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[Exempt from filing fees pursuant to Government Code section 6103]

FILED UNDER SEAL

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

PEOPLE OF THE STATE OF CALIFORNIA, by and through the COMMISSIONER OF BUSINESS OVERSIGHT,

Plaintiff,

v.

SILVER SADDLE COMMERCIAL DEVELOPMENT, LP, a California limited partnership; SILVER SADDLE RANCH & CLUB, INC. a California corporation; THE GALILEO COMMERCIAL PROPERTY OWNERS ASSOCIATION, INC., a California non-profit corporation; THOMAS M. MANEY, an individual, and DOES 1 through 100, inclusive,

Defendants.

And,

MARIAN G. DUCREUX, an individual, CLIFFORD J. REYNOLDS, an individual, WAYNE A. PEDERSEN, an individual, and Relief Does 1 through 10, inclusive,

Relief Defendants.

CASE NO.: 37-2019-00049151-CU-MC-CTL

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF EX PARTE APPLICATION FOR TEMPORARY RESTRAINING ORDER; ASSET FREEZE; APPOINTMENT OF A RECEIVER; AND ORDER TO SHOW CAUSE RE: PRELIMINARY INJUNCTION

(Corporations Code sections 25110, 25401, 25530 and CCP 527(c)(2)(C), CA Rules of Court sections 3.1201 and 3.1175(a))

Date: September 24, 2019
Time: 8:30 a.m.
Dept: C-73
Judge: Hon. Joel R. Wohlfeil

State of California - Department of Business Oversight

State of California - Department of Business Oversight

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

The People of the State of California, by and through the Commissioner of Business Oversight (Commissioner), in this application seek to obtain, on an ex parte basis without notice to defendants Silver Saddle Commercial Development, LP[1], Silver Saddle Ranch & Club, Inc., The Galileo Commercial Property Owners Association, Inc., Thomas M. Maney, and relief defendants Marian G. Ducreux, Clifford J. Reynolds, and Wayne A. Pedersen, (collectively Defendants), an order (1) freezing assets and appointing a receiver over Defendants Silver Saddle Commercial Development, Silver Saddle Ranch & Club, and The Galileo Commercial Property Owners Association (hereinafter Business Entity Defendants); and (2) temporarily restraining Defendants from violating the California Corporations Code until a preliminary injunction can be issued.

The Commissioner's request is based on the evidence that Defendants perpetrated an illegal investment scheme in California raising millions of dollars from over 2,000 unsophisticated investors by making blatant misrepresentations to investors and selling unqualified, non-exempt securities. First, Defendants aggressively peddled grossly over-priced fractionalized interests in vacant desert land in rural Kern County to thousands of unsophisticated investors by the deliberate omission of material facts and blatant misrepresentations.[2] Defendants comingled and diverted investor funds that should have been preserved for the investors' benefit, used malfeasant financial accounting designed to cover-up the wrongful comingling and diversion, and implemented aggressive sales techniques and threats of lawsuits if the investors complained.

Through misleading and targeted advertising to various ethnic communities, Defendants succeeded in attracting thousands of unsophisticated California investors lacking the experience or education to understand what they were buying. California investors paid thousands of dollars for over 3,000 investment contracts based on the Defendants' lack of truthful information. The evidence discovered by the Commissioner's investigation to date demonstrates that Defendants wrongfully received tens of millions of dollars of investor funds and continue to receive and squander

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[1] Silver Saddle Commercial Development, LP's general partner, SSCD Management, LLC, is a forfeited Texas limited liability company. *See* Declaration of Daniel Kim, filed herewith, Ex. 17, p.1.

[2] Cal. Corporations Code, § 25401.

substantial investor funds to this day.[3]

Second, Defendants failed to apply to the Department of Business Oversight (DBO) for a permit to sell securities.[4] Security offerings must undergo a review process where the issuer must demonstrate that the terms of the investment are "fair, just and equitable." Defendants sold thousands of securities in California without completing this obligatory process and each sale was a separate violation of selling unqualified securities.

Accordingly, as set forth below, the People ask the court to immediately put an end to Defendants' illegal conduct by issuing a temporary restraining order: 1) enjoining Defendants from the offer and sale of unqualified, non-exempt securities; 2) enjoining Defendants from the offer and sale of securities by means of misrepresentations and omissions of material facts; 3) freezing all assets related to or controlled by the Business Entity Defendants; and 4) appointing a receiver to immediately take control over the Business Entity Defendants' assets for the benefit of investors and victims of Defendants' unlicensed and fraudulent activities.

II. SUMMARY OF FACTS

A. The Galileo Project Investment.

Beginning in at least 2011, Defendants offered and sold securities in the form of an investment contract called "The Galileo Project" or "Landbanking Plus" (hereinafter Galileo Project). Defendants represented that the Galileo Project investment comprised a total of 4,000 available "units," offered in one-quarter, one-half, or full units. Each investment contract generally consisted of four bundled components:

(a) A payment by the investor of money, generally between $10,000.00 to $30,000.00, for an undivided, 1/4000th fractionalized interest in circa 1,020 acres of undeveloped, commercially zoned, desert real estate in Kern County, California. (Declaration of Lisa Medina (hereinafter Medina Decl.), ¶ 5 and Ex. 1; Declaration of Daniel Kim (hereinafter Kim Decl.), Ex. 3 (Deposition Transcript of Clifford J. Reynolds (hereinafter Reynolds Depo Tr.), Bates RN000088).)

