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SOUTHERN DISTRICT OF CALIFORNIA

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10 UNITED STATES DISTRICT COURT
11 SOUTHERN DISTRICT OF CALIFORNIA

12 SECURITIES AND EXCHANGE
13 COMMISSION,

14 Plaintiff,

15 v.

16 EMVEST MORTGAGE FUND, LLC,
17 EMVEST, INC., and MILON LYLE
18 BROCK,

19 Defendants.

Case No. '04 CV 2295 DMS (LSP)

MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
EX PARTE APPLICATION BY
PLAINTIFF SECURITIES AND
EXCHANGE COMMISSION FOR
TEMPORARY RESTRAINING
ORDER AND ORDERS:
(1) FREEZING ASSETS;
(2) APPOINTING A TEMPORARY
RECIEVER; (3) PROHIBITING
THE DESTRUCTION OF
DOCUMENTS; (4) EXPEDITING
DISCOVERY; AND (5) REQUIRING
ACCOUNTINGS; AND AN ORDER
TO SHOW CAUSE RE
PRELIMINARY INJUNCTION AND
APPOINTMENT OF A
PERMANENT RECEIVER

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1 **I. INTRODUCTION**

2 By its *Ex Parte* Application, Plaintiff Securities and Exchange Commission
3 (“Commission”) seeks a temporary restraining order and other emergency relief to
4 immediately halt an ongoing Ponzi scheme perpetrated by defendants Emvest
5 Mortgage Fund, LLC (the “Fund”), Emvest, Inc., and Milon Lyle Brock
6 (collectively “defendants”).

7 Since 2003, the defendants have engaged in the fraudulent sale of securities
8 in the Fund, making misrepresentations about the use of investor proceeds, the
9 source of returns to investors, and the preservation of investor capital. Through its
10 fraudulent offering, as of August 31, 2004, the defendants had raised \$18 million
11 from 270 investors. For the past two years, the Fund has not generated sufficient
12 revenue to support the payout of the 12% returns that it promised. Instead, the
13 Fund has used capital from new investors to pay returns and cover the Fund’s
14 operating losses. In 2003 and 2004, the Fund used about \$1.5 million of investor
15 capital to pay investor returns and cover losses.

16 Presently, the Fund has no accountants and no financial statements showing
17 the current value of each investor’s capital account. Nor have the defendants
18 properly valued the investors’ capital accounts to reflect the accounts’ reduced
19 value as a result of the use of investor capital to pay returns. Thus, in the past year,
20 those investors who have left the Fund have been overpaid to the detriment of
21 other investors. The defendants’ conduct is ongoing, and if their conduct is not
22 stopped, they will continue to dissipate the investors’ capital by paying returns that
23 exceed the Fund’s earnings.

24 By engaging in this conduct, the defendants have violated, and unless
25 enjoined will continue to violate, the antifraud provisions of the Securities Act of
26 1933 (“Securities Act”), and the Securities Exchange Act of 1934 (“Exchange
27 Act”). Accordingly, the Commission seeks a temporary restraining order and
28 orders freezing the assets and appointing a temporary receiver over and the Fund

1 and Emvest, Inc., prohibiting the destruction of documents, expediting discovery,
2 and requiring accountings. The Commission further seeks an order to show cause
3 regarding the propriety of issuing a preliminary injunction and appointing a
4 permanent receiver to continue the requested relief pending trial.

5 **II. STATEMENT OF FACTS**

6 **A. The Defendants**

7 **Emvest Mortgage Fund, LLC** is a California limited liability company
8 formed in February 2002, with offices in San Diego, California. (Hannan Dec. Ex.
9 8.) From March 2002 through August 2004, the Fund conducted a \$50 million
10 securities offering at \$1,000 per share, promising a 12% return per year. (Hannan
11 Dec. Ex. 8.) The Fund represented that it would use investor capital to make and
12 purchase loans secured by real property in California. (Hannan Dec. Ex. 8, p.
13 139.¹)

14 **Emvest, Inc.** is a California corporation that was formed in October 2001,
15 with offices in San Diego, California. Emvest, Inc. manages the Fund. (Hannan
16 Dec. Ex. 8, p. 137; Sable Dec. Ex. 9, p. 22.) As the manager of the Fund, Emvest
17 controls the selection of the loans and makes decisions regarding the Fund's equity
18 and debt capitalization. (Hannan Dec. Ex. 6, p. 52; Ex. 7, p. 96; & Ex. 8, p. 142.)

