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12
 13 **UNITED STATES DISTRICT COURT**
 14 **CENTRAL DISTRICT OF CALIFORNIA**

15 SECURITIES AND EXCHANGE
 16 COMMISSION,

17 Plaintiff,

18 vs.

19 DIVERSIFIED LENDING GROUP, INC.;
 APPLIED EQUITIES, INC.; and BRUCE
 20 FRIEDMAN;

21 Defendants,

22 and

23 TINA M. PLACOURAKIS,

24 Relief Defendant.

Case No.

**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
 RECEIVER, (3) PROHIBITING THE
 DESTRUCTION OF DOCUMENTS,
 (4) GRANTING EXPEDITED
 DISCOVERY, AND (5) REQUIRING
 ACCOUNTINGS; AND 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 halt the fraudulent sale of securities by defendants Diversified Lending Group, Inc.
5 (“DLG”), Applied Equities, Inc. (“AEI”), and Bruce Friedman (“Friedman”)
6 (collectively, “the defendants”). The defendants have raised approximately \$216
7 million from hundreds of investors nationwide since at least January 2004 through an
8 ongoing fraudulent scheme. The defendants offer and sell securities in the form of
9 one or five year “Secured Investment Notes” (the “Notes”) representing that DLG
10 pools investor money and invests it 70%-80% in real estate property and 20%-30% in
11 mortgage lending.

12 In fact, the defendants did not invest DLG investor proceeds as represented.
13 They instead diverted a substantial amount of investor money to undisclosed business
14 ventures or investments unrelated to real property or mortgage lending, including
15 Friedman’s charitable foundation, equity securities, and businesses operated by
16 affiliates and Friedman’s family members and friends.

17 Additionally, Friedman has been misappropriating millions of dollars from
18 DLG for his personal use. Of the approximately \$216 million raised from investors
19 since 2004, Friedman misappropriated at least \$17 million to support his lavish
20 lifestyle, including purchases of luxury homes, cars, vacations, jewelry, and designer
21 clothing and accessories.

22 By engaging in this conduct, the defendants have violated, and unless
23 enjoined will continue to violate, the antifraud provisions of Section 17(a) of the
24 Securities Act of 1933 (“Securities Act”), 15 U.S.C. § 77q(a), and Section 10(b) of
25 the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78j(b), and
26 Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. Accordingly, the Commission
27 seeks temporary, preliminary, and permanent injunctions enjoining each of the
28 defendants from violating the above antifraud provisions; a temporary restraining

1 order and preliminary injunction freezing the assets of each of the defendants and
2 relief defendant Tina M. Placourakis (“relief defendant Placourakis”) and
3 prohibiting them from destroying documents; appointment of a receiver over
4 defendants DLG and AEI, their subsidiaries and affiliates; expedited discovery; and
5 an order that the defendants provide accountings. The Commission further seeks
6 an order to show cause why a preliminary injunction should not be granted and a
7 permanent receiver appointed.

8 The Commission requests, pursuant to Fed. R. Civ. P. 65(b) and Local Rules
9 7-19, 7-19.2 and 65-1, that the Court consider its *Ex Parte* Application for
10 emergency relief without prior notice to the defendants, in order to prevent further
11 dissipation of investor funds and other assets by the defendants before the
12 Commission’s Application is considered.

13 For these reasons, and as explained in more detail below, the Commission’s
14 *Ex Parte* Application should be granted.

15 **II. STATEMENT OF FACTS**

16 **A. The Defendants**

17 **Diversified Lending Group, Inc.** is a closely held California corporation,
18 with its principal place of business in Sherman Oaks, California. (Declaration of
19 Melissa Grant (“Grant Declaration”) ¶ 5.) Neither DLG nor its securities is
20 registered with the Commission. (*See id.*) DLG is licensed by the California
21 Department of Real Estate. (*See id.*)

22 **Applied Equities, Inc.** is a California corporation and wholly-owned
23 subsidiary of DLG, with its principal place of business in Sherman Oaks,
24 California. (Grant Declaration ¶ 6.) AEI is not registered with the Commission.
25 (*See id.*) It is licensed by the California Department of Insurance. (*See id.*)

26 **Bruce Friedman**, age 59, resides in Los Angeles County, California. (Grant
27 Declaration ¶ 7.) He is the president, CEO, and sole shareholder of DLG, and
28 through DLG controls AEI. (*See id.*) Friedman was a real estate broker licensed

