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SOUTHERN DISTRICT OF CALIFORNIA

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14 UNITED STATES DISTRICT COURT
15 SOUTHERN DISTRICT OF CALIFORNIA

BY FAX

16 SECURITIES AND EXCHANGE
17 COMMISSION,

18 Plaintiff,

19 v.

20 EMVEST MORTGAGE FUND, LLC,
21 EMVEST, INC., and MILON LYLE
22 BROCK,

23 Defendants.

Case No. 04 CV 2295 DMS (LSP)

**SUPPLEMENTAL BRIEF
SUPPORTING ENTRY OF
PRELIMINARY INJUNCTION AND
APPOINTMENT OF PERMANENT
RECEIVER**

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1 **I. INTRODUCTION**

2 The Plaintiff Securities and Exchange Commission ("Commission") submits
3 this brief to: (1) alert the Court to the defendants' failure to comply with the
4 Court's November 16, 2004 Temporary Restraining Order ("Order"); (2) provide
5 new evidence supporting the Commission's arguments for preliminary injunction,
6 which are set forth in its *Ex Parte* Application by Plaintiff Securities and Exchange
7 Commission for Temporary Restraining Order ("*Ex Parte* Application") and
8 accompanying papers; and (3) address the issue the Court raised regarding
9 payment of the receiver's fees.

10 First, the defendants have refused to comply with the Order. Despite the
11 plain language of the Order, the defendants have not given the Court-appointed
12 receiver access to, let alone control over, the affiliates and subsidiaries of Emvest
13 Mortgage Fund, LLC (the "Fund") or Emvest, Inc. Without access to the books
14 and records of the Emvest affiliates, the receiver cannot adequately trace the
15 money transferred to the affiliates and determine the extent to which the Emvest
16 affiliates were used as a means to funnel Fund assets into the defendants' own
17 pockets.

18 Second, since the Commission filed its *Ex Parte* Application on November
19 16, 2004, the Commission has obtained and analyzed additional evidence
20 supporting entry of a permanent injunction. The evidence shows that despite the
21 ongoing investigation by the Commission, the defendants have continued to use
22 investor capital to pay investor returns in September, October, and November of
23 this year. Unless the injunction and receivership are continued, there is a grave
24 risk that the defendants will resume their improper dissipation and misuse of Fund
25 assets.

26 Finally, the Commission respectfully submits that it should not be required
27 to pay the receiver's fees. The Order raises the issue whether the receiver's fees
28 should be paid by the defendants or by the Commission. (Order ¶ XIII.) The

1 securities laws, principles of sovereign immunity, and equitable considerations
2 dictate that the receiver's fees should not be paid by the Commission.

3 **II. ARGUMENT**

4 **A. The Defendants Have Violated the Temporary Restraining Order**
5 **By Refusing to Give the Receiver Access to the Books and Records**
6 **of the Fund's Affiliates**

7 The Order gives the receiver access to and control over the affiliates and
8 subsidiaries of the Fund and Emvest, Inc. The Order specifically states that:

9 Dennis M. Murphy is appointed as temporary receiver of
10 Emvest Mortgage Funds, LLC, and Emvest, Inc., *and their*
11 *subsidiaries and affiliates*, with full powers of an equity
12 receiver, including (but not limited to) full power of all funds,
13 assets, collateral, premises . . . belonging to, managed by, or *in*
14 *the possession or control of* Emvest Mortgage Fund, LLC, and
15 Emvest, Inc., *and any other of their subsidiaries and affiliates*
16

17 (Order ¶ IV (emphasis added).) It also directs:

18 that Defendants *and their subsidiaries and affiliates*, and their
19 officers, agents, servants, employees . . . and any other persons
20 who are in custody, possession, or control of any assets,
21 collateral, books, records, . . . or other property of, or managed
22 by Emvest Mortgage Fund, LLC and Emvest, Inc., *shall*
23 *forthwith give access to and control of such property to the*
24 *temporary receiver.*"

25 (Order ¶ IX (emphasis added).)