19 **Milon Lyle Brock** resides in San Diego, California. Brock founded Emvest,
20 Inc., and is its Chief Executive Officer ("CEO"). (Hannan Dec. Ex. 2 (Canty test.),
21 p. 32:16-23.²) As CEO of Emvest, Inc., Brock manages the Fund. (Hannan Dec.
22 Ex. 1 (Brock test.), pp. 69:23-70:6.) Brock is also the CEO and President of
23 Emerald Bay Financial, Inc. ("EB Financial"), a San-Diego based mortgage broker
24 that sells existing trust deeds to individual trust deed investors. (Hannan Dec. Ex.
25

26 ¹ Evidentiary citations that reference an exhibit number and a page number
27 refer to the page number written on the lower right-hand corner of the exhibit.

28 ² Citations to testimony transcript refer to the name of the witness and the page and
line number of the testimony transcript.

1 1 (Brock test.), pp. 67:17-68:21 & Ex. 2 (Canty test.), pp. 28:4-30:7.) Brock
2 supervised the Fund's monthly operations, signed almost all the Fund's checks,
3 and reviewed the Fund's monthly collections. (See Hannan Dec. Ex. 3 (De Anda
4 test.), pp. 112:2-118:9; see also Bowers Dec. ¶ 11.) Brock was founder and CEO
5 of Emerald Bay Financial, Inc. an affiliate through which the Fund sells some of its
6 loans to individual trust deed investors. (Hannan Dec. Ex. 1 (Brock test.), pp.
7 67:17-69:21.)

8 **B. The Fraudulent Offering**

9 **1. The Offering**

10 In March 2002, the Fund began conducting a \$50 million offering,
11 comprised of 50,000 shares priced at \$1,000 per share. (Hannan Dec. Exs. 6, 7, 8
12 & 1 (Brock test.), pp. 195:20-197:14.) As of August 31, 2004, the Fund had raised
13 about \$18 million from 270 investors. (Bowers Decl. ¶ 13 & Ex. 7.) The
14 prospectus represented that the Fund would pay investors "a 12% per annum
15 priority return on their unreturned original invested capital" on a monthly basis.
16 (Hannan Dec. Ex. 6, pp. 50-51; Ex. 7, pp. 90-91; Ex. 8, pp. 149-50.)

17 The Fund solicited investors through cold calls, radio ads, newspaper ads,
18 and newsletters. (Hannan Dec. Exs. 9, 10 & 11; Hannan Dec. Ex. 2 (Canty test.),
19 pp. 119:19-120:15 & 268:4-270:18; Hannan Dec. Ex. 1 (Brock test.), pp. 224:14-
20 225:8; Hannan Dec. Ex. 5 (Bradley test.), pp. 41:11-42:11.) The Fund also
21 solicited investors through its website, located at www.megayield.com. (Hannan
22 Dec. Ex. 12.)

23 These solicitations claimed that the Fund would use the capital it raised to
24 make and purchase loans, and emphasized that the Fund would pay 12%. (Hannan
25 Dec. Exs. 9 & 10.) Some of the newsletters boasted that current investors were
26 earning 12.5% with "no loss of principal." (Hannan Dec. Exs. 11 & 13.) Emvest's
27 website summarized the Fund's prospectus, touting "a double-digit return" of 12%
28 on the principal investment. (Hannan Dec. Ex. 12, pp. 194-95.) The website also

1 stated that one of the Fund's objectives was to "[p]reserve and return your capital
2 contributions," and that the investment was suitable for IRAs and pension plans
3 that seek "capital preservation." (Hannan Dec. Ex. 12, p. 197.) Brock reviewed
4 and approved most of the solicitations, including the website's content. (Hannan
5 Decl. Ex. 5 (Bradley test.), p. 67:3-13 & Ex. 1 (Brock test.), pp. 237:17-238:13.)

6 **2. The Fund's Use of Capital and Operating Results**

7 Although the Fund used investor capital to make and purchase loans, the
8 Fund did not generate sufficient income to pay the promised 12% to investors, and
9 by 2004, the Fund was a money-losing operation. (*See* Bowers Dec. ¶ 16; *see also*
10 Hannan Dec. Ex. 4 (Levy test.), pp. 80:17-81:23.) Despite this, from July 2002
11 through June 2004, the Fund paid investors a 12.5% return, telling investors it was
12 paying higher returns because the Fund was "outperforming projections." (Sable
13 Dec., Ex. 2, p.13; *see also* Hannan Dec. Ex. 1 (Brock test.), pp. 94:12-20, 95:6-
14 96:14 & Ex. 3 (De Anda test.), p. 112:2-15.)

15 From January through August 2004, the Fund raised \$7.24 million in new
16 investor capital and used \$1.286 million of that new capital to pay returns to
17 existing investors and to cover its operating losses. (Bowers Dec. ¶¶ 14(b)(v), 17
18 & Ex. 11.) Specifically, the Fund's bank records show that from January through
19 August 2004, the Fund had operating revenue of \$1.299 million and operating
20 expenses of \$1.411 million, resulting in a \$112,000 operating loss. (Bowers Dec.
21 ¶¶ 14-16 & Ex. 11.) During this same period, however, the Fund paid investors
22 \$1.174 million – in order to maintain the 12% to 12.5% return. (Bowers Dec. Ex.
23 11.)

