See, e.g., SEC v. Lauer*, 445 F. Supp. 2d 1362, 1365 n. 4 (S.D. Fla. 2006) (rejecting as "frivolous" the argument that an asset freeze is a litigation tactic to pressure defendant and deny defendant an adequate defense).

its securities enforcement practice, who was formerly a trial counsel for the Commission. The Commission provided notice of the *ex parte* filing to counsel shortly after the TRO was issued. (Bulgozdy Dec. ¶ 5.)

In an effort to attack the Commission's credibility, Feathers' counsel offers his personal opinion that he does not believe there was any need for emergency action by the Commission. (Letter at pp. 4, 7.) Counsel's personal view, expressed in the context of an effort to get $375,000 in fees with more to come, is entitled to no weight. Moreover, Congress expressly gave the Commission discretion to bring an emergency action to stop a securities fraud,[2] and its Enforcement Manual explicitly provides that a Wells notice is discretionary and need not be issued when the staff recommends filing an emergency action. (Bulgozdy Dec. ¶ 6 and Ex. 1.)

**3. Defendant's Assertions Concerning the SBA are Incorrect**

Defendant tries to challenge the Commission's allegations by claiming the Small Business Administration ("SBA") "sanctioned" and "approved" the actions of the defendants. (Letter at pp. 2, 3.) But the SBA is a separate federal agency that is not charged with enforcing the federal securities laws. In any event, defendant's claims about the SBA are inaccurate. Thus, defendant asserts, incorrectly, that "Mr. Feathers and his funds [*sic*] were repeatedly and exhaustively audited by the SBA" (Letter at p. 7), and that "[t]hroughout their lives, the Funds [*sic*] continued to be audited every year both by the SBA and private accountants." (*Id.* at p. 3.) These assertions are not true because: (1) the SBA examination report shows that it examined SBC LLC in 2011; and (2) the SBA examination report plainly states: "This was SBC [LLC]'s *first* safety and soundness examination." (emphasis added). There is no evidence that the SBA ever audited the "funds" – IPF, SPF, or CMF, or SB Capital, manager of the funds – particularly to determine whether Feathers or the entities were committing violations of the federal securities laws in the offer and sale of securities.

**4. Defendant's Claims Regarding Professionals Lack Merit**

Feathers repeatedly asserts that attorneys and independent auditors employed by the Receivership Entities did not find any problems with the defendants' operations. (*E.g,* Letter at pp. 2, 7-8.) To the contrary, the independent outside auditor for IPF and SPF found problems with the 2009 and 2010 financial statements of IPF and SPF, because of the so-called "Manager's Note" – the $5 million that SB Capital owed to IPF and SPF. As a result, the auditor was unable to issue a "clean" audit opinion and opined that the financial statements were not prepared in accordance with GAAP, and the effect of that failure could not be assessed. (*See* Declaration of Roger Boudreau (Docket No. 8), Ex. 3 at SBCC002968, Ex. 7 at SBCC004892.) In short, the independent auditor opined that the financial statements of IPF and SPF were not reliable – which is a problem.

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[2] *See, e.g.,* Section 20(d) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77t(d); Section 21(d)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78u(d)(1).

Feathers' assertions about attorneys are directly contradicted by a non-privileged letter produced to the Commission by IPF's independent outside auditor. An April 24, 2012 letter from IPF's counsel, Dennis Doss of the Doss Law Firm, to Mark Feathers, Investors Prime Fund, LLC, raises issues with the so-called "Manager's Note" and the sale of assets between IPF and SPF. With regard to the asset sales between IPF and SPF, the letter refers to the sale of loans from IPF to SPF as "possibly generating phantom income to IPF while financially harming [SPF]." With regard to the Manager's Note, the letter opines that the offering materials "currently" being used for IPF "have not disclosed the exact size and nature of the amount the manager has taken from IPF, which is highly misleading." (Bulgozdy Dec. Ex. 2.)