26 The defendants, however, have refused to give the receiver access to the
27 books and records of several affiliates. (Declaration of Molly M. White in Support
28 of the Commission's Supplemental Brief ("White Dec.") ¶¶ 3, 5, 7 & 10; Exs. 4 &
6.) Those affiliates include: (1) Emerald Bay Financial, Inc.; (2) Emerald Bay
Funding, Inc.; (3) Emerald Bay Financial of Southern California, Inc.; (4) Unified
Mortgage Service, Inc.; (5) CNA Foreclosure Services, Inc.; (6) TriStar; and (7)
Heritage. (See White Dec. Ex. 2.)

Pursuant to Rule 405 of the Securities Act of 1933 ("Securities Act"), "[a]n
'affiliate' of, or person 'affiliated' with, a specified person is a person that directly,

1 or indirectly through one or more intermediaries, controls or is controlled by, *or is*
2 *under common control* with, the person specified.” 17 C.F.R. § 230.405
3 (emphasis added). Black’s Law Dictionary defines an affiliated company as a
4 “[c]ompany effectively controlled by another company. A branch, division, or
5 subsidiary.” (Black’s Law Dictionary (6th Ed.)) By the defendants’ own
6 admissions, each of the aforementioned entities is an affiliate of the Fund or
7 Emvest, Inc.

8 First, the Fund’s 2003 financial statements list the Fund’s and Emvest’s
9 affiliates. Note 12 of the Fund’s financial statements (entitled “Related Party
10 Transactions and Common Control”) state that “The Company’s Manager, Emvest
11 Incorporated, *has common ownership and management of affiliated companies*
12 doing business with the Emvest Mortgages Fund, LLC.”¹ (See Declaration of
13 Susan F. Hannan in Support of the Commission’s *Ex Parte* Application (“Hannan
14 Dec. I”) Ex. 14, p. 227 (emphasis added); see also White Dec. Ex. 3, p. 20.) Note
15 12 then lists Emvest, Inc.’s affiliates as:

- 16 1) Emerald Bay Financial, Inc., a “California corporation with common
17 ownership and management to Emvest, Incorporated” that originates loans
18 on behalf of Emvest, Inc., “receiving loan origination, broker’s finders, and/
19 or other fees from third parties”;
- 20 2) Emerald Bay Funding, Inc., a “split off of Emerald Bay Financial, Inc., a
21 California Corporation, with common ownership and management to
22 Emvest, Incorporated” that originates loans that are later sold to Emvest,
23 Inc., “receiving loan origination, broker’s finders and/or other fees from
24 third parties”;

25
26 ¹ Both the Prospectus and Article 4.4 of the Fund’s Operating Agreement,
27 which is attached to and incorporated into the Fund’s Prospectus, require the Fund
28 to send investors the Annual Report and the Fund’s financial statements. (See
Hannan Dec. I Ex. 6, pp. 58 & 72; Ex. 7, pp. 98-99 & 120; & Ex. 8, pp. 147 &
174.)

1 3) Emerald Bay Financial of Southern California, Inc., which operates "a
2 loan origination unit in Orange County, California, with common
3 ownership and management to Emvest, Incorporated";

4 4) Unified Mortgage Service, Inc., a "California Corporation with common
5 ownership and management to Emvest, Incorporated" that provides loan
6 servicing and management of real estate services; and

7 5) CNA Foreclosure Services, Inc., a "California Corporation with
8 common ownership and management to Emvest, Incorporated" that
9 provides foreclosure services.

10 (Hannan Dec. I Ex. 14, p. 227; *see also* White Dec. Ex. 3, p. 20.) Note 4 of the
11 financial statements, which describes the funds that Emvest, Inc. transferred into
12 the Fund, identifies two other loan portfolios, Tristar Mortgage Fund Ltd.