1 by the California Department of Real Estate, but that license expired in 2000. (*See*
2 *id.*) Friedman is not registered with the Commission. (*See id.*) In 1981, Friedman
3 was convicted by the State of California for grand theft of personal property and
4 was incarcerated for 23 months. (*See id.*)

5 **B. The Relief Defendant**

6 **Tina M. Placourakis**, age 49, resides in Scottsdale, Arizona. (Grant
7 Declaration ¶ 8.) Investor funds were transferred to an account controlled jointly
8 by Placourakis and Friedman. (Declaration of Nina Y. Yamamoto (“Yamamoto
9 Declaration”) ¶ 11.)¹

10 **C. The Fraudulent Scheme**

11 **1. The Secured Investment Notes and Solicitation of Investors**

12 Friedman formed DLG, a purportedly income-producing “scratch and dent”
13 (*i.e.*, damaged and distressed) real estate business, in May 2004 and acquired AEI
14 as its wholly-owned subsidiary shortly thereafter. (Grant Declaration ¶ 27.) The
15 defendants describe DLG as a “boutique mortgage banking firm with more than 80
16 years experience,” and AEI as DLG’s investment servicing division. (*See id.*) The
17 defendants represent that DLG sells Secured Investment Notes (the “Notes”) to
18 generate proceeds for DLG’s so-called “investment pool,” which purportedly
19 reinvests those funds in real estate and mortgage lending ventures. (*See id.*)
20 Investors have the option of loaning DLG money through one-year or five-year
21 Notes. (*See id.*) DLG promises to repay investors their principal and guarantees
22 that investors will receive an additional rate of return of either 9% or 12% per
23 month. (*See id.*)

24 The defendants sold the Notes through a nationwide network of insurance
25 agents and unregistered salespeople (the “Agents”). (Grant Declaration ¶ 21.) AEI
26

27 ¹ Ms. Yamamoto is a certified public accountant employed by the
28 Commission. (Yamamoto Declaration ¶ 1.) Ms. Yamamoto reviewed records
produced to the Commission during its investigation from Wells Fargo Bank and
Merrill Lynch. (*Id.* ¶¶ 4, 5.)

1 contracted with the Agents to offer and sell the Notes in exchange for various sales
2 commissions. (*See id.* ¶¶ 24-26.) The defendants represented to state securities
3 regulators that they trained the Agents (indeed, Friedman personally trained many
4 of the Agents) in DLG's business and carefully controlled what representations the
5 Agents made to prospective investors about DLG and the Notes. (*See id.*) Using
6 PowerPoint presentations that the defendants had pre-approved, the Agents
7 represented to prospective investors at workshops, seminars, and meetings that any
8 proceeds from the Notes would be reinvested in real estate and mortgage loans and
9 that DLG guaranteed investors' principal and 9% or 12% rates of return. (*See id.* ¶
10 24.) The Agents also represented that investors could cash out the Notes upon
11 written demand. (*See id.* ¶ 26.)

12 The Agents provided potential investors a "Welcome Packet," which was
13 created and maintained by the defendants. (Grant Declaration ¶ 26, Exs. 5, 8, &
14 11-13.) The packet included DLG's Information Circular (which appears to be the
15 functional equivalent of a private placement memorandum), a pamphlet about
16 DLG, an investor application, and two of DLG's most recent monthly investment
17 pool newsletters. (*See id.* ¶ 26.) Significantly, the Welcome Packet materials
18 repeat the Agent's representations concerning DLG's use of investor proceeds and
19 the Notes' safety and profitability. (*See id.*) For example, the Information Circular
20 states that DLG "invest[s] substantially all of [its] net investable funds and
21 distribution reinvestments in mortgage loans and real property." (*See id.* ¶ 27, Exs.
22 3-6.) The Information Circular further states that DLG's primary objectives are to
23 "preserve your investment" and to provide cash distributions from the rental
24 income earned from DLG properties and the interest income earned from DLG's
25 mortgage loans. (*See id.*) In addition, while DLG provided investors with
26 purportedly "audited" financial statements, DLG's auditor does not appear to be
27 licensed by any state, is not registered with the PCAOB, and has just one employee
28 who is also not licensed. (*See id.* ¶ 19.)