24 Similarly, in 2003, the Fund used \$323,766 of new investor capital to pay
25 distributions to existing investors. According to the Fund's 2003 tax return, the
26 Fund had gross operating income of \$770,661 and operating expenses of \$185,965,
27 resulting in a \$584,696 operating profit. (Bowers Dec. ¶¶ 6-8.) The Fund,
28 however, paid a total of \$908,462 in investor returns. (Bowers Dec. ¶ 9; *see also*

1 Hannan Dec. Ex. 4 (Levy test.), pp. 80:17-81:23.) The Fund, therefore, used more
2 than \$300,000 of investor capital to pay the investor returns. (See Bowers Dec. ¶
3 10; see also Hannan Dec. Ex. 15, Ex. 1 (Brock test.), pp. 90:8-91:10, Ex. 4 (Levy
4 test.), pp. 199:7-201:9.)

5 Not only have the defendants dissipated investor capital, but they also have
6 knowingly failed to properly value the investors' capital accounts, so that they
7 reflect the reduction of their capital. On August 16, 2003, the Fund's accountants
8 told Brock that the Fund's 12.5% payments to investors had "been in excess of the
9 actual earnings of the fund," and that those investors who had left the fund
10 "received distributions in excess of their actual capital accounts."³ (Hannan Dec.
11 Ex. 15; Hannan Dec. Ex. 4 (Levy test.), pp. 86:4-87:14, 200:6-202:23.) The
12 accountants advised Brock that he needed to "address the calculation as to how
13 investors are paid out when leaving the fund *before making any further*
14 *distributions.*" (Hannan Dec. Ex. 15 (emphasis added).) Brock ignored the
15 accountants and continued to pay investors 12.5%. (Hannan Dec. Ex. 4 (Levy
16 test.), p. 203:3-22.)

17 Seeing that there had been no change, in January or February 2004, the
18 Fund's accountants again raised the problem with Brock. (Hannan Dec. Ex. 4
19 (Levy test.), p. 205:4-20.) Although Brock understood the problem, he did not
20 indicate that he would change anything. (Hannan Dec. Ex. 4 (Levy test.), pp.
21 205:21-206:15.) Indeed, Brock continued to offer and sell the Fund's securities,
22 continued to pay distributions that exceeded the Fund's earnings, and continued to
23 improperly value the investors' capital accounts. (Hannan Dec. Ex. 1 (Brock test.),
24 pp. 94:12-20, 95:6-20 & Exs. 9, 10, 12 & 13.)

26 ³ The accountants to the Fund and Emvest, Inc. not only discussed the issue
27 with Brock, but also memorialized the discussion in an August 16, 2003
28 memorandum. (Hannan Dec. Ex. 4 (Levy test.), p. 199:16-200:5; Hannan Dec. Ex.
15.)

1 Moreover, at this point, the Fund has no financial statements showing the
2 current value of each investor's capital account. (Hannan Dec. ¶ 22.) The Fund
3 does not calculate monthly profits and losses. (Hannan Dec. Ex. 3 (De Anda test.),
4 pp. 117:5-118:19.) Rather, each month, Brock reviews the loan portfolio's
5 earnings and instructs the bookkeeper to send investors their monthly distribution
6 checks. (Hannan Dec. Ex. 3 (De Anda test.), pp. 112:2-118:19.) Although the
7 Fund's accountants prepared financial statements for 2003, the accountants
8 resigned in 2004. (See Hannan Dec. ¶ 22 & Ex. 3 (De Anda test.), p. 122:11-18.)
9 Since then, the defendants have either been unwilling or unable to hire new
10 accountants, and the Fund continues to operate without financial statements. (See
11 Hannan Dec. ¶ 22.)

12 **3. Misrepresentations and Omissions**

13 Since 2003, the defendants have fraudulently offered and sold securities in
14 the Fund. The defendants have misrepresented that (1) a substantial amount of
15 investor proceeds would be used to make and purchase loans secured by real
16 property; (2) the Fund would not pay finder's fees or commissions to Fund
17 affiliates; (3) the Fund would pay investors a 12% return on their capital; and (4)
18 an objective of the Fund was to preserve investors' capital.