**B. Feathers Has Not Identified The Frozen Assets That Are The Subject of His Request**

Feathers makes two passing references to the assets he is seeking, and provides no information for the Court to determine what the asset is, whether it actually exists, or whether it has any value. Defendant states he "contributed approximately $550,000 to the Funds," and is requesting "less than the $550,000 paid by Mr. Feathers to the Funds." (Letter at pp. 2, 9.) Feathers provides the Court with no evidence to support his claimed contribution of $550,000, when it was made, and whether those funds were expended long ago. Indeed, defendant's definition of "the Funds" includes all of the Receivership Entities, so it is unclear if Feathers is claiming to have invested in IPF or SPF, or whether the contribution was to SB Capital – which is not a fund at all.[3]

Moreover, if the Court is going to consider this vague contribution as a basis to release assets of the Receivership Entities frozen for the benefit of the defrauded investors, it should also consider that during the past two or three years, Feathers took a substantial amount in salary, and owed SB Capital approximately $266,800 at the time the Receiver was appointed, according to the books and records of SB Capital. (*See* Letter at p. 4 (acknowledging Feathers has been paid $485,850); Receiver's First Status Report and Inventory (Docket No. 30) at p. 8 ll. 23-24.) It is therefore unclear whether Feathers may have already taken out all of the $550,000 he claims to have contributed to "the Funds."

**C. Feathers Has Neither a Constitutional "Right to Counsel" in This Civil Matter Nor a Right to Use Assets He Does Not Own to Pay His Legal Fees**

In addition to the many factual inaccuracies in his Letter, Feathers also misstates the law when he argues he has a right to counsel in this civil enforcement action and a right to have assets he does not own pay his legal fees. Neither contention is supported by the law.

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[3] In a letter dated July 20, 2012, Feathers' counsel claimed that Feathers contributed $650,000 to purchase stock of SB Capital in 2006 and 2007. The Declaration of Mark Feathers re: Assets, made under oath, at ¶ 10, also uses that higher figure. No explanation is offered for the discrepancy.

**1. Defendant does not have a Constitutional "Right to Counsel" in this Civil Action**

Feathers posits, without citation to precedent, that "[n]umerous federal courts have upheld the right of individuals subject to government enforcement actions to retain counsel," particularly where defendant has "meritorious defenses that he will never be able to assert unless he has proper representation." (Letter at p. 4.) The Commission does not dispute that Feathers may use his own resources to retain counsel of his choice, as could any litigant in a civil proceeding. Similarly, Feathers has the right to act as his own counsel in this proceeding. However, to the extent Feathers is asserting that he has some constitutional right to counsel, that contention is contrary to well-established precedent.

The law is clear that there is no right to counsel in civil proceedings. *See, e.g., Lassiter v. Dep't of Social Services*, 452 U.S. 18 (1981) ("fundamental fairness" places presumption of indigent's right to counsel only when may be deprived of liberty). *See also SEC v. Prater*, 296 F. Supp. 2d 210, 218 (D. Conn. 2003) (recognizing that defendants in SEC enforcement proceeding "have no right to counsel in the non-criminal context"); *SEC v. Current Fin. Servs.*, 62 F. Supp. 2d 66, 67 (D.D.C. 1999) (rejecting a claim that asset freeze violated constitutional right to counsel in SEC action because "the Sixth Amendment provides defendants the right to counsel only in criminal, not civil, proceedings.").

Moreover, courts have routinely denied requests to unfreeze assets to fund the legal defense in civil enforcement actions by regulatory agencies. In *FTC v. World Wide Factors, Ltd.*, 882 F.2d 344 (9th Cir. 1989), the Ninth Circuit stated: "Courts regularly have frozen assets and denied attorney fees or limited the amount for attorney fees" in civil enforcement actions. As the Ninth Circuit explained, "[a]ny doubt as to the constitutionality of freezing assets and precluding entirely their use for payment of attorney fees in circumstances even more extreme than this case ha[s] now been resolved." *Id.* at 347 (*citing Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 626 (1989) and *United States v. Monsanto*, 491 U.S. 600, 615 (1989)). *See also SEC v. Cherif*, 933 F.2d 403, 416-17 (7th Cir. 1991) ("A criminal defendant has 'no Sixth Amendment right to spend another person's money for services rendered by an attorney,' …. It would be anomalous to hold that a civil litigant has any superior right to counsel than one who stands accused of a crime." (citation omitted)).