(b) A separate payment by the investor of $500.00, $1,000.00 or $2,000.00 (for, respectively,

[3] See Declaration of Lisa Medina (Medina Decl.), filed herewith, ¶¶ 6-7.
[4] Cal. Corporations Code, § 25110.

one-quarter unit, one-half unit, or one full unit) into a pool of investors' funds called the "Capital Improvement Fund" (CIF). (Medina Decl., ¶ 5(g).) Most of the investors purchased a full unit and made or contractually committed to make a $2,000.00 contribution to the CIF. (*Id.* at ¶ 5(a) and Ex. 1.) Defendants told investors that their capital contributions to the CIF would be pooled together, used to develop the land and eventually "exceed $8,000,000.00." (Kim Decl., Ex. 1 (Witness Declaration of Maria Ramos (hereinafter Ramos Wit. Decl.), ¶ 17, Bates MR0008, MR0010 and MR0017).) Defendants described the CIF as a "built in property development account" for the investors' benefit. (*Id.*, at Bates MR0008).

(c) Recurring monthly charges to the investor to establish and maintain a "membership" in the Silver Saddle Ranch & Club resort (Silver Saddle Ranch or Ranch), as well as a monthly recurring "assessment fee" associated with The Galileo Commercial Property Owners Association, which purportedly held and was responsible for the CIF funds. (Kim Decl., Ex. 1 (Ramos Wit. Decl., Bates MR0064 and MR0066).)

(d) An "exclusive" option for the investors to jointly purchase the Silver Saddle Ranch for $500,000.00, which was represented by Defendants in marketing materials to have a replacement cost value of $12,000.000.00. (Kim Decl., Ex. 3 (Reynolds Depo Tr., at Ex. 6, Bates RN000017 and Ex. 9 RN000022).)

B. Defendants Sold Thousands of Investments and Collected Tens of Millions of Dollars.

From 2011 to 2019, Defendants sold 3,032 Galileo Project investment contracts for a total purchase price of $56,517.148.00[5] as follows: 2,379 full units; 341 half units; and 312 quarter units. (Medina Decl., ¶ 5(a) and Ex. 1.) The full units were sold at a purchase price ranging from $9,990.00 to $31,990.00. (*Id.*, at ¶ 5(h) and Ex. 1.)

The investment contracts were sold between April 30, 2011, and January 7, 2019. ((*Id.*, at ¶ 5(h) and Ex. 1). Most investors are spread throughout California. (*Id.*, Ex. 2.)

Most investors paid for their investment contract by putting down a substantial cash down payment for the undivided property interest and entering into a ten-year finance agreement with the

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[5] This represents only the aggregate purchase price for the undivided property interests, excluding the investors' contributions for the Capital Improvement Fund and the recurring membership fees and association dues.

Business Entity Defendants. (Medina Decl., ¶ 5(e).) As illustration, investor Maria Ramos, whose declaration is submitted herewith (Kim Decl., Ex. 1), executed a Purchase Agreement and Escrow Instructions contract by which she agreed to pay $16,990.00 for her undivided property interest. Ramos put down an initial deposit consisting of a down payment and closing costs (in her case, $4,193.00) for the 1/4000 undivided interest in the property and financed the remaining balance with Defendant Silver Saddle Commercial Development at an interest rate of 15.9%. (Kim Decl., Ex. 1 (Ramos Wit. Decl., ¶ 19, Bates MR0039-MR0040, MR0059-MR0061).) The Commissioner's belief is that the over 2,000 known California investors purchased their investment contracts in essentially the same way. (*See* Medina Decl., Ex 1, Schedule listing each of the known Galileo Project investment contracts and the associated purchase price of the property.)

Many investors are continuing to make recurring monthly payments to Defendants under their finance agreements. (Medina Decl., ¶ 5(e).) A specific JP Morgan Chase bank account identified by Defendants as the primary account into which recurring investment payments by investors are made was recently examined by the DBO. (Medina Decl. ¶ 13, Ex. 9.) From January 2018 to June 2019, a total of $4,886,306.71 of new investor funds was deposited into the account. During the same period, a total of $4,842,236.66 was withdrawn by, and/or transferred to, Defendants' various company accounts. (*Ibid.*) In June 2019 alone, $207,130.75 was deposited and $217,998.76 was withdrawn. (*Ibid.*) Defendants continue to receive investor funds and nearly all the funds are immediately disbursed through Defendants' company accounts. (*Ibid.*)

C. Defendants Marketed to Specific Communities in California.

Defendants specifically targeted California investors from several ethnic communities, many of whom spoke English as a second language and were unsophisticated. To lure prospective investors to the Silver Saddle Ranch, Defendants targeted these communities by setting up sweepstakes offering prizes at ethnic supermarkets throughout California, including those catering primarily to the Filipino community. (Kim Decl., Ex. 4 (Deposition Transcript of Marian G. Ducreux (hereinafter Ducreux Depo Tr.), 73:7-23, 74:18-22*)* and Ex. 1 (Ramos Wit. Decl., ¶ 2).) Defendants sent emails stating "congratulations!" and offered a free dinner and a prize to entice investors to the dinner. (Kim Decl., Ex. 4 (Ducreux Depo Tr., 68-69, 70:18-25, 71:8-12, 72:7-17;

Bates RN 0000017- RN 0000018, RN 0000068 - RN 0000072).) At the dinner, Defendants offered a free weekend at the Silver Saddle Ranch (Kim Decl., Ex. 1 (Ramos Wit. Decl., ¶¶ 3-5).)