1 Once investors invested in the Notes, the defendants continued to represent to
2 them their money was being used as represented and that their investments were
3 profitable and safe. First, the defendants sent investors account statements on at
4 least a quarterly basis, which set forth investors' year-to-date account balances and
5 interest payments. (Grant Declaration ¶ 27.) Second, the defendants sent DLG
6 investors a monthly investor mailing that recited DLG's purported three-fold
7 investment philosophy of: (1) "[p]reservation of our investors' capital";
8 (2) "[d]elivering absolute returns;" and (3) "[h]aving lower volatility than major
9 traditional indices." (*See id.*) DLG's monthly mailing also reported DLG's assets
10 under management and year-to-date gain. DLG's most recent monthly mailing,
11 dated December 31, 2008, reported \$659.3 million in assets under management and
12 a 23.34% year-to-date gain. (*See id.* ¶ 31.) These purported gains appear highly
13 suspect given recent market conditions and investor complaints that DLG is
14 unwilling or unable to return their money. (*See id.* ¶ 32, Ex. 12.)

15 **2. The Defendants Falsely Represented that Investor Proceeds**
16 **Would Be Used to Invest in Real Estate and Mortgage Loans**

17 Both orally and in written DLG materials, the defendants represented that
18 investor proceeds would be used for real property and mortgage loans. First, the
19 defendants trained the Agents to represent orally to prospective investors that DLG
20 investor proceeds would be used for these purposes. (Grant Declaration ¶¶ 24, 26.)
21 Second, through written materials created and maintained by the defendants and
22 distributed by the Agents, the defendants again represented to investors that their
23 money would be pooled and invested in real estate or mortgage loans. (*See id.* ¶
24 27.) Specifically, the Information Circular that investors receive before investing
25 states – under the heading “**OUR BUSINESS STRATEGY**” – that:

26 [DLG] will seek to invest substantially all of our net investable funds
27 and distribution reinvestments in real property and mortgage loans,
28 after paying applicable fees and expenses. The allocation of our

1 investments between real property and mortgages will be at the
2 discretion of our Manager depending on the amounts available for
3 investments and investment opportunities. We anticipate investing
4 approximately 70% of our net investable funds in real property and
5 30% in mortgage loans. (Grant Declaration ¶ 16, Ex. 6.)

6 The Information Circular reiterates DLG's purported intent to invest 70% of
7 investor proceeds in real estate and 30% in mortgage loans under headings entitled
8 **"REAL ESTATE PROGRAM OBJECTIVES"** and **"MORTGAGE PROGRAM**
9 **OBJECTIVES."** (*See id.*) The Information Circular further represents that the
10 purpose behind DLG's investment strategy of 70% in real estate and 30% in loans is
11 to meet its principal investment objectives of: (1) protecting investors' principal
12 ("[p]reserv[ing] your capital contributions") and (2) making profits on the
13 investments that are then provided to investors ("[p]rovid[ing] cash distributions
14 from the net income earned on our properties [and] mortgage loans.") (*See id.*)

15 Nothing in the Information Circular states or even suggests that investor
16 funds will be used for business ventures other than real estate and mortgage loans.
17 (Grant Declaration ¶ 30, Ex. 6.) In fact, the Information Circular represents that
18 DLG "may not change [its] investment objectives . . . except upon approval of a
19 majority of our Board. [DLG] has no authority to do anything that would impair
20 our ability to carry on our ordinary business as a mortgage or real property
21 investor." (*See id.*) The Information Circular further represents under the heading
22 **"VARIOUS OTHER POLICIES AND PROCEDURES"** that "[w]ithout
23 approval of a majority of the Board, we will not . . . change the nature of our
24 business or our investment policies." (*See id.*)

25 DLG's monthly mailings further reassured investors that their proceeds were
26 being used for real estate and mortgage loan ventures. (Grant Declaration ¶ 26.)
27 Specifically, each monthly mailing repeated the investment objectives set forth in
28 the Information Circular. (*See id.* ¶¶ 26-27.) In addition, the **"INVESTMENT**

1 **OVERVIEW**” section stated that “Diversified Lending Group uses only
2 investments in Income Stream Real Estate.” (*See id.* ¶¶ 28, 31.)