In *CFTC v. Noble Metals International, Inc.*, 67 F.3d 766 (9th Cir. 1995), the Ninth Circuit affirmed a district court's refusal to allow frozen assets to be used for payment of legal fees, where the frozen assets "fell far short of the amount needed to compensate" the victims of the fraud. *Id.* at 775. Numerous other courts have refused to release frozen assets to pay for legal fees, and have not recognized any right to retain counsel in a civil enforcement action. *See, e.g., SEC v. Quinn*, 997 F.2d 287, 289 (7th Cir. 1993) (defendant not entitled to use tainted assets to retain counsel in SEC enforcement proceeding); *SEC v. Trabulse*, 526 F. Supp. 2d 1008 (N.D. Cal. 2007) (rejecting

defendant's claim that asset freeze was imposed to prevent defendant from defending himself).[4]

**2. Feathers does not have a Right to use Investor Funds to pay his Personal Legal Fees**

Feathers asserts that he is asking to use "*his receivership assets* to pay for the legal defense in this matter," and that he is only asking to use "*his own assets* for the services of competent legal counsel." (Letter at pp. 1, 2 (emphasis added).) In fact, Feathers' personal assets were not placed into receivership, but were only frozen. The assets held by the Receivership Entities are the corporate assets of IPF, SPF, CMF, SB Capital, and SBC LLC. These corporate assets, which consist mainly of assets of IPF, SPF, CMF, and SBC LLC, are frozen for the benefit of the investors in the three funds who have been defrauded by defendants. It would be manifestly unfair to allow Feathers to take yet more money from the defrauded investors to pay for his personal defense, thus increasing the losses to investors.

**a. It is well established that a defendant does not have a right to use the assets of others to pay legal fees**

The Supreme Court has held that a defendant has no right to use another person's funds for attorney fees. *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 626 (1989) (a defendant has no right to spend another person's funds for attorney fees even if those funds are the only way a defendant can retain the attorney of his choice); *see also United States v. Monsanto*, 491 U.S. 600, 615 (1989) (a district court may restrain a defendant from using disputed funds to pay attorney fees before a final judgment on the merits has been rendered). Neither a criminal defendant nor a civil litigant has the right to pay counsel with another person's money. *SEC v. Cherif*, 933 F.2d 403, 416-417 (7th Cir. 1991). "It is well established that there is no right to use the money of others for legal services." *SEC v. Grossman*, 887 F. Supp. 649, 661 (S.D.N.Y. 1995), *aff'd sub nom. SEC v. Hirschberg*, 101 F.3d 109 (2d Cir. 1996).

As the Court explained in *SEC v. Quinn*, 997 F.2d 287, 289 (7th Cir. 1993), while parties to litigation usually may spend their resources as they please to retain counsel, "their" resources is "a vital qualifier." In *SEC v. Trabulse*, 526 F. Supp. 2d 1008 (N.D. Cal. 2007), Judge Alsup denied defendant Trabulse's request to use frozen assets of a hedge fund Trabulse had managed for his

[4] *See also CFTC v. Douglas Elsworth Wilson*, Case No. 11-cv-1651, 2011 WL 6398933, at *3 (S.D. Cal. Dec. 20, 2011) (it would frustrate the purpose of regulation to allow a defendant to use funds linked directly to the fraud for attorney's fees); *SEC v. Onyx Capital Advisors, LLC*, Case No. 10-cv-11633, 2011 WL 4528216, at *3 (E.D. Mich. Sept. 29, 2011) (recognizing that a defendant in a securities action cannot use the victims' assets to hire counsel); *SEC v. Roor*, Case No. 99-civ-3372, 1999 WL 553823, at *3 (S.D.N.Y. July 29, 1999) ("A defendant in a case brought by the S.E.C. may not use income derived from alleged violations of the securities laws to pay for legal counsel."); *SEC v. Current Fin. Servs.*, 62 F. Supp. 2d 66, 69 (D.D.C. 1999) ("A defendant is not entitled to foot his legal bill with funds that are tainted by his fraud.").