At the Silver Saddle Ranch, sales pitches were sometimes made in languages other than English. (Kim Decl., Ex. 4 (Ducreux Depo Tr., 87:18-23, 88:5-7).) At other times, non-English speaking investors were given the sales pitch in English, but were not provided a complete translation and were left to understand the investment on their own. (Kim Decl., Ex. 2 (Witness Declaration of Merry Qiuxia Wang (hereinafter Wang Wit. Decl.), ¶¶ 5, 7).) A primary salesperson, relief defendant Marian G. Ducreux, confirmed that most of the investors to whom she sold the investment contracts spoke English as a second language (Kim Decl., Ex. 4 (Ducreux Depo Tr., 89:2-5).) Some of the investors primarily spoke Spanish or Chinese. (*Id.*, at 103:7-12.) The Filipino community was the "biggest market" for advertising the investment. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 156:13-14). Clifford Reynolds (Reynolds), the Managing Director of the Silver Saddle Ranch, testified that the Filipino community was targeted because it "valued the purchase of land" and the Chinese community was targeted because it "looked at owning land as wealth." (*Id.,* at 156:21-24). Reynolds further testified, "[t]he major marketing was in the Filipino grocery stores. . . [We] marketed to a lot of people who English was their second language." (*Id.,* at 157:21-25; 158:1-5.)

Defendants were very successful in their efforts to target unsophisticated investors: in a detailed questionnaire sent out electronically to all known investors by the Commissioner on August 1, 2019, 204 investors responded as of August 28, 2019, and 83.92 percent of those that responded stated that they had no investment experience prior to investing in the Galileo Project. (Kim Decl., ¶¶ 7-8.)

D. Defendants Have Dissipated Most of the Investor Funds.

Between September 2011 and June 2019, approximately $106,529,931.61 was deposited, and $105,863,753.06 was withdrawn, from Defendants' sixteen known corporate bank accounts. (Medina Decl., ¶ 6, Ex. 3 (Schedule evidencing total deposits and withdrawals).) DBO also determined that the Business Entity Defendant aggregated bank account cash balances in the last 16 months remained low, falling as low as $387,642.60 on June 30, 2018. (*Id.,* at ¶ 7, Ex. 5 (Schedule

evidencing last 16 months of withdrawals/deposits).)

Overall, as set forth in the Medina Declaration, Business Entity Defendants' bank accounts consistently maintained very low total cash balances—Defendants moved millions of dollars, virtually all the investors' funds, from the corporate bank accounts soon after the Defendants received the investors' money. (Medina Decl., ¶ 7.)

E. Defendants' Accounting Evidences Fraud.

Extensive malfeasance is readily evident in the Business Entity Defendants' accounting. Based on the examination of the DBO's examiner—and as explained in detail in the attached Medina Declaration—the various investment bank accounts evidenced an attempt by Defendants to commingle and dilute large amounts of the investor funds in order to make it difficult to trace how investor money was spent. (*See* Medina Decl., ¶ 8, Ex. 6, Ex. 7 and Ex. 8.)

F. Defendants Comingled and Diverted the Investors' Capital Improvement Fund.

An essential aspect of the Galileo Project investment, as marketed to investors, was that each investor would contribute to the "Capital Improvement Fund" (CIF), represented by Defendants as a mandatory contribution into a pooled investor account to be used in the future by investors to develop the property. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 62:17-21, Bates RN 000022, RN 000026, RN 000030).) Defendants told potential investors that they "get to decide" how to use the CIF money. (Kim Decl., Ex. 4 (Ducreux Depo Tr., 53:3-11).) However, as set forth in the attached Medina Declaration, rather than allowing the investors' money to accrue and appreciate in the CIF for the benefit of the investors, Defendants diverted the money in the CIF and comingled those funds with other Silver Saddle-controlled accounts for many years. (Medina Decl, ¶¶ 9-12.) These funds were not conserved for the benefit of the investors as promised. (*Ibid.*)

G. Defendants Failed to Qualify the Galileo Project Investment in Violation of Corporations Code section 25110.

The Galileo Project investment contracts were not qualified or registered as securities with the DBO or any federal securities regulatory bodies, as required under Corporations Code section 25110. (Kim Decl., Ex. 9, Certificate of Search). Nor did the Defendants file any notices of exemptions with the DBO in order to sell the securities without qualification. (*Ibid.*). This is

undisputed—contractual documents drafted by Defendants and provided to investors state that "[n]either the subject property nor this Disclosure Statement have been reviewed or approved by any national, state or local governmental body or regulatory agency." (Kim Decl., Ex. 1 (Ramos Wit. Decl., Bates MR0063).)

H. Defendants Made Many Misrepresentations and Omitted Material Facts.

In addition to diverting and comingling the investors' funds, Defendants made, and caused to be made, numerous misrepresentations of material facts and/or omitted to state material facts in offering and selling the Galileo Project investment contracts in violation of Corporations Code section 25401.

1. The Galileo Project Property Was Drastically Overpriced.

It is evident that the unsophisticated Galileo Project investors, many of whom paid between $20,000.00 to $31,990.00, for their interest in the Galileo Project property, were, by any measure, deeply misled and deceived with respect to the value of their purchased property. As set forth in the attached Declaration of Joseph Aiu, a Department of Real Estate (DRE) Supervising Special Investigator II with 39 years of DRE experience, rather than being worth tens of thousands of dollars, the 1/4000th undivided interest in the Galileo Project property sold to investors was worth approximately $337.59. (Declaration of Joseph Aiu, (hereinafter Aiu Decl.), ¶¶ 9-10.)