19 First, the defendants misrepresented how the Fund would use investor
20 proceeds. Under the heading "Use of Proceeds," the Fund's Prospectus states:
21 "The net proceeds from the sale of Shares [in the Fund] after payment of sales
22 commissions of four percent (4%) of the gross offering proceeds and of
23 approximately \$7,500 of other offering costs will principally be used for the
24 funding or acquisition of Loans." (Hannan Dec. Ex. 8, p. 145.) This statement
25 leads investors to believe that more than 95% of the money raised will be used to
26 make or purchase loans. The prospectus omitted to state that a substantial portion
27 of investor proceeds would be used to pay returns to other investors. In fact, in
28 2004, the defendants used approximately 18% of the \$7.24 million of capital they

1 raised to pay distributions to existing investors and cover the Fund's operating
2 losses. (See Bowers Dec. ¶¶ 15(b)(v) & 17 (the Fund raised \$7.24 million from
3 January through August 2004; the Fund used \$1.285 million of new investor
4 capital to pay returns).)

5 Second, the defendants falsely represented that the Fund would not pay
6 finder's fees or commissions to Fund affiliates. The Fund's prospectus states that
7 "affiliates of [Emvest] may receive loan origination, broker's, finder's and/or other
8 fees *from third-parties (but not the Company)* in connection with the acquisition
9 and/or disposition of assets comprising the [Fund's] Loan Portfolio, and may also
10 receive directly from the [Fund] Servicing Fees for servicing the [Fund's] Loans."
11 (Hannan Dec. Ex. 8, p. 151 (emphasis added).) Despite this prohibition, in May
12 and June of 2004, the Fund paid a total of \$243,719.47 in finder's fees or
13 commissions to EB Financial, which is an affiliate of Emvest. (Hannan Dec. ¶ 20
14 & Ex. 16; *see also* Hannan Dec. Ex. 3 (De Anda test.), pp. 76:12-77:7, 78:16-79:8,
15 82:6-85:11 & 92:5-93:2.) Brock was aware that these commissions were being
16 paid because he instructed the Fund's bookkeeper to write the checks and then
17 signed them. (See Hannan Dec. Ex. 16; *see also* Hannan Dec. Ex. 3 (De Anda
18 test.), pp. 82:6-85:11.)

19 Third, in offering and selling the Fund's securities, the defendants
20 misrepresented that the Fund would pay investors 12% returns on their
21 investments. (See Hannan Dec. Ex. 8, p. 138.) These representations were
22 misleading because they did not disclose that all or a substantial portion of the
23 return on their investment was funded with investor capital. (See Bowers Dec. ¶¶
24 10, 17; *see also* Hannan Dec. Ex. 15, Ex. 1 (Brock test.), pp. 90:8-91:10, Ex. 4
25 (Levy test.), pp. 199:7-201:9.)

26 Fourth, the defendants falsely represented that the Fund's objective was to
27 preserve the investors' capital contribution. (Hannan Dec. Ex. 12, p. 197; *see also*
28 Sable Dec. Ex. 10, p. 24 & Ex. 13, pp. 28-29.) These representations were false.

1 Brock knew that the Fund was decreasing the investors' capital accounts by
2 distributing more money than it earned in 2003 and 2004. (Hannan Dec. Ex. 15 &
3 Ex. 4 (Levy test.), pp. 200:6-205:20.) Nevertheless, until at least April 2004, and
4 some time after, the Fund's website continued to state that one of the Fund's
5 objectives was to preserve capital. (Hannan Dec. Ex. 15.)

6 **4. The Ongoing Fraud**

7 The fraudulent conduct is ongoing. There are still 270 investors in the Fund,
8 which is expected to remain in existence until 2008, and the defendants continue to
9 dissipate Fund assets by using new investor money to pay monthly distributions of
10 12%. (See Hannan Dec. Ex. 1 (Brock test.), pp. 20:20-21:4; see also Bowers Dec.
11 ¶ 13 & Exs. 6 & 7.) Meanwhile, the defendants continue to send investors
12 misleading information, claiming that the Fund is successful. (See, e.g., Sable Dec.
13 Ex. 16, p. 33.)

14 For example, in June 2004, the Fund lowered its distributions from 12.5% to
15 12%. (Sable Dec., Ex. 12, p. 26.) In doing so, the Fund did not disclose that the
16 Fund was not earning enough to pay even the 12% return. Instead, the August
17 2004 monthly newsletter, which was sent to investors with their checks, stated:
18 "We have set the monthly distribution at 12% and are confident it will continue for
19 the foreseeable future . . ." (Sable Dec., Ex. 12, p. 26.) There is no basis for the
20 statement that 12% distributions should continue for the foreseeable future because
21 the Fund has continued to lose money in 2004, the Fund has no current financial
22 statements, and the Fund does not calculate monthly profits and losses. (See
23 Bowers Dec. ¶ 16; Hannan Dec. ¶ 22 & Ex. 3 (De Anda Test.), pp. 117:5-110:9.)
24 Investors are not aware that the distribution checks include a return of investor
25 capital.⁴ (See Sable Dec. Ex. 1, p. 5; see also Hannan Dec. Ex. 17 (investor
26

27 ⁴ The defendants sent investors copies of I.R.S. Schedule K-1, the federal tax
28 form showing a partner's share of income, deductions, etc. (See, e.g., Hannan Dec.
Ex. 18.) By reviewing a K-1, it is possible to see the reduction of an investor's

1 questionnaires); Hannan Dec. Ex. 3 (De Anda test.), pp. 95:7-10, 122:5-10.)