3 In reality, the defendants did not use investor funds solely to invest in real
4 estate and mortgage loan ventures. Instead, they used investor proceeds for other
5 undisclosed purposes, such as to fund Friedman’s charitable foundation or to
6 purchase auction rate securities. (Yamamoto Declaration ¶ 11) They also used
7 investor funds to finance undisclosed business activity, such as the \$13 million
8 acquisition of magnetic resonance imaging businesses. (*See id.*) Accordingly, the
9 proposed defendants’ representations that DLG would invest substantially all of its
10 investors’ proceeds in real estate and mortgage loan activities were false.

11 Very recently, in the December 31, 2008 monthly mailing, DLG altered its
12 longstanding disclosure about the use of investor funds. (Grant Declaration ¶ 29.)
13 In a section entitled “**COMMENTARY**,” DLG states that “[w]e have expanded
14 our horizons to include the industries that will benefit most from these [recent
15 economic] changes, alternative energy and healthcare just to mention two.” (*See*
16 *id.* ¶ 31.) However, this purported disclosure is inadequate at best. First, it
17 appeared many months after DLG began using investor funds for these undisclosed
18 business and investment ventures. (*See id.*) Second, the disclosure appears in the
19 middle of a long paragraph printed in extremely small type, and it is at odds with
20 the “**INVESTMENT OVERVIEW**” section, which appears in standard type and
21 continues to represent that DLG is using investor proceeds for real estate activities.
22 (*See id.*) Moreover, the language of the purported disclosure gives no detail as to
23 when DLG invested in these other business ventures, whether the Board approved
24 this significant shift in business strategy as required by DLG’s policies, how much
25 was invested in other business ventures, or the potential impact on the safety and
26 profitability of the Notes. (*See id.* ¶¶ 30-31.)

27 ///

28 ///

1 **3. Investor Funds Have Been Misappropriated and Misused By**
2 **Friedman and Placourakis for Personal Expenditures**

3 Friedman misappropriated at least \$17 million of investor funds to finance his
4 extravagant lifestyle. (Yamamoto Declaration ¶ 11) Friedman used these funds to
5 buy lavish vacations, jewelry, designer clothing and accessories, electronics, tickets
6 for sporting events, and a \$6.5 million home in Malibu, California. (*See id.*)
7 Placourakis has misappropriated at least \$275,000 in investor funds in 2007 and
8 2008. (*See id.*) Placourakis received \$200,000 from DLG in a bank account she
9 holds jointly with Friedman. (*See id.*) In addition, from April 2007 to April 2008,
10 DLG paid Placourakis \$75,504 purportedly for “consulting” services (*see id.*),
11 despite the fact that Placourakis does not appear to have any connection to DLG’s
12 real estate and mortgage lending business.

13 Friedman never disclosed to DLG investors that he transferred investor
14 proceeds from the investment pool to accounts for his own use. (Grant Declaration
15 ¶¶ 13, 30, Ex. 6.) To the contrary, while he was misappropriating millions of
16 investors’ funds, Friedman sent DLG investors monthly mailings representing that
17 DLG continued to use investor proceeds for real estate and mortgage lending. (*See*
18 *id.* ¶¶ 23, 28-29, Ex. 11.)

19 **III. ARGUMENT**

20 **A. The Court Should Issue A Temporary Restraining Order**
21 **Prohibiting Violations Of The Antifraud Provisions Of The**
22 **Exchange Act**

23 **1. Special Standards Apply To the Commission’s Application**

24 Section 21(d) of the Exchange Act provides that the Commission may obtain
25 a permanent or temporary injunction or restraining order without a bond on a
26 proper showing. 15 U.S.C. § 78u(d). To obtain such relief, the Commission must
27 demonstrate: (1) a *prima facie* case that a violation of the securities laws has
28 occurred; and (2) a reasonable likelihood that the violation will be repeated. *See*

1 *SEC v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 n.2 (11th Cir. 1999); *SEC*
2 *v. United Financial Group, Inc.*, 474 F.2d 354, 358-59 (9th Cir. 1973).