13 ("TriStar") and Heritage Mortgage Fund Ltd. ("Heritage"). (*See* Hannan Dec. I,
14 Ex. 14, pp. 223-24.) That Note also explains that Emerald Bay Financial, Inc. is
15 the general partner of TriStar and Heritage. (*See* Hannan Dec. I, Ex. 14, pp. 223-
16 24; *see also* White Dec. Ex. 3, pp. 16-17.)

17 Second, the defendants have repeatedly identified these same entities as
18 affiliates of the Fund and Emvest, Inc. in the literature that they have sent
19 investors. For example, one brochure states that "Emerald Bay Financial/ Emvest
20 Incorporated is a group of affiliated companies and businesses that are designed to
21 provide you, the investor, with great value and excellent investment opportunities.
22 Here's a synopsis of the companies and the way they work." (*See* Declaration of
23 Chester A. Sable ("Sable Dec.") Ex. 9, p. 22.) The brochure then lists: (1)
24 Emerald Bay Financial, Inc.; (2) Emvest Incorporated and Emvest Mortgage Fund,
25 LLC; (3) Unified Mortgage Service, Inc., and (4) CNA Foreclosure Service, as part
26 of that "group of affiliated companies." (*See* Sable Dec. Ex. 9, p. 22.)

27 As another example, a sheet of "Answers to Frequently Asked Questions,"
28 that the defendants sent investors states: "The Prospectus for Emvest only takes

1 into account Emvest Mortgage Fund, LLC the corporation. There is however, a
2 broader picture of the company than just Emvest LLC. The company has *four*
3 *other divisions* that occupy 2 floors and three suites in the San Diego office.” (See
4 Sable Dec. Ex. 11, p. 25.) That flyer then describes Emerald Bay Financial, Inc.,
5 Unified Mortgage Services, Inc., Emvest Mortgage Fund, LLC, Inc., and CNA
6 Foreclosures as those other “divisions.” (See Sable Dec. Ex. 11, p. 25.) Moreover,
7 the August 2004 newsletter that was sent to Fund investors lists the following
8 companies as “Manager and Affiliates”: Emvest Incorporated, Emerald Bay
9 Funding, Inc., Lenders Reconveyance, Inc., and Unified Mortgage Service, Inc.
10 (See Sable Dec. Ex. 12, p. 26.) These are not the only examples. (See also Sable
11 Dec. Ex. 10, p. 23; Ex. 16, p. 33; & Ex. 17, p. 35.)

12 Finally, the testimony of Sylvia De Anda, the Fund’s controller, further
13 establishes that Emerald Bay Financial and Emerald Bay Funding are affiliates of
14 the Fund. Ms. De Anda testified that as the controller of Emerald Bay Financial,
15 she handles bookkeeping, making and tracking bank deposits, and payroll
16 functions for both the Fund, and Emvest Mortgage Fund II, LLC (“Fund II”).²
17 (Hannan Dec. II Ex. 1 (De Anda test.), pp. 39:22-40:17.) Ms. De Anda also
18 handles the bookkeeping for Emerald Bay Funding, Inc. (Hannan Dec. II Ex. 1 (De
19 Anda test.) pp. 41:2-12.) The fact that the bookkeeping and payroll functions of
20 these entities is handled by the same person further supports the fact that these
21 companies are under the common control of Brock and Emvest.

22 Based on these indisputable facts, defendants have no grounds for arguing
23 that any of the aforementioned entities are not affiliates of the Fund or Emvest, Inc.
24 Indeed, the defendants’ refusal to allow the receiver to examine those entities’
25

26 ² As previously described in the Commission’s Memorandum of Points and
27 Authorities in Support of its *Ex Parte* Application, Emvest Mortgage Fund II is a
28 new mortgage investment fund that Emvest began in June 2004. (See
Memorandum of Points and Authorities in Support of *Ex Parte* Application, p. 9.)