2 Moreover, in April 2004, the defendants announced the creation of a new
3 mortgage investment fund, providing another vehicle through which the defendants
4 may commit fraud. (See Sable Dec. Ex. 17, p. 35.) By June 2004, Brock began
5 soliciting investments in Emvest Mortgage Fund II, LLC ("Fund II"), claiming that
6 the Fund II will pay investors "a 9.9% per annum priority return on their
7 unreturned original invested capital" on a monthly basis. (See Hannan Dec. Ex.
8 20; see also Sable Dec. Ex. 17, p. 35.) Emvest, Inc. also manages Fund II.
9 (Hannan Dec. Ex. 1 (Brock test.), p. 30:22-24.) Given the Fund's operating losses
10 in 2004, it is unlikely that Fund II will generate enough revenue to pay a 9.9%
11 return.

12 **III. ARGUMENT**

13 **A. The Court Should Issue a Temporary Restraining Order** 14 **Prohibiting Violations of the Federal Securities Laws**

15 **1. Special Standards Apply to the Commission's Application**

16 Section 20(b) of the Securities Act, 15 U.S.C. § 77t(b), and Section 21(d) of
17 the Exchange Act, 15 U.S.C. § 78u(d), provide that the Commission may obtain a
18 permanent or temporary injunction or a restraining order without a bond upon a
19 proper showing. See *SEC v. Wencke*, 622 F.2d 1363, 1375 (9th Cir. 1980). To
20 obtain such relief, the Commission must merely show: (1) a *prima facie* case that
21 a violation of the securities laws has occurred; and (2) a reasonable likelihood that
22 the violation will be repeated. See, e.g., *SEC v. Unique Fin. Concepts, Inc.*, 196
23 F.3d 1195, 1199 n.2 (11th Cir. 1999); *SEC v. Unifund SAL*, 910 F.2d 1028, 1037
24

25 capital account. When the defendants sent investors their K-1s, however, they
26 included a letter that claimed the Fund was "continuing to generate returns above
27 12%." (Hannan Dec. Ex. 19.) In light of investor statements that they were not
28 told they were being paid a return of their capital (see Sable Dec. Ex. 1, p. 5; see
also Hannan Dec. Ex. 17), and the misleading letter that accompanied the K-1s, the
defendants did not adequately disclose how the Fund was performing.

1 (2d Cir. 1990); *SEC v. United Fin. Group*, 474 F.2d 354, 358-59 (9th Cir. 1973).

2 The Commission appears before this Court “not as an ordinary litigant, but
3 as a statutory guardian charged with safeguarding the public interest in enforcing
4 the securities laws.” *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d
5 Cir. 1975). The need for temporary relief is of great importance when, as here, the
6 Commission acts to protect the public interest and the investing public. “[W]hen
7 ‘the public interest is involved in a proceeding of this nature, [the district court’s]
8 equitable powers assume an even broader and more flexible character than when
9 only a private controversy is at stake.’” *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th
10 Cir. 1989) (quoting *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1112 (9th Cir. 1982)).

11 For this reason, when seeking a temporary restraining order or other pretrial
12 relief, the Commission faces a lower burden than a private civil litigant does.
13 Unlike private litigants, the Commission does not need to show a risk of
14 irreparable injury or a balance of equities to establish its need for injunctive relief.
15 See *SEC v. Unifund SAL*, 910 F.2d at 1036-37 (in discharging its statutory
16 responsibilities, Commission is relieved of burden of showing risk of irreparable
17 injury). Therefore, once the Commission meets its burden, a temporary restraining
18 order and preliminary injunction should be granted. As explained below, the
19 evidence submitted by the Commission in this case establishes that the defendants
20 are violating the federal securities laws, and that it is likely that they will continue
21 to do so unless they are enjoined.

22 **2. Defendants Have Violated the Antifraud Provisions of the**
23 **Federal Securities Laws**

24 Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), prohibits fraud in the
25 offer and sale of securities. Similarly, Section 10(b) of the Exchange Act, 15
26 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, prohibit fraud
27 in connection with the purchase or sale of any security.