2. Defendants Disclosed No Risks.

In addition to misrepresenting the value of the land, the Defendants disclosed no risks to investors and falsely portrayed the Galileo Project as an investment of extraordinary promise. On August 1, 2019, the Commissioner sent an electronic questionnaire to approximately 2,300 Galileo Project investors. (Kim Decl., ¶ 7, Ex 5, Commissioner's Survey). As evidenced in the survey responses, Defendants misrepresented:

- that the Galileo Project was "a once in a lifetime deal that [investors] shouldn't let go of" (Kim Decl., Ex. 6, Bates DBOSURV0020.);
- that "[the investor] was signing an investment of a lifetime [and] buying land that will quadruple in value later" (*Id.,* at Bates DBOSURV0021.);
- and that the investment was a "great investment because in a few years, these businesses

would expand and would want to buy the Galileo land, and that as a result the value of the land would increase, and [the investors] would make a great profit." (Kim Decl., Ex. 1, (Ramos Wit. Decl., ¶ 11).)

3. Defendants Misrepresented that Investors Could Realize an Immediate Investment Return.

Defendants also falsely advertised that the Galileo Project offered "High Investment Returns," and further represented that "your investment could realize a tremendous return virtually overnight." (Kim Decl., Ex. 3 (Reynolds Depo Tr., Bates RN 000022).) The former Managing Director of the Silver Saddle Ranch conceded that the Galileo Project was not the type of investment that would generate a prompt return. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 129:22-25, 130:1-5; 130:23-25, 131:1-7).) Moreover, given the realistic value of the property, these promises were clearly false.

4. Defendants Misrepresented the Value of the Silver Saddle Ranch Purchase Option.

The Defendants also told investors they would have an option to purchase the Silver Saddle Ranch for $500,000.00, which Defendants represented was "valued at $12 million." (Kim Decl., Ex. 3 (Reynolds Depo Tr., Bates RN 000017, RN 000022).) In fact, the $12 million-dollar valuation had been concocted by defendant Thomas or "Tom" Maney (Maney). The testimony of the former Managing Director of the Silver Saddle Ranch, Clifford Reynolds, reveals that Maney approached Reynolds and told him that Maney wanted Reynolds to "come up" with a way to value the Ranch at $12 million dollars—without any appraisal or any other responsible steps taken to set a realistic value:

> Q. [Department Counsel]: But just so that I'm clear, in 2010, Tom Maney came to you and said, I want -- I want to say that this resort is valued at a replacement cost of 12 million dollars. Come up with how to support that; correct?
>
> A. [Mr. Reynolds]: That's correct.
> (Kim Decl., Ex.3 (Reynolds Depo Tr. 119:7-24, 120:20-25).)

Mr. Reynolds later confirmed in an internal email to Silver Saddle accountant Terry Hansen that he "backed into" the $12 million-dollar valuation of the Ranch at Maney's instruction. (Kim

Decl., Ex. 3 (Reynolds Depo Tr., 234:14-25, 235:1-14, Bates RN 000193).)

In addition to claiming that the Silver Saddle Ranch was worth $12 million dollars, Defendants misrepresented to investors that the Ranch was a successful going concern, when it was not. One Galileo Project marketing document stated: "you . . . have an exclusive option to own and operate the entire Silver Saddle Resort, its real estate, operations and total cash flow." (Kim Decl., Ex. 3 (Reynolds Depo Tr., 130:7-14, Bates RN 000022). Defendants failed to disclose to the investors that—far from operating as a successful business—the Ranch was a "loss leader" and perennially lost money because it was used to provide free rooms and entertainment to potential investors. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 127:9-15).)

5. Defendants Misrepresented That the Investment Property Was Serviced with Water, Telephone and Electricity.

Defendants also misrepresented the condition of the Galileo Project property by claiming in advertisements that the Galileo Project property was "[a]lready serviced by paved roads, piped water, electricity [and] telephone" and further that, "this is improved real estate that is already serviced by paved roads, electricity, telephone and piped water…" (Kim Decl., Ex. 3 (Reynolds Depo Tr., Bates RN 000016). To the contrary, Mr. Reynolds stated that "some of [the parcels] had paved roads" and "there was some dirt roads going through or around some of those parcels," and that there was no electrical service or telephone service on the Galileo Project property. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 112:12-25; 113:1-16).)

6. Defendants Misled Investors Regarding the Investors' Role in the Property's Future Development.

Defendants' offering materials and investment contracts portrayed the Galileo Project as an "active" investment where investors would participate in the management and control of the investment. (Kim Decl., Ex. 1 (Ramos Wit. Decl., Bates MR0008, MR0010 and MR0016) and Ex. 3 (Reynolds Depo Tr., 62:16-21, 63:12-22).) For that purpose, each investor, by purchasing a full-, half-, or quarter unit, became a member of The Galileo Commercial Property Owners Association and, allegedly, could vote on how to develop the investment property and spend the money in the CIF (those decisions required a majority vote (51%) of all investors, excluding the developer Silver

Saddle Commercial Development). (Kim Decl., Ex. 10, Declaration of Covenants, Conditions and Restrictions for the Galileo Commercial & Industrial Development (hereinafter CC&Rs), p.5, section III, subsection (B) and p.7, section III, subsection (C)(7)).) In reality, however, only full-unit owners who were current on their payment obligations to the Business Entity Defendants had the right to vote. (Kim Decl., Ex. 10 (CC&Rs, p. 3, section II, subsection 32 and p.17, section III, subsection (I)) and Ex. 14 (Articles of Incorporation of The Galileo Commercial Property Owners Association, Inc., Art. IV.) Thus, it is undisputed that as to those investors who purchased half- and quarter units – a total of 653 separate investments as of 2019 – the Galileo Project is a "passive" investment and, contrary to Defendants' representations, those investors had no right to vote or decide how the property would be developed.