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

12 For these reasons, the Commission faces a lower burden than a private civil
13 litigant when seeking a temporary restraining order or other pretrial relief. Unlike
14 private litigants, the courts presume irreparable injury in Commission enforcement
15 actions in which injunctive relief is sought. *United States v. Nutri-Cology, Inc.*, 932
16 F.2d 394, 397-98 (9th Cir. 1992) (“[i]n statutory enforcement cases . . . passage of the
17 statute is itself an implied finding by Congress that violations will harm the public”).
18 In fact, under established Ninth Circuit precedent, an injunction is authorized “solely
19 upon a showing of a statutory violation,” so long as the Commission shows a
20 possibility of success on the merits. *Id.* at 398. Because the evidence in this case
21 establishes that the Defendants are violating the federal securities laws, and that it is
22 reasonably likely they will continue to do so unless enjoined, the Court should grant
23 the Commission’s application for temporary relief.

24 **2. The Defendants Have Violated The Antifraud Provisions**

25 **a) The Interests Sold By Defendants Were Securities**

26 Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange
27 Act define the term security to include “investment contracts.” The investment
28 interests offered by the defendants are securities in the form of investment

1 contracts. In *Reves v. Ernst & Young*, 494 U.S. 56, 64 (1990), the Supreme Court
2 held that notes are presumed to be securities, unless they bear a family
3 resemblance to specified financial instruments that the Supreme Court specifically
4 excluded from the definition of “security.” *Id.* at 66. Under the family
5 resemblance test, the court examines four factors: (1) the motivation that would
6 prompt a reasonable buyer and seller to enter into a transaction; (2) the plan of
7 distribution; (3) the reasonable expectations of the investing public; and (4)
8 whether some factor, such as the existence of another regulatory scheme, reduces
9 the risk of the instrument, thereby rendering the application of the securities laws
10 unnecessary. *Id.* at 65-67.

11 With regard to the first factor, a note is likely to be a security “[i]f the
12 seller’s purpose is to raise money for the general use of a business enterprise or to
13 finance substantial investments and the buyer is interested primarily in the profit
14 the note is expected to generate.” *Reves*, 494 U.S. at 66; accord *SEC v.*
15 *Wallenbrock*, 313 F.3d 532, 538 (9th Cir. 2002) (holding that a commercial or
16 consumer purpose is less akin to a security). Here, DLG told investors that the
17 purpose of the Notes was to raise funds for its “investment pool” that provides
18 capital for DLG’s substantial real estate and mortgage lending activities (Grant
19 Declaration ¶ 27), and investors “bought [the Notes] in order to earn a profit in the
20 form of interest.” *Reves*, 494 U.S. at 68.

21 The second *Reves* factor shows that DLG’s Notes are securities because they
22 were “offered and sold to a broad segment of the public.” *Id.* at 68. Since 2004,
23 DLG has solicited hundreds of investors in several states and raised approximately
24 \$216 million. (Yamamoto Declaration ¶ 10.) In addition, DLG through AEI
25 offered commissions to the Agents for recruiting investors. (Grant Declaration ¶
26 36, Ex. 16.) The broad availability of the Notes in multiple states coupled with
27 DLG and AEI’s interest in widening the scope of distribution by paying
28 commissions indicating that the Notes are securities. *Cf. Wallenbrock*, 313 F.3d at

1 539 (holding same).

2 The third *Reves* factor suggests that DLG's notes are securities because a
3 reasonable member of the investing public would consider them investments. *See*
4 *Reves*, 494 U.S. at 68. DLG and the Agents engaged by AEI to offer and sell the
5 Notes characterized the Notes as "investments," the people who bought the Notes as
6 "investors," the fund into which their money was deposited as the "investment pool,"
7 and the objectives of the Fund as DLG's "investment philosophy." (Grant
8 Declaration ¶ 27.) Given those characterizations, a reasonable member of the
9 investing public would consider DLG's Notes to be investments, not short term loans.

10 The fourth *Reves* factor suggests that the Notes are securities because there
11 is no regulatory scheme that would significantly reduce the risk of the investments
12 offered by DLG. *See Wallenbrock*, 313 F.3d at 540 (*citing Marine Bank v.*
13 *Weaver*, 455 U.S. 551 (1982) (federal banking regulations); *International*
14 *Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979) (federal protection of
15 retirement benefits)). In addition, although DLG characterizes the Notes as
16 "secured," any such security is questionable because it appears to involve only
17 DLG's "corporate guarantee." (Grant Declaration ¶ 32, Ex. 14.) Accordingly,
18 nothing about DLG's Notes rebuts the presumption that they are securities.