28 ///

1 a) **Defendants Made Misrepresentations and Omissions**
2 **of Material Facts**

3 The defendants violated the antifraud provisions of the federal securities
4 laws by misrepresenting material facts to investors. A fact is material if there is a
5 substantial likelihood a reasonable investor would consider it significant in making
6 an investment decision. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988);
7 *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

8 The defendants have made the following misrepresentations: (1) that
9 investor proceeds would be used to make and purchase loans secured by real
10 property; (2) that the Fund would not pay finder's fees or commissions to Fund
11 affiliates; (3) that the Fund would pay investors a 12% return on their capital; and
12 (4) that the Fund's objective included preserving investors' capital. None of these
13 statements were true. As previously discussed, substantial portions of investor
14 proceeds have been used to pay returns to other investors. In 2004, about 18% of
15 the capital that the Fund raised, totaling \$1.285 million, was used to pay returns
16 and cover the Fund's operating losses. (*See also supra* Section II.B.3) Because
17 the defendants used investor capital to pay investor returns, the investors' capital
18 has not been preserved. Moreover, despite the prohibition on paying commissions
19 to affiliates, in May and June of 2004, the Fund paid almost \$245,000 in
20 commissions and finder's fees to one of its affiliates, EB Financial. (*See supra*
21 Section II.B.3.)

22 These misrepresentations and omissions are material because reasonable
23 investors would attach significance to the fact that their funds were not being used
24 as represented, and that a large portion of the distributions they were being paid
25 was not generated by trust deed investments, but instead was investor capital.

26 b) **Defendants Acted With Scienter**

27 The defendants have acted with the scienter necessary to establish violations
28 of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and

1 Rule 10b-5. *Aaron v. SEC*, 446 U.S. 680, 701-02 (1980). Scierer is a “mental
2 state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst v.*
3 *Hochfelder*, 425 U.S. 185, 193 n.12 (1976). In the Ninth Circuit, scierer may be
4 established by a showing of recklessness. *SEC v. Dain Rauscher, Inc.*, 254 F.3d
5 852, 856 (9th Cir. 2001). Proof of recklessness may be inferred from
6 circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-
7 91 n.30 (1983) (“proof of scierer required in fraud cases is often a matter of
8 inference from circumstantial evidence”).

9 Brock, and through him the Fund and Emvest, have acted with scierer.⁵
10 Brock knew, or was reckless in not knowing, that the representations the Fund
11 made regarding returns was false. Brock knew what representations were being
12 made to the public. He helped draft, review, and approve the Fund’s prospectus.
13 (Hannan Dec. Ex. 1 (Brock test.), pp. 83:11-84:21; Canty p. 108:19-24) Brock
14 also reviewed the most of the newsletters and solicitations before they were
15 published. (Hannan Dec. Ex. 1 (Brock test.), pp. 237:17-238:13.) Moreover,
16 because Brock was responsible for the Fund’s operations and wrote most of its
17 checks, Brock knew, or should have known that the Fund was not generating
18 enough operating income to cover the 12% to 12.5% returns it was paying. (See
19 Bowers Dec. ¶ 11 (Brock signed most of the checks).) Brock certainly knew the
20 representations were false by August 2003, when the Fund’s accountants told
21 Brock that the Fund was paying more in returns than it was earning, that the Fund
22 was not properly administering the investors’ capital accounts, and that investors
23 who were leaving the Fund were overpaid to the detriment of other investors. (See
24 *supra* Section II.B.2.) Brock nevertheless continued to offer and sell the Fund’s
25 securities, continued to pay 12.5% and 12% returns, and took no steps to properly
26

27 ⁵ Brock’s scierer is imputed to the defendant entities because Brock was in
28 control of and managed the Fund and Emvest, Inc. See *SEC v. Manor Nursing
Centers, Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

1 adjust the Fund's books and records to show the actual amounts in the investors'
2 capital accounts. (See, e.g., Sable Dec. Exs. 15, 16 & 17.)

3 **3. There is a Reasonable Likelihood That the Defendants Will**
4 **Continue Their Fraudulent Scheme Unless Enjoined**

5 To obtain an injunction, the Commission only needs to show that there is a
6 reasonable likelihood of future violations. See *SEC v. Murphy*, 626 F.2d 633, 655
7 (9th Cir. 1980) (Commission has "burden of showing there [is] a reasonable
8 likelihood of future violations of the securities laws"); *SEC v. United Fin. Group,*
9 *Inc.*, 474 F.2d at 358-59. Whether a likelihood of future violations exists depends
10 on the totality of the circumstances. See *SEC v. Murphy*, 626 F.2d at 655 (courts
11 must assess "totality of the circumstances" surrounding defendant and his
12 violations); *SEC v. Fehn*, 97 F.3d 1276, 1295-96 (9th Cir. 1996). The existence of
13 past violations may give rise to an inference that there will be future violations.
14 See *SEC v. Murphy*, 626 F.2d at 655; see also *United States v. Odessa Union*
15 *Warehouse Coop*, 833 F.2d 172, 176 (9th Cir. 1987) (citing *SEC v. Koracorp*
16 *Indus., Inc.*, 575 F.2d 692, 698 (9th Cir. 1978)).