1 books and records suggests that they have something to hide. Without access to
2 these records, the receiver's ability to trace the Fund's payments to the affiliated
3 entities and to determine whether the defendants have improperly funneled Fund
4 assets through Emvest's affiliates into their own pockets, will be hindered.³

5 **B. Recently Developed Evidence Shows That There is Reasonable**
6 **Likelihood that Defendants Will Continue Their Fraudulent**
7 **Scheme Unless Enjoined**

8 As set forth in its *Ex Parte* Application and accompanying papers, the
9 Commission has met the standard for obtaining a preliminary injunction and other
10 relief against the defendants. Since the Commission filed its *Ex Parte* Application,
11 however, the Commission has had an opportunity to obtain additional discovery
12 and to complete further analysis showing that until the appointment of the
13 temporary receiver in November, the defendants continued to use investor capital
14 to pay returns. The defendants' continued misconduct suggests that without a
15 receiver in place, the defendants will likely resume their misconduct and commit
16 future violations. *See SEC v. Murphy*, 626 F.2d 633, 655 (9th Cir. 1980). To
17 prevent future misconduct, the Court should enter a preliminary injunction and
18 make the receiver's appointment permanent.

19 Last week, the defendants provided the Commission with the Fund's bank
20 records for September 2004.⁴ (Declaration of Kelly Bowers in Support of the
21

22 ³ The Commission has some concerns that the defendants may be using the
23 affiliates in just this fashion, because the Fund's controller testified that Emerald
24 Bay Financial pays for the 2003 Mercedes E320 that she drives. (Hannan Dec. II
25 Ex. 1 (De Anda test.), pp.41:20-42:2.)

26 ⁴ Further discovery needs to be taken regarding a large transaction that
27 occurred in September. Just three days after Sylvia De Anda testified in the course
28 of the Commission's investigation, on September 23, 2004, the Fund issued two
checks for the benefit of Ms. De Anda. (*See* Hannan Dec. II Exs. 2 & 3.) The first
check was for more than \$1.5 million, and the second check was for \$30,000. (*See*
Hannan Dec. II Exs. 2 & 3.) Ms. De Anda testified that the two checks were for a

1 Commission's Supplemental Brief ("Bowers Dec. II") ¶ 3.) Those records show
2 that in September, the Fund generated a profit of \$78,034.34, but paid \$180,208.04
3 in distributions to investors. (See Bowers Dec. II ¶¶ 6-7 & Ex. 1.) Thus, in
4 September alone, the Fund used another \$102,173.70 of investor capital to pay
5 returns to investors. (Bowers Dec. II ¶¶ 6-7 & Ex. 1.) Sylvia De Anda, the
6 controller of Emerald Bay Financial, Emerald Bay Funding, and the Fund,
7 confirmed that the Fund continued to make 12% distributions in October and
8 November. (Hannan Dec. II Ex. 1 (De Anda test.) pp. 73:10-74:24.)

9 Finally, despite the fact that the Fund was supposed to be closed to new
10 investors as of August 16, 2004 (see Sable Dec. Ex. 12, p. 26), the Fund's
11 controller testified that the Fund continued to accept investments in September.
12 (Hannan Dec. II, Ex. 1 (De Anda test.), pp. 110:2-21, 111:4-14; see also Bowers
13 Dec. II Ex. 1 (showing that the Fund received additional investments in
14 September).) She also testified that she was not given any instructions to stop
15 allowing new investments in the Fund. (Hannan Dec. II, Ex. 1 (De Anda test.), pp.
16 111:4-14, 113:12-114:8.) Although it is unclear whether the receipt of these
17 additional investor funds is the result of intentional misconduct, at a minimum the
18 Fund is poorly managed.