19 DLG's Notes also qualify as securities in the form of investment contracts.
20 An investment contract is: (1) an investment of money, (2) in a common enterprise,
21 (3) with a reasonable expectation of profits to be derived solely from the
22 entrepreneurial or managerial efforts of others. *SEC v. W.J. Howey Co.*, 328 U.S.
23 293, 298-99 (1946). The first *Howey* prong is met here because investors gave
24 approximately \$216 million to DLG. (Yamamoto Declaration ¶ 10.) To establish
25 the second prong, the common enterprise element, the Ninth Circuit requires either
26 vertical commonality (the fortunes of the investors are linked with those of the
27 promoters) or horizontal commonality (a pooling of investor funds and interests).
28 *See, e.g., SEC v. R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991).

1 Horizontal commonality is present here because investor funds were deposited into
2 the same bank account for use in DLG's various business operations. (Yamamoto
3 Declaration ¶ 10.) The third *Howey* prong is satisfied here because investors
4 invested in DLG with a reasonable expectation of profit based on DLG's and
5 Friedman's ability to generate profits from DLG's real estate and mortgage lending
6 activities. (Grant Declaration ¶¶ 18, 29, Ex. 8.)

7 **b) The Defendants' Representations And Actions Were**
8 **Fraudulent**

9 Section 17(a) of the Securities Act prohibits fraud in the offer or sale of
10 securities, and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and Rule 10b-5
11 thereunder, 17 C.F.R. § 240.10b-5, prohibit fraud in connection with the purchase or
12 sale of any security. Rule 10b-5 provides that:

13 It shall be unlawful for any person, directly or indirectly, by
14 the use of any means or instrumentality of interstate
15 commerce, or of the mails, or of any facility of any national
16 securities exchange,

- 17 (a) to employ any device, scheme or artifice to defraud,
18 (b) to make any untrue statement of a material fact or to
19 omit to state a material fact necessary in order to make
20 the statements made, in the light of the circumstances
21 under which they were made, not misleading; or
22 (c) to engage in any act, practice, or course of business
23 which operates or would operate as a fraud or deceit
24 upon any person, in connection with the purchase or sale
25 of any security.

26 Section 17(a) is worded similarly. The antifraud provisions of the Securities Act
27 and the Exchange Act both prohibit fraudulent conduct or practices in connection
28 with the offer or sale of securities. *See SEC v. Dain Rauscher, Inc.*, 254 F.3d 852,

1 855 (9th Cir. 2001). Violations of Section 17(a)(1) of the Securities Act and
2 Section 10(b) of the Exchange Act and Rule 10b-5 thereunder require proof of
3 scienter. Violations of Sections 17(a)(2) and (3) merely require a showing of
4 negligence. *Id.* at 856.

5 As explained below, (1) the defendants' actions violated the above antifraud
6 provisions; and (2) the defendants acted with the requisite scienter in violating
7 Section 17(a)(1) and Section 10(b) and Rule 10b-5 thereunder.

8 (1) **The Defendants' Misrepresentations Were**
9 **Material**

10 Violations of the antifraud provisions require that the misstatements and
11 omissions made by the defendants concern material facts. *Basic Inc. v. Levinson*,
12 485 U.S. 224, 231-32, 108 S. Ct. 978, 99 L.Ed.2d 194 (1988); *TSC Indus., Inc. v.*
13 *Northway, Inc.*, 426 U.S. 438, 449, 96 S. Ct. 2126, 48 L.Ed.2d 757 (1976). *See*
14 *also SEC v. Dain Rauscher, Inc.* 254 F.3d at 856. A fact is material if there is a
15 substantial likelihood that a reasonable investor would consider it important in
16 making an investment decision. *Id.* Liability arises not only from affirmative
17 representations but also from failures to disclose material information. *SEC v.*
18 *Dain Rauscher*, 254 F.3d at 855-56. The antifraud provisions impose "a duty to
19 disclose material facts that are necessary to make disclosed statements, whether
20 mandatory or volunteered, not misleading." *SEC v. Fehn*, 97 F.3d 1276, 1290 n.12
21 (9th Cir. 1996).

22 Here, the defendants unquestionably made misrepresentations and omissions
23 of material fact. Investors understood from oral and written misrepresentations
24 made by the defendants that DLG used investor funds to invest in real estate and
25 mortgage lending ventures that would generate returns of 9% to 12% compounded
26 monthly. (