17 The key factor to be considered is the past illegal conduct of the defendant,
18 from which the Court may infer a likelihood of future violations. See *United States*
19 *v. Odessa Union Warehouse Co-op*, 833 F.2d at 176 (citing *SEC v. Koracorp.*
20 *Indus., Inc.*, 575 F.2d 692, 298 (9th Cir. 1978)). Indeed, in *United States v. Nutri-*
21 *Cology, Inc.*, 982 F.2d 394 (9th Cir. 1992), the Ninth Circuit held that where the
22 public interest is at stake, "an injunction [is] authorized solely upon a showing of a
23 statutory violation." 982 F.2d at 398. Courts also consider factors such as the
24 degree of scienter involved; the isolated or recurrent nature of the violative
25 conduct; the defendant's recognition of the wrongful nature of the conduct; the
26 likelihood that, because of the defendant's occupation, future violations may occur;
27 and the sincerity of the defendant's assurances (if any) against future violations.
28 See, e.g., *SEC v. Murphy*, 626 F.2d at 655.

1 Injunctive relief is appropriate here because defendants have committed
2 securities fraud.⁶ They have made material misrepresentations and omissions
3 concerning the use of investor proceeds, the payment of commissions to affiliated
4 entities, and the preservation of investor capital. The defendants have acted with a
5 high degree of scienter because more than a year after the accountants warned
6 Brock that the Fund was not covering the payments it was making to investors and
7 that the Fund should track capital accounts, Brock has continued have the Fund
8 pay returns of at least 12% and has not properly tracked investors' capital
9 accounts. The conduct is not isolated; it has continued for almost two years now
10 and has involved hundreds of investors. Moreover, with the solicitation of
11 investors in Fund II, Brock has provided another vehicle for future violations to
12 occur. On this record, injunctive relief is appropriate.

13 **B. The Court Should Immediately Freeze the Fund's and Emvest,**
14 **Inc.'s Assets in Order to Protect Investor Funds**

15 Federal courts have inherent equitable authority to issue a variety of
16 ancillary relief measures in Commission injunctive actions. *SEC v. Wencke*, 622
17 F.2d at 1369. Included in these powers is the authority to freeze assets of both
18 parties and non-parties. *SEC v. Hickey*, 322 F.3d 1123, 1131 (9th Cir. 2003); *SEC*
19 *v. International Swiss Invs. Corp.*, 895 F.2d 1272, 1276 (9th Cir. 1990). Courts
20

21 ⁶ This is not the first time that Brock has had trouble with his businesses.
22 Brock held a California real estate sales license from 1973 until 1980 and a real
23 estate broker's license from 1980 until 1996. (Hannan Dec. Ex. 21.) In 1984,
24 Brock's broker license was suspended for 30 days, as a result of a trust account
25 violation. (Hannan Dec. Ex. 1 (Brock test.), pp. 58:10-60:8.) Then, in 2000,
26 Brock civilly settled an action filed by the San Diego District Attorney's Office
27 relating to Brock's activities as a mortgage broker. (Hannan Dec. Exs. 21 & 1
28 (Brock test.), pp. 56:13-58:7.) Without admitting wrongdoing, Brock agreed to
reconvey a deed of trust and released the trustor from any claims, was prohibited
from improperly recording liens and from obtaining a real estate broker or sales
license for two years, and was required to complete 50 hours of community
service. (Hannan Dec. Ex. 21.)

1 use freeze orders to prevent waste and dissipation of assets and to ensure their
2 availability for disgorgement for the benefit of victims of the fraud. *See, e.g., SEC*
3 *v. Hickey*, 322 F.3d at 1132 (affirming imposition of asset freeze over nonparty
4 brokerage firm to effectuate disgorgement order against defendant); *FTC v. H.N.*
5 *Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir. 1982); *SEC v. Manor Nursing Centers*,
6 458 F.2d at 1105-06. Indeed, the Ninth Circuit has found that “the public interest
7 in preserving the illicit proceeds [of a defendant’s fraud] for restitution is great.”
8 *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir. 1999).