Moreover, all decisions of The Galileo Commercial Property Owners Association were made by a Board of Directors. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 183:2-14, Bates RN-000088).) From 2011 to mid-2019, the Board of Directors consisted of five board members – three representatives of the Business Entity Defendants, including defendant Thomas Maney, and two investors. (Kim Decl., Ex. 3 (Reynolds Depo Tr., 57:23-25, 58:1-3; 58:12-17) and Ex. 2 (Wang Wit. Decl., Bates MQW0007-MQW0012).) Thus, even as to the full-unit investors, for the period 2011 to mid-2019, the Galileo Project was a "passive' investment because all decisions of The Galileo Commercial Property Owners Association were made by a Board of Directors that was controlled by Defendants.

As part of their high-pressure sales tactics, Defendants also made misleading statements that were contrary to the information in the investment documents provided to investors. Defendants made vague promises to some investors that they would invest money in the Galileo Project and passively collect a return in the future from Defendants. For example, one investor was told during the Galileo Project sales pitch that "Silver Saddle would build something on the land and later, when they make money, we as investors would make money as well… My understanding was that all I needed to do for that investment was buy the land." (Kim Decl., Ex. 2 (Wang Wit. Decl., ¶ 7).) The same investor later asked her daughter to check the value of her land; her daughter later told her that the land, for which she had paid $18,900.00, was worth $400. (*Id.* at ¶ 13.)

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7. Investors Were Falsely Told That They Could Build Their Own Residential Home on the Galileo Project Property.

Defendants also misrepresented to some investors that they could build their own residential homes on the commercially zoned land. One investor was shown a model home and falsely told that "[the investors] could build our house there if we bought the land." (Kim Decl., Ex. 1 (Ramos Wit. Decl., ¶ 7).) Another investor recalls that she was shown a model home and told that a previous investor had purchased land from Silver Saddle, and that "if I buy land from Silver Saddle, I could also build a house." (Kim Decl., Ex. 2 (Wang Wit. Decl., par. 4)). None of these representations was true because the investment documents specifically provided that the Galileo Project property was restricted to commercial/industrial use only. (Kim Decl., Ex. 10 (CC&Rs p. 1, section I, p. 2, section II, subsection 17, and p. 4, section III); see also Ex. 4 (Ducreux Depo Tr., 50:7-14).)

8. Defendants Used Aggressive Sales Tactics and Threatened Litigation.

Many investors were subject to high-pressure sales pitches and were badgered into signing contracts after Defendants failed to provide a meaningful explanation of the material terms of the investment. Defendants would then threaten the investors that Defendants would ruin their credit and sue them if they ceased paying. One investor stated that they were rushed to sign the contract without knowing "what kind of investment it is" and when they tried to cancel the transaction the next day, they were told that their "credit score will be affected too much if we try to cancel and block the transaction." (Kim Decl., Ex. 6 at Bates DBOSURV0005.) Another investor explained that after paying off the full purchase price of $10,000.00 for the investment interest, the family received recurring bills for maintenance and membership fees and were threatened by Defendants that they would be sent to collections, their credit would be harmed, and they would lose their entire investment if they did not make the recurring payments. (*Id.* at Bates DBOSURV0011.)

Similarly, Defendants falsely told another investor that she "could build two houses" on the Galileo Project and that the land would "double or triple [in value]." (Kim Decl., Ex. 1 (Ramos Wit. Decl., ¶¶ 13, 16).) After years of making payments, when the investor's family member had passed away and the investor had incurred high medical and funeral bills, the investor attempted to cancel the contract. Defendants refused, telling the investor that if the investor did not continue to pay,

"Silver Saddle would sue me and I would have to pay all the late payments, plus interest and penalties." (*Id.* at ¶¶ 24-25).)

That defendants threatened to ruin credit ratings of dissatisfied investors—and even to bring retaliatory litigation against them personally—is beyond dispute. As but one written example, in 2015, Silver Saddle attorney Jeffrey Hansen sent a letter from his Texas office to a dissatisfied California investor, threatening to initiate "appropriate litigation" and accusing the investor of "tortious conduct." (Kim Decl., Ex. 3 (Reynolds Depo Tr., Bates RN-000196 – RN-000197).)

9. Defendant Maney Failed to Disclose A Prior Regulatory Action.

To the People's knowledge, defendant Maney also failed to disclose that his prior employer, Great Western Cities, was sued by the United States Attorney's Office in 1977 to enforce a previous Federal Trade Commission order involving illegal real estate investments in California City, California (and New Mexico and Colorado). As Executive Vice President and General Counsel, Defendant Maney executed a permanent Consent and Final Judgment, levying penalties, ordering consumer restitution, and requiring truthful real estate practices. (*See* Kim Decl., Ex. 18.)