19 **C. The Commission Should Not Pay the Receivership Fees**

20 The Commission respectfully submits that the Commission should not bear
21 the costs of the receiver. Both Section 22(a) of the Securities Act, 15 U.S.C. §
22 77v, and Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act"),
23 15 U.S.C. § 78aa, state, in identical language, that "[n]o costs shall be assessed for
24

25
26 loan to her and her husband for a hotel that they purchased in Arizona. (Hannan
27 Dec. II Ex. 1 (De Anda test.), pp. 17:14-18:15, 19:25-22:7, 23:21-27:8, 28:13-
28 29:11.) Although the transaction may be legitimate, the timing of the loan and Ms.
De Anda's testimony about the transaction raise questions that merit further
investigation.

1 or against the Commission in any proceeding under this title brought by or against
2 it in the Supreme Court or such other courts.” Courts have held that these
3 provisions “represent statutory recognition of the traditional doctrine of sovereign
4 immunity which prohibits the assessment of damages, fees or costs against the
5 Government without its consent.” *See SEC v. Independence Drilling Corp.*, 595
6 F.2d 1006, 1008 (5th Cir. 1979); *see also United States v. Testan*, 424 U.S. 392,
7 399 (1976) (“It long has been established [] that the United States, as sovereign, is
8 immune from suit save as it consents to be sued”) (internal citation and
9 quotations omitted); *Barry v. Bowen*, 884 F.2d 442, 444 (9th Cir. 1989).

10 The United States has not waived its sovereign immunity with respect to
11 Commission enforcement actions. To the contrary, Congress has made clear the
12 government’s intent to preserve its sovereign immunity by enacting Sections 22(a)
13 of the Securities Act and Section 27 of the Exchange Act. The principle of
14 sovereign immunity is particularly important in Commission enforcement actions
15 because in such actions the Commission appears before the Court “not as an
16 ordinary litigant, but as a statutory guardian charged with safeguarding the public
17 interest in enforcing the securities laws.” *SEC v. Management Dynamics, Inc.*, 515
18 F.2d 801, 808 (9th Cir. 1975). Accordingly, it would be improper to direct the
19 Commission to pay the receivership fees in this matter.⁵ *See Independence*

21 ⁵ In *CFTC v. Frankwell Bullion Ltd.*, 99 F.3d 299 (9th Cir. 1996), the Ninth
22 Circuit recognized the principle of sovereign immunity. *Id.* at 305 (“Money
23 awards may be imposed against the United States only if there has been an express
24 waiver of sovereign immunity.”). In *Bullion*, however, the Ninth Circuit found
25 that the CFTC had waived its sovereign immunity. *Id.* On that basis, the court
26 reasoned that the CFTC should be treated like any other private litigant and
27 assessed a portion of the receiver’s fees. *Id.*

28 The instant case is distinguishable because the United States has not waived
its sovereign immunity. Instead, Congress has reaffirmed the Commission’s
sovereign immunity by enacting Section 22(a) of the Securities Act and Section 27
of the Exchange Act, a distinction noted by the court in *Bullion*. *Id.*

1 *Drilling*, 595 F.2d at 1008 (reversing the district court's assessment of receivership
2 fees against the Commission based on the federal securities laws and the doctrine
3 of sovereign immunity).

4 Furthermore, equitable considerations dictate that the Commission, and more
5 generally the taxpayers, should not bear the costs of a receivership that inures to
6 the benefit of the investors and the defendants. As between private litigants, courts
7 may only assess receivership fees against those who receive a benefit from the
8 receivership. *See SEC v. Elliott*, 953 F.2d 1560, 1576 (9th Cir. 1992) ("The court
9 in equity may award the receiver fees from property securing a claim if the
10 receiver's acts have benefited that property."); *In re San Vicente Medical Partners*
11 *Ltd.*, 962 F.2d 1402, 1409 (9th Cir. 1992) (holding that the district court did not
12 abuse its discretion by assessing receivership fees against a company that was not a
13 defendant before the court in the applicable Commission action because the
14 receivership "produced substantial and important [financial] benefits" for that
15 company).⁶ Courts recognize the receiver's acts as "benefits" in the fees context
16 when they are specific and pecuniary in nature, including managing the increasing
17 value of the collateral, managing the day-to-day operations of the business, and
18 paying taxes on the property secured by the receivership. *See SEC v. Elliott*, 953
19 F.2d at 1576-77. Here, the receivership will not confer such a specific, pecuniary
20 benefit on the general taxpayers.⁷