9 To obtain an asset freeze, the Commission need only establish the mere
10 possibility that dissipation of assets exists. *FSLIC v. Sahni*, 868 F.2d 1096, 1097
11 (9th Cir. 1989) (citing *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1112 (9th Cir.
12 1982)). It is unnecessary for the Court to find that a dissipation of funds is likely.
13 *Id.* Here, more than a mere possibility of dissipation exists. The Fund has been
14 dissipating assets for the past two years, despite warnings by the Fund’s
15 accountants in August 2003 and in early 2004. Not only have the defendants
16 continued to use investor capital to pay the returns to investors, and thereby further
17 deplete investors’ capital accounts, the defendants have not kept adequate books
18 and records. This inadequate bookkeeping has allowed some investors to
19 withdraw more than they should have been allowed – thus, further dissipating the
20 assets of others. Without an asset freeze, the defendants will likely continue to
21 dissipate the Fund’s assets by paying excessive returns, and by allowing some
22 investors to withdraw more capital than should be in their capital accounts.

23 **C. Appointment of a Receiver is Necessary and Appropriate**

24 It is necessary and appropriate to appoint a receiver over the assets of the
25 Fund and Emvest, Inc. The Court has broad discretion to appoint an equity
26 receiver in Commission enforcement actions. *SEC v. Wencke*, 622 F.2d at 1365.
27 The appointment of a receiver is appropriate to “marshal and preserve [assets]
28

1 against further misappropriation and dissipation.”⁷ *Id.* at 1372. Factors such as
2 the integrity of management and the likelihood of future misuse of assets are
3 critical in determining whether a receiver should be appointed. *See SEC v. Fifth*
4 *Ave. Coach Lines, Inc.*, 289 F. Supp. 3, 42 (S.D.N.Y. 1968).

5 Here a receiver is necessary and appropriate. First, based on the fraudulent
6 conduct of the defendants, and their mismanagement of the Fund, it would be
7 inappropriate to place faith in management’s integrity. Second, if Brock or his
8 subordinates continue to control the disposition of the Fund’s or Emvest, Inc.’s
9 assets, there will likely be a “run on the bank,” with investors seeking to withdraw
10 their investments in the Fund. Given the poor quality of the books and records at
11 the Fund and Emvest, Inc., it is likely that, as in the past, preferential distributions
12 will occur and some investors will withdraw a disproportionate share of the
13 remaining assets in the Fund. A receiver is therefore needed to ensure that the
14 distribution of client funds is handled equitably, orderly, and promptly.

15 **D. Orders Prohibiting the Destruction of Documents, Expediting**
16 **Discovery, and Requiring Accountings Are Necessary and**
17 **Appropriate**

18 The Court’s broad equitable powers in Commission enforcement actions
19 include the ability to order ancillary relief to require an accounting and prohibit
20 document destruction. *SEC v. Wencke*, 622 F.2d at 1369; *SEC v. International*
21 *Swiss Invs. Corp.*, 895 F.3d at 1276. Accountings are particularly appropriate here
22 because investor principal may have been used to pay purported returns.
23 Accordingly, it is necessary to identify all available assets to help ensure that funds
24

25 ⁷ A receiver is not required to post a bond in Commission actions because
26 such a bond could further deplete the resources available to investors and other
27 creditors. *See SEC v. Universal Fin.*, 760 F.2d 1034, 1039 (9th Cir. 1985) (“[i]n
28 our view, the main effect of requiring such a bond would be to deplete further the
resources available to investors and others with an interest in the receivership
estate”).

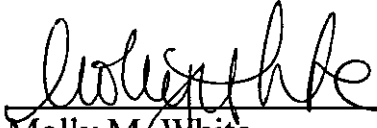
1 and assets are frozen properly and to satisfy any future order of disgorgement
2 against the defendants. An order prohibiting the destruction of documents is
3 necessary because of the possibility that the defendants will destroy evidence of
4 their violations.

5 Expedited discovery is authorized by Rules 30, 33, and 34 of the Federal
6 Rules of Civil Procedure, and by a court's broad equitable powers in Commission
7 enforcement actions to order all necessary ancillary relief. *See SEC v. Wencke*,
8 622 F.2d at 1369. The Commission seeks expedited discovery to develop
9 additional evidence regarding the defendants' wrongdoing with respect to the
10 Fund, and possibly with respect to the Fund II, and to ensure that any asset freeze
11 is fully implemented. The Commission has brought this action expeditiously to
12 immediately halt the ongoing fraudulent scheme and has not had an opportunity to
13 subpoena all relevant documents nor examine all persons who have essential
14 information, such as additional evidence regarding the defendants' fraudulent
15 conduct. Accordingly, the Court should grant expedited discovery.

16 **IV. CONCLUSION**

17 For the foregoing reasons, the Commission respectfully requests that the
18 Court grant the requested relief and order a temporary restraining order and orders
19 freezing assets, appointing a temporary receiver over the assets of the Fund and
20 Emvest, Inc., prohibiting the destruction of documents, expediting discovery, and
21 requiring accountings. The Commission also respectfully requests that the Court
22 issue an order to show cause regarding a preliminary injunction and the
23 appointment of a permanent receiver.

24
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