10. Commissioner's Administrative Action Against Defendants.

On June 18, 2019, the Commissioner issued administrative actions against Defendants Thomas Maney, Silver Saddle Commercial Development, LP, Silver Saddle Ranch & Club, Inc. and The Galileo Commercial Property Owners Association, Inc., ordering Defendants to desist and refrain from the further offer or sale of securities in the State of California in violation of Corporations Code sections 25110 and 25401, requesting ancillary relief in the form of a repurchase offer, and requesting penalties. (Kim Decl., Ex. 7 and Ex. 8). The administrative actions are currently pending before the Office of Administrative Hearings.

III. LAW AND ARGUMENT

A. The Commissioner Has the Authority to Bring This Action and to Seek the Requested Relief.

California Securities Law of 1968 (CSL), Corporations Code sections 29540(a) and 25530(a) authorize the Commissioner to bring this action for injunctive and ancillary relief whenever it appears that any person has engaged or is about to engage in any violation under the Corporations

Code. (Corp. Code, §§ 29540(a), 25530(a); *see also* Gov. Code § 11180.) Where an injunction is authorized by statute to protect the public, the usual equitable considerations, such as inadequacy of legal remedy, irreparable harm, and balancing of interests are irrelevant and it is not necessary to allege or prove them. (*Porter v. Fiske* (1946) 74 Cal.App.2d 332, 338.) The California Supreme Court in *IT Corp. v. County of Imperial* (1983) 35 Cal.3d 63, 72, states the proper standard to apply when a governmental entity seeks to enjoin alleged violations of a statute is as follows:

> Where a governmental entity seeking to enjoin the alleged violation of an ordinance which specifically provides for injunctive relief establishes that it is *reasonably probable* it will prevail on the merits, a rebuttable presumption arises that the potential harm to the public outweighs the potential harm to the defendant…" (Italics added.)

The Commissioner has discovered and provided overwhelming evidence that Defendants committed numerous violations of the CSL and fraudulently diverted investor funds. In this case, there is compelling evidence of a pattern of illegal conduct by Defendants in violation of Corporations Code sections 25110 and 25401, which meets the Commissioner's burden of proof that it is "reasonably probable it will prevail on the merits." Defendants' illegal conduct is ongoing and has resulted in the loss of millions of dollars taken in this unqualified and fraudulent securities offering. Defendants continue to receive thousands of dollars of investors' money each month. If Defendants are permitted to continue their unlawful scheme and squander investor funds, the harm to the public will be irreparable.

It is therefore essential to prevent further losses—the court can and should grant the injunctive and ancillary relief prayed for ex parte without notice to Defendants at this time until a preliminary injunction can be issued after a noticed OSC hearing.

B. Defendants Offered and Sold Unqualified Non-exempt Securities in Violation of Corporations Code Section 25110.

Defendants violated Corporations Code Section 25110, which prohibits offering and selling securities in an issuer transaction which have not been qualified under the CSL and are not exempt from qualification. The Galileo Project investment contracts sold by Defendants meet the test for securities, have not been qualified, and are not exempt.

California Corporations Code section 25019 defines a "security" in relevant parts:

"Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; participation in any profit-sharing agreement; collateral trust certificate; interest in a limited liability company; or, in general, any interest or instrument commonly known as a "security" [.]

"The list of instruments which come within the statutory definition of a 'security' … is an expansive one." (*People v. Figueroa* (1986) 41 Cal.3d 714, 734.) To effectuate the purpose of the CSL, "the courts look through form to substance." (*Silver Hills v. Sobieski* (1961) 55 Cal.2d 811, 814.) "The *primary* purpose of the corporate securities law is to protect innocent investors." (*Southern California First Nat'l Bank v. Quincy Cass Associates* (1970) 3 Cal. 667, 675.) In determining whether a transaction involves a security, "California courts have applied, either separately or together, two distinct tests: (1) the 'risk capital' test described in *Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 815, and (2) the federal test described in *SEC v. W.J. Howey Co.* (1946) 328 U.S. 293, 298-299 (*Howey*). [Citations.] A transaction is a security if it satisfies either test. [Citation.]" (*Reiswig v. Department of Corporations* (2006) 144 Cal.App.4th 327, 334 (*Reiswig*).)

1. <u>The Galileo Project Investment Is an "Investment Contract" Under *Howey*.</u>

The federal test for a security focuses on "'whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.'" (*SEC v. Edwards* (2004) 540 U.S. 389, 393 (*Edwards*), quoting *Howey*, supra, 328 U.S. at p. 301.) "'The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.' [Citation.]" (Figueroa, *supra*, 41 Cal.3d at p. 737, fn. 28.)

Bundled contracts and agreements must be analyzed together to see whether together they constitute an investment contract. A bundle of items may amount to an investment contract even if each separate component would not. In *SEC v. Howey*, the leading case on the definition of "investment contract," the defendants sold parcels in an orchard to investors and a separate servicing contract; the court held that the components were a security when analyzed together. (*Howey*, supra, 328 U.S. 293, 299-300.)

Here, under the rule of bundling in *Howey*, all of the straws in the investment bundle must be

considered together. Like in *Howey*, the bundle of interests sold to the investors in this case does not consist merely of the purchase of undivided interests in real estate for appreciation—crucially, the bundle includes a mandatory capital contribution toward the development of the real estate in question, the Capital Improvement Fund. And it includes other components as well, including a mandatory membership in the Silver Saddle Ranch and mandatory membership dues, and an option to purchase the Silver Saddle Ranch.

