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August 10, 2012

Hon. Edward J. Davila
United States District Judge
San Jose Courthouse
Courtroom 4, 5th Floor
280 South First Street
San Jose, California 95113

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

Dear Judge Davila:

Although the Court did not specifically request briefing from the Receiver on the issue of Mr. Feathers' legal fees, I thought it might be helpful to the court to have my perspective on certain factual contentions relevant to the issue, as well as to the proposed use of receivership estate funds to pay Mr. Feathers' counsel, which I wish to conserve.

Mr. Feathers' Alleged Contributions to the Companies

Mr. Feathers initially contended he contributed \$650,000 to the companies. In his letter brief, he contends he contributed \$550,000 but only provided evidence of one cash payment of \$50,000 and two payments totaling approximately \$166,000 to Mr. Feathers' apparent former business partner. The documents provided therefore do not support that contention. And, although my accounting is not complete, the company records do not reflect such contributions. To the contrary, the capital accounts only reflect reductions in Mr. Feathers' purported equity. Moreover, SB Capital's Balance Sheet reflects Loans to Related Parties attributable to Mr. Feathers in the approximate amount of \$246,000. I believe any assertion of an equity interest, particularly when the amounts owed to investors exceed the amount of assets, to be incorrect.

In addition, the company's records reflect payments to Mr. Feathers for consulting fees and dividends in the amount of at least \$232,000 over a 28-month period in addition to his monthly salary of \$15,000 per month. Mrs. Feathers was also taking a salary of \$15,000 per month at the time the Receiver was appointed. Mr. Feathers contends that these are market salaries, however, given that the companies were not generating an operating profit, they could

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be considered excessive. Moreover, the Feathers' children and their care giver were on the company payroll. The companies' records also reflect payments for expensive cars.

Additionally, the company credit card statements reflect the use of company credit cards for personal expenses. For example in November 2011, Mr. Feathers charged air fare to Hawaii for Mr. and Mrs. Feathers and their children in the amount of \$3,598.50 to the company American Express card. The charge was partially offset by membership rewards points, but the cash portion was paid for by the company and booked as travel expense. The credit card statements are replete with numerous expensive restaurant bills and hotel bills. Particularly curious are charges totaling approximately \$14,000 to Scott's Seafood Grill over an 18 month period and which include eleven recurring charges of \$500 each, conceivably for gift certificates. The bank records do not reflect the companies being reimbursed for personal expenses put on company cards.

Indemnity

Mr. Feathers contends that he is entitled to have the Receivership Entities pay for his defense under the indemnity provisions in the Operating Agreements for the companies. This is inconsistent with the language in the documents. For example, the Seventh Amended and Restated Operating Agreement for Investors Prime Fund states:

The Manager and its agents or Affiliates and the shareholders, officers, directors, employees and agents of such agents or Affiliates and the employees and agents of the Company shall be entitled to be indemnified and held harmless by the Company, at the expense of the Company, against any loss, expense, claim or liability (including reasonable attorneys' fees, which shall be paid as incurred) resulting from the assertion of any claim or legal proceeding relating to the performance or nonperformance of any act concerning the activities of the Company, including claims or legal proceedings brought by a third party or by Members, on their own behalf or as a Company derivative suit, so long as the party to be indemnified determined in good faith that such course was in the best interests of the Company and did not constitute fraud, bad faith or willful misconduct; provided, that any such indemnity shall be paid solely from the assets of the Company.

First, acts or omissions constituting fraud, bad faith or willful misconduct are excluded. Second, the provision does not require the company to defend Mr. Feathers, only to indemnify him, assuming he is determined not to have committed fraud. These limitations in the indemnity provision protect the investors from further harm in the event directors or officers commit fraud. Accordingly, Mr. Feathers is not entitled to have his legal expenses reimbursed until he has established that he did not commit fraud.

Use of Receivership Estate Funds to Pay Mr. Feathers' Attorney Fees

As noted in my First Interim Report, my initial accounting indicates that there will be a shortfall of approximately \$12 million and I am very reluctant to support any increase in that

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amount caused by the use of receivership assets for the Defendant's defense. Many investors will lose large portions of their retirement savings. I believe that the harm to investors in having the limited receivership estate resources used to pay Mr. Feather's attorney fees outweighs any harm to Mr. Feathers, at least until his personal assets and those of Mrs. Feathers have been exhausted. More than \$46,000 of Mr. Feathers' assets have already been unfrozen, and Mr. Feather's declaration regarding assets reflects a 401(k) account with a balance of more than \$175,000. I also believe that Mr. and Mrs. Feathers should be given a reasonable period of time to obtain new employment, after which time they should pay counsel from their earnings.

During the telephonic hearing held on July 27, 2012, Mr. Fickes made references to the fact that the Receiver and his counsel are being paid from the receivership estate. This is not an appropriate comparison. I have been appointed by the Court to preserve and protect the assets of the companies, and perform other tasks enumerated in the Preliminary Injunction Order. My work and that of my counsel is designed to maximize the value of assets available to be returned to investors. Mr. Feathers seeks to have receivership estate resources used to pay for his defense of charges against him personally, which costs in no way benefit the investors, and would only exacerbate the losses they will suffer.

Yours very truly,



Thomas A. Seaman, CFA
Small Business Capital Corp., et al