personal legal fees. Judge Alsup stated: "'Just as a bank robber cannot use the loot to wage the best defense money can buy, so a swindler in securities markets cannot use the victims' assets to hire counsel who will help him retain the gleanings of crime.'" *Id.* at 1018 *(quoting SEC v. Quinn*, 997 F.2d 287, 290 (7th Cir. 1993)). Thus, a preliminary question in any inquiry concerning the use of frozen funds to pay for legal expenses are whether they are, in fact, the defendant's property, or the property of third parties. This question is distinct from the issue of whether the funds are "tainted" proceeds of a fraud. *See, e.g., SEC v. Lauer*, 445 F.Supp. 2d 1362, 1369-70 (S.D. Fla. 2006) (funds derived from the fraud, and thus "tainted," should not be released from freeze to pay legal fees).

**b. The assets of the Receivership Entities are not Feathers' personal property**

The assets of the Receivership Entities do not belong to Feathers and are not his to use. They are the assets of IPF, SPF, CMF, and SB Capital, and their subsidiaries and affiliates. The bulk of the assets belong to IPF and SPF. Indeed, it was Feathers' misappropriation of assets from IPF and SPF to pay the expenses of SB Capital including his own expenses that is the basis for some of the Commission's claims. Feathers fails to explain how he has any claim to any of the assets of IPF, SPF, or CMF that are now being held by the Receiver for the benefit of the defrauded investors. The assets of IPF, SPF, and CMF are owned by the investors, not by Feathers. Indeed, Feathers fails to provide a rationale how he has a claim on the assets of SB Capital, other than as a general creditor.

Feathers would have this Court ignore the corporate structure that he created, and provides no legal basis for such an outcome. "A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003) (*citing and quoting Burnet v. Clark*, 287 U.S. 410, 415 (1932) ("A corporation and its stockholders are generally to be treated as separate entities")). Moreover, "[a]n individual shareholder, by virtue of his ownership of shares, does not own the corporation's assets." *Dole Food Co.*, 538 U.S. at 475. Thus, assuming Feathers is a shareholder of SB Capital, he has no personal claim to its assets.[5] Indeed, it is unclear whether SB Capital is solvent, because it owes over $5 million to IPF and SPF. As of June 29, 2012, SB Capital had about $296,000 in its combined bank accounts. (Bulgozdy Dec. ¶ 8.)

To the extent Feathers is asserting a claim to any assets held by the Receiver based on his unsupported $550,000 contribution, he is a claimant and should submit a claim – just as the defrauded investors will assert a claim for repayment of their investments. The Court may well determine that equity would require that any claims made by Feathers to the assets of the Receivership Entities should be subordinated to the claims of the defrauded investors.

By seeking payment of his legal fees upfront from the Receivership Entities, Feathers is asking this Court to exercise its discretion and give him priority over the claims of the defrauded

[5] To the extent Feathers owns stock in SB Capital, his stock remains in his custody and control, subject to the asset freeze. Feathers' stock is not owned by the Receivership Entities.

investors, based on a contribution he has failed to substantiate with any evidence. Defendant claims that the proposed payment of attorney fees "do not run the risk of diminishing potential returns to investors," (Letter at p. 9 n. 2), but every dollar paid to defendant's personal attorneys is a dollar that is not available to be returned to investors, and increases, dollar for dollar, the losses incurred by the investors that Feathers defrauded. The investors, who have already bankrolled Feathers' extravagant lifestyle, should not now be forced to bankroll Feathers' defense costs.