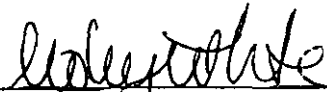
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23 ⁶ This line of cases does not address the possibility of the United States paying
24 receivership fees, but instead addressed the situation where the court had to decide
25 who should pay the receiver's fees as between private litigants.

26 ⁷ The Order also states that "[a]t the preliminary injunction hearing, the Court
27 shall determine whether the receivership fees shall be paid by Defendants or by the
28 SEC." (Order ¶ XIII.) The Commission respectfully submits that the receiver's
29 compensation should be decided after his work is completed, so the Court can
30 better evaluate the receiver's work. *See In re San Vicente Medical Partners Ltd.*,
31 962 F.2d 1402, 1410 (9th Cir. 1992).

1 **III. CONCLUSION**

2 For the foregoing reasons, the Commission respectfully requests that the
3 Court grant a preliminary injunction, and permanently extend the receivership over
4 the Fund, Emvest, and their affiliates and subsidiaries.

5
6 DATED: November 24, 2004



Molly M. White
Susan F. Hannan
Attorneys for Plaintiff Securities and
Exchange Commission

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PROOF OF SERVICE

1 I am over the age of 18 years and not a party to this action. My business address
2 is:

3 U.S. SECURITIES AND EXCHANGE COMMISSION, 5670 Wilshire
4 Boulevard, 11th Floor, Los Angeles, California 90036-3648
Telephone No. (323) 965-3998; Facsimile No. (323) 965-3908.

5 On November 24, 2004, I served the document entitled **SUPPLEMENTAL**
6 **BRIEF SUPPORTING ENTRY OF PRELIMINARY INJUNCTION AND**
7 **APPOINTMENT OF PERMANENT RECEIVER** upon the parties to this action
addressed as stated on the attached service list:

8 **OFFICE MAIL:** By placing in sealed envelope(s), which I placed for
9 collection and mailing today following ordinary business practices. I am
10 readily familiar with this agency's practice for collection and processing of
correspondence for mailing; such correspondence would be deposited with
the U.S. Postal Service on the same day in the ordinary course of business.

11 **PERSONAL DEPOSIT IN MAIL:** By placing in sealed
12 envelope(s), which I personally deposited with the U.S. Postal Service.
Each such envelope was deposited with the U.S. Postal Service at Los
Angeles, California, with first class postage thereon fully prepaid.

13 **EXPRESS U.S. MAIL:** Each such envelope was deposited in a
14 facility regularly maintained at the U.S. Postal Service for receipt of
Express Mail at Los Angeles, California, with Express Mail postage
15 paid.

16 **HAND DELIVERY:** I caused to be hand delivered each such envelope to
the office of the addressee.

17 **FEDERAL EXPRESS BY AGREEMENT OF ALL PARTIES:** By
18 placing in sealed envelope(s) designated by Federal Express with delivery
fees paid or provided for, which I deposited in a facility regularly maintained
19 by Federal Express or delivered to a Federal Express courier, at Los
Angeles, California.

20 **ELECTRONIC MAIL:** By transmitting the document by electronic mail
21 to the electronic mail address as stated on the attached service list.

22 **FAX (BY AGREEMENT ONLY):** By transmitting the document by
23 facsimile transmission. The transmission was reported as complete and
without error.

24 **(Federal)** I declare that I am employed in the office of a member of the bar
25 of this Court, at whose direction the service was made. I declare under
penalty of perjury that the foregoing is true and correct.

26 Date: November 24, 2004

Magnolia M. Marcelo
27 _____
28 MAGNOLIA M. MARCELO