The only issue under these facts is whether the investors reasonably expected to earn profits from the efforts of others. First, the investors clearly would need to rely on the efforts of others, since the CIF was comingled and diverted by Defendants, and many investors were not informed that they would be involved in the future development of the property. (Kim Decl., Ex. 2 (Wang Wit. Decl., ¶¶ 5, 7).)

Second, under California law, the test for whether an investor in a money-making venture expects to earn profits from the efforts of others turns on the investor's actual ability or inability to manage the venture or is dependent on the promoter's or other third person's special expertise. *Williamson v. Tucker*, (5th Cir. 1981) 645 F.2d 404, 423, explained this rule:

> A scheme which sells investments to inexperienced and unknowledgeable members of the general public cannot escape the reach of the securities laws merely by labeling itself a general partnership or joint venture. Such investors may be led to expect profits to be derived from the efforts of others in spite of partnership powers nominally retained by them.[6]

Under *Williamson*, the investors' dependence on the efforts of others is present when "the partner has irrevocably delegated his powers, or is incapable of exercising them, or is so dependent on the particular expertise of the promoter or manager that he has not reasonable alternative to reliance on that person." (*Id.* at 422-423.) *Williamson* explained the inquiry as the following:

> A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the

[6] *Williamson v. Tucker, supra*, 645 F.2d at 423.

> partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers."[7]

In this instance, the Galileo Project meets the definition of a security under the *Williamson* test. First, under the first prong of the *Williamson* test, the investors who purchased half- and quarter-unit interests in the Galileo Project had no voting rights and could not exercise any power or control over the investment. It is undisputed that those passive investors reasonably expect to earn profits from the efforts of others. The full-unit investors were also powerless until the contingent event at some future time when they would presumably be given control of developing the land; until then, they relied entirely on Defendants.

The investment is also a security under the second prong of the *Williamson* test because the investors are, by reason of their lack of experience and sophistication, simply not capable of exercising the power to affect their expectation of profit and are dependent on the expertise and knowledge of the promoters. The focus of the inquiry in California is on the investor's experience and sophistication in the *particular type* of business into which she has invested.[8] Thus, in a California case, the court found an investment to be a security because the promoters "were soliciting investments from people who would, as a practical matter, lack the knowledge to effectively exercise the managerial powers conferred by the joint venture agreements."[9] Additionally, as in the present case, the subject investors lived far away from the business such that they were effectively precluded from exercising managerial control—thus, the combination of an investor's lack of experience and training and of the investor's geographical remove from the business establishes the investors' dependence on others. Furthermore, in the present case, Defendants failed to even explain the general terms of the investment to some investors.

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[7] *Williamson v. Tucker* (5th Cir. 1981) 645 F.2d 404, 424, quoted in *Consolidated Management Group, LLC v. Department of Corporations* (2008) 162 Cal.App.4th 598, 611.

[8] *Consolidated Management Group, LLC v. Department of Corporations* (2008) 162 Cal.App.4th 598, 611-612.

[9] *Consolidated Management Group, LLC, supra*, 162 Cal.App.4th at 612.

2. The Galileo Project Investment Is A Security Under The "Risk Capital" Test.

The Galileo Project investment is also a security under the risk capital test. The risk capital test consists of the following factors: (1) whether funds are being raised for a business venture or enterprise; (2) whether the transaction is offered indiscriminately to the public at large; (3) whether the investors are substantially powerless to effect the success of the enterprise; and (4) whether the investors' money is substantially at risk because it is inadequately secured. (*Moreland v. Department of Corporations*, (1987) 194 Cal.App.3d 506, 519.)

The first, second and third factors cannot be reasonably disputed—the money here was raised for a business purpose, the investment contracts were offered to the public, and the unsophisticated investors—most of whom are passive—could not carry out any meaningful development of the undeveloped land. In addition, the fourth element of the test (i.e., that the investor's money was substantially at risk because it was inadequately secured) is met, given that the price charged for the real property element of the investment—at $10,000 to $30,000 per quarter-acre—was exceedingly overpriced for a 1/4000 fractional interest in property that has a market value, in total, of approximately $337.00. (*See* Aiu Decl., ¶ 10.) The investment, at all times, was and is severely undercapitalized and is a security under the risk capital test.

C. Defendants Violated the Anti-Fraud Provisions of Corporations Code Section 25401 By Making Misrepresentations and Omissions of Material Fact During the Offer and Sale of Securities.

Defendants also violated section 25401 which prohibits the sale of any securities, whether qualified or not, by means of any untrue statement or omission of material fact. (Corp. Code, § 25401.) In *People v. Simon* (1995) 9 Cal.4th 493, the court stated that such misrepresentations or omissions need not even be knowing:

> An enforcement action by the commissioner to enjoin future sales by means of false or misleading statements is designed to protect the public... For that reason, it is irrelevant that the defendant knows that the statements or omissions are false or misleading. In light of the language of section 25401, it is reasonable to conclude that the Legislature did not intend to permit members of the public to be harmed by such sales simply because the offeror was unaware that his or her sales pitch was misleading. [*Id.* at 515-516.]

Under section 25401, all material facts must be disclosed, and a fact is "material" if there is a

substantial likelihood that, under all the circumstances, a reasonable investor would consider it important in reaching an investment decision. (*Insurance Underwriters Clearing House, Inc. v. Natomas Co.* (1986) 184 Cal.App.3d 1520, 1526.)

The evidence provided establishes that Defendants violated Corporations Code section 25401 in numerous ways. Defendants' untrustworthiness is beyond dispute: numerous misrepresentations, diversion of funds, an abandon for truthful disclosures, accounting malfeasance, the draining of virtually all of the investors' funds, and a reckless and deliberate omission of material information are evident and justify the need for the requested relief to be granted ex parte with no notice.