**c. Defendant's legal authority does not support use of Receivership Assets for Feathers' personal legal fees**

The legal authority cited by Feathers does not support a right to use other people's money, and specifically funds obtained from defrauded investors, to pay Feathers' personal legal expenses. In *FSLIC v. Fe*rm, 909 F.2d 372 (9th Cir. 1990), the district court issued a "preliminary injunction freezing Ferm's assets during the pendency of FSLIC's action against her." *Id.* at 373. The district court then modified the injunction and permitted Ferm to withdraw funds from her own assets to pay reasonable attorney's fees. *Id.*

Similarly, in *FSLIC v. Dixon*, 835 F.2d 554, (5th Cir. 1987), the district court froze the individual defendants' assets, to "prevent these officers and directors from dissipating their allegedly ill-gotten assets." *Id.* at 556. *Dixon* did not sanction the use of assets of a separate entity – such as the failed Vernon Savings and Loan in that case, for use for the defendants' personal defense, but only addressed whether the defendants' personal assets should be released from the asset freeze. *See also SEC v. Cherif*, 933 F.2d 403, 417 (7th Cir. 1991) (observing that *Dixon* was decided before the Supreme Court decisions in *Caplan & Drysdale* and *Monsanto*, which "held that the use of frozen assets for attorney's fees could be disallowed in circumstances much more extreme than in *Dixon*").

Other authorities cited by defendant do not stand for the proposition that a court should release frozen assets of third parties – other people's money, to pay for an individual's defense. In *SEC v. Duclaud Gonzalez de Castilla*, 170 F. Supp. 2d 427 (S.D.N.Y. 2001), the court expressly found that it had "authority to freeze personal assets temporarily and the corollary authority to release frozen personal assets, or lower the amount frozen." *Id.* at 429. In *Duclaud*, the assets that were being unfrozen were not assets of entities in receivership. (defendant Duclaud sought assets from his frozen Carribbean Legal Trust account; non-party witness Guerrero sought assets from an account of which he was the beneficial owner). *Id.* at 428-29. In *SEC v. Schiffer*, Case No. 97-civ-5853,1998 WL 307375 (S.D.N.Y. June 11, 1998), the court addressed whether to release assets from defendant Schiffer's frozen accounts, and not from accounts of receivership entities. In *U.S. v. Jamie*, Case No. 10-cv-498, 2011 WL 145196 (S.D. W. Va. Jan. 18, 2011), a criminal case, the court considered whether to release "frozen personal assets or lower the amount frozen," and did not address whether defendant could use other people's money to fund his defense. *Id.* at *1. In *SEC v. Petters*, Case No. 09-1750, 2010 WL 4922993 (D. Minn. Nov. 29, 2010), the assets of the individual defendant Bell were placed into receivership with the assets of the entity defendants – unlike the case here where Feathers' individual assets, while frozen, are not subject to the management and control by the Receiver. ("All assets belonging to [movant] Bell . . . are subject to a receivership and asset freeze").

Feathers relies on a criminal case, *U.S. v. Payment Processing Center*, 439 F. Supp. 2d 435 (E.D. Pa. 2006), for the proposition that he should be able to use Receivership Assets under an indemnification theory. However, *Payment Processing* involves the specific question of whether a defendant entity was able under Pennsylvania law to indemnify its agents who were defendants in a criminal injunctive action under 18 U.S.C. § 1345 for mail fraud. *Id*. at 436. In that case, the company sought to indemnify the defendants, as opposed to this case, where Feathers is seeking to force the Receivership Entities to pay his legal fees. In *Payment Processing*, the district court held that the "focus on defendant's ability to fund a defense is an important factor in determining whether equity favors the use of restrained property for defense costs." *Id*. at 440. Here, Feathers has not even attempted to make any such showing of his other assets or income that he could use to fund his defense.

In the specific context of a request for indemnification in an SEC civil enforcement action, at least one court refused to release assets to pay for legal fees under an indemnification provision similar to the one contained in the IPF Operating Agreement, on the grounds that under Delaware law "whether the potential indemnitee is entitled to indemnification generally cannot be determined until after the merits of the underlying controversy have been decided." *SEC v. Onyx Capital Advisors, LLC*, Case No. 10-cv-11633, 2011 WL 4528216, at *3-4 (E.D. Mich. Sept. 29, 2011).

Another case relied upon by Feathers, *SEC v. Dowdell*, 175 F. Supp. 2d 850 (W.D. Va. 2001), is distinguishable for a number of reasons. First, *Dowdell* again did not involve the release of assets of third party receivership entities, but only involved personal assets of the defendants. Second, in *Dowdell*, defendants did not consent to entry of a preliminary injunction, as Feathers did here, but were contesting the injunction and questioning the validity of the Commission's case on the merits. Third, in *Dowdell*, the court was concerned with reaching a fair result at the preliminary injunction hearing, and asked for reasonable estimates of fees "necessary to take them through the hearing on the preliminary injunction." *Id*. at 856. That is a marked contrast to the posture of this case.

With advice of counsel, Feathers consented to the entry of the PI, the asset freeze, and the appointment of the permanent Receiver. Feathers appeared with counsel at the date and time set for the hearing on preliminary injunction, and expressed no objections to the merits of the Commission's case or the validity of its allegations. In cases involving consents to preliminary injunctions and asset freezes, courts have denied requests for the release of frozen assets. *See, e.g., SEC v. Onyx Capital Advisors, LLC*, Case No. 10-cv-11633, 2011 WL 4528216 (E.D. Mich. Sept. 29, 2011)(court, having found that SEC made *prima facie* case for fraud against defendant, who consented to preliminary injunction and asset freeze, denied relief from asset freeze for legal fees); *SEC v. Lauer*, 445 F. Supp. 2d 1362 (S.D. Fla. 2006) (court rejected request to release funds for legal fees where defendant, while represented by counsel, consented to preliminary injunction and asset freeze).

Feathers has not cited any authority for the proposition that courts exercise their discretion to

take frozen funds from the pockets of defrauded investors, who have already suffered losses at the hands of the defendant, so that the defendant can pay his personal legal fees. Indeed, as discussed above, Judge Alsup recently denied a similar request by a defendant to use the frozen assets of a hedge fund the defendant managed to pay his personal legal expenses in an SEC enforcement action. *See Trabulse*, 526 F. Supp. 2d at 1018.

### C. To The Extent Feathers Seeks to Use Frozen Personal Assets to Pay His Legal Fees, He Has Not Made the Required Showing to Justify Release of those Funds

In his Letter, Feathers does not identify any personal assets that he would use to pay his legal fees. But if it is defendant's intent to rely on his own assets – rather than the assets of the Receivership Entities – defendant has failed to make the required showing to justify lifting or modifying the Court's freeze over Feathers' personal assets.

#### 1. Feathers has not met the Standard for Modification of the Court's Asset Freeze

"To succeed on a motion to modify [a] freeze to permit payment of attorneys' fees and other expenses, [a] defendant 'must establish that such modification is in the interest of the defrauded investors.'" *Richards v. Mountain Capital Management, LLC*, Case No. 10-civ-2790, 2010 WL 2473588, at *2 (S.D.N.Y. June 17, 2010) (*quoting SEC v. Credit Bancorp Ltd.*, Case No. 99-civ-11395, 2010 WL 768944, at *4 (S.D.N.Y. Mar. 8, 2010) (citation omitted)). To that end, a defendant must establish that the funds he seeks to release are untainted and that there are sufficient funds to satisfy any disgorgement remedy that might be ordered in the event a violation is established at trial. *See, e.g., CFTC v. Douglas Elsworth Wilson*, Case No. 11-cv-1651, 2011 WL 6398933 (S.D. Cal. Dec. 20, 2011) (ordering return from attorney trust account of tainted funds). The court should also assess the defendant's financial ability to fund a defense before lifting a freeze on their personal assets. *See, e.g., SEC v. Speqtrum, Inc.*, Case No. 10-2111, 2012 WL 517526 (D.D.C. Feb. 16, 2012).

Feathers has not made any showing that releasing funds from the Receivership Entities is in the interest of the defrauded investors, that Feathers will have sufficient funds to satisfy any disgorgement remedy that might be ordered of him, or provided information on his ability to fund a defense from other assets.[6] Indeed, defendant's proposal appears poised to decrease the efficiency of administration of the case and will exponentially increase the costs of the Receivership – beyond the $375,000, plus unspecified costs and expert fees. Defendant proposes to take discovery from the Receiver (Letter at p. 9), as well as from the professionals who provided services to the Receivership Entities. (*Id.*) Such discovery will require the Receiver and his counsel to expend fees responding to

[6] Feathers owns a company that is not subject to the freeze which he continues to operate and which could generate funds for his defense – if not now, at some point in the future. Feathers and his family have other assets, frozen or not, that could be used for his defense. However, Feathers' Letter fails to address such pertinent information for consideration by the Court.

discovery requests (including reviewing the professionals' documents for privilege), which will increase the administrative costs of the Receiver and, in turn, decrease the recovery for the defrauded investors.

Moreover, Feathers' proposal for at least $375,000 in legal fees is not to achieve a resolution of the case, which would enable the Court to permit the Receiver to make distributions to defrauded investors. Instead, Feathers proposes to expend all these funds with the aim of eventually seeking "to vacate or modify the preliminary injunction." (Letter at p. 10.) Thus, rather than moving towards resolution, Feathers proposes to spend much more than $375,000 to go back to square one.

**2. The Court Should Review the Reasonableness of any Fee Request**

Assuming that Feathers identifies any of his own assets, subject to the freeze, that he wants to use to pay for his legal defense, the Court should review any such request for reasonableness of the fees. Indeed, even the cases relied upon by Feathers recognize that a court can substantially limit the amount of legal fees released from a defendant's personal frozen funds. *See, e.g., U.S. v. Jamie*, *supra* (reducing the hourly rate charged by counsel defending a criminal case); *SEC v. Petters*, *supra* (reducing $123,110 fee request for defense of criminal case to $61,218.72). Moreover, Feathers does not provide any precedent for a Court to award fees before they are incurred. Feathers' attorneys apparently took the case without receiving a retainer or obtaining payment of any kind from Feathers. Having entered an appearance, counsel now wants the Court to award it a substantial retainer against future work from the assets of the Receivership Estate, with the threat that counsel will move to withdraw if counsel does not receive fees. Defendant cites no precedent where a court has approved a substantial retainer under similar circumstances.

The decision in *FTC v. American Tax Relief*, LLC, et al., Case No. 11-cv-6397 DSF, slip opinion (C.D. Cal. Apr. 19, 2012), provides pertinent guidance in this situation. (Bulgozdy Dec. Ex. 3.) In *American Tax Relief*, defendant's law firm sought an interim fee payment of $1.3 million in legal fees, against a frozen retainer of $1.68 million. (*Id.* at p. 1.) Judge Fischer recognized that when dealing with assets frozen for the benefit of defrauded victims, "the Court's role is more like that of a fiduciary. It has the duty to preserve assets for the benefit of the victims." *Id.* at p. 2. The court rejected the application for an interim payment of fees, finding that "it is not at all unusual for attorneys to wait to be paid – if payment is appropriate at all – until after resolution by settlement or trial." *Id.* at p. 5. The court continued: "Court dockets …are heavy with fee motions submitted after the case is resolved. Reserving its determination is in the interests of potential victims as well as the interests of judicial economy." *Id.* Moreover, here, if Feathers prevails, he can recover his funds from the Receivership Estate as a claimant, and Feathers can pay his attorneys in full according to whatever agreement exists between Feathers and his counsel. *See id.* ("It should also be remembered that if Defendants prevail, SMRH can be paid in full according to whatever agreement exists between it and Defendants."). Indeed, waiting until the case is completed to evaluate any fee application by defense counsel will conserve judicial resources, because the "whole exercise" of evaluating the amount and reasonableness of defendant's fees "will be rendered unnecessary" if defendant prevails. *Id.*

## III. CONCLUSION

For the foregoing reasons, the Commission requests that the Court exercise its discretion and deny defendant Mark Feathers' application to fund his personal defense using assets of the Receivership Entities, to which he has no valid claim, and which have been frozen for the benefit of the defrauded investors.

Respectfully submitted,

/s/ John B. Bulgozdy

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