D. A Temporary Restraining Order Should Issue Prohibiting Further Violations.

There is compelling evidence of a pattern of illegal conduct by Defendants which meets the Commissioner's burden of proof that it is "reasonably probable it will prevail on the merits." (*IT Corp. v. County of Imperial, supra*, 35 Cal.3d 63, 72). Defendants' illegal conduct is ongoing and has resulted in the loss of millions of dollars taken in this unqualified and fraudulent securities offering. Defendants failed to preserve investors' funds for the benefit of the investors as promised; they consistently commingled and disbursed those funds as soon as they received them. Defendants continue to receive thousands of dollars each month in investors' funds.

It is therefore essential to prevent further losses—the court can and should issue a Temporary restraining Order ex parte without notice to Defendants at this time until a preliminary injunction can be issued after a noticed OSC hearing. If the People were required to wait until notice was given, a great or irreparable injury would result as Defendants are likely to transfer or dissipate the assets that are still under their control.

E. The Appointment of a Receiver Ex Parte Without Notice Is Appropriate and Necessary to Protect Investors' Assets.

Corporations Code sections 29540 and 25530 authorize ancillary relief including the appointment of a receiver upon a proper showing when "any person has engaged, or is about to engage, in any act or practice constituting a violation of any provision" of the California Commodities and Securities Laws. (*Securities and Exchange Com'n v. Keller Corporation* (1963) 323 F.2d 397.) "[A] receiver is permissible and appropriate where necessary to protect the public

interest and where it is obvious . . . that those who have inflicted serious detriment in the past must be ousted." (*Securities and Exchange Com'n v. Bowler* (1970) 427 Fed.2d 190, 198.) Courts also have ordered the appointment of a receiver where "no injunction [the court] could frame would cure for the past or prevent in the future the mismanagement and illegalities found in the operation of the defendant ..." (*Securities and Exchange Comm'n v. Heritage Trust* (1975) 402 F.Supp. 744, 753).

Appointments of receivers on an ex parte application without notice to the Defendants have been upheld in cases on a prima facie showing of fraud in connection with the sale of securities to the public: "[G]enerally the granting of such orders [ex parte appointment of receivers] rests in the sound discretion of the trial court..." (*People v. Christ's Church* (1947) 79 Cal.App.2d 858, 861, citing *Misita v. Distillers Corp., Ltd.* (1942) 54 Cal.App.2d 244, 250 ("the appointment of a receiver may be made 'ex parte' and without notice if the 'imperative necessity' or emergency is shown in the petition or supporting affidavits.")

Defendants have engaged in numerous securities violations and fraudulently diverted millions of dollars. Most of the investors' funds paid are already gone. Such egregious activity shows that Defendants "have inflicted serious detriment in the past" and cannot be trusted to manage investor assets still under their control. Defendants continue to receive substantial investor funds—this demonstrates the "imperative necessity" to issue the order appointing a receiver and freezing assets of the Business Entity Defendants ex parte without notice to avoid the further imminent loss of investor assets.

In the event this application is granted, Plaintiff has arranged for Thomas McNamara of Regulatory Resolutions to act as the receiver in this action. The firm is highly qualified with extensive experience in acting as a court appointed receiver in large and complex business operations involving securities fraud. A copy of the firm's CV and list of appointments for prior complex receiverships are attached as Exhibit 1 to the People's Nomination of Receiver. The duties and powers of the receiver requested are contained in the proposed order lodged herewith.

F. The Court Should Order an Immediate Asset Freeze and Prohibit the Destruction of Documents.

Courts have inherent equitable authority to freeze the assets of parties in injunctive actions

brought by governmental agencies for violations of securities laws. (*SEC v. International Swiss Investments Corp.* (9th Cir. 1990) 895 F. 2d 1272, 1276). Courts use freeze orders to prevent waste and dissipation of assets and to ensure their availability for restitution and disgorgement for the benefit of victims of fraud. (*SEC v. Hickey* (9th Circuit 2003) 322 F.3d at 1132). Plaintiff also requests an Order prohibiting the destruction of all documents regarding the Business Entity Defendants.

IV. CONCLUSION

Plaintiff has provided overwhelming evidence establishing it is "reasonably probable it will prevail on the merits" of the claims that Defendants fraudulently obtained and squandered millions of dollars in investor funds and committed numerous violations of the Corporate Securities Law. The investors' remaining assets are at imminent risk of being diverted or lost.

Based on the applicable legal standards, the Court can and should grant the relief requested on an ex parte, no notice basis to preserve the remaining assets. Plaintiff therefore requests the court issue an order: 1) appointing Thomas McNamara of Regulatory Resolutions as receiver over the Business Entity Defendants' assets and businesses; 2) issuing a TRO restraining Defendants from further violations of the laws listed above and preventing the destruction of documents; and 3) issuing a freeze of all of the assets of the Business Entity Defendants until an accounting can be performed by the receiver and recommendations made. This relief is necessary under the circumstances to maintain the status quo and preserve assets, at least until a noticed preliminary injunction hearing can be held. A proposed order specifying the injunctive and ancillary relief requested and the powers and duties of the receiver in more detail is lodged herewith.

Respectfully submitted,

Dated: September 6, 2019

MANUEL P. ALVAREZ
Commissioner of Business Oversight

By: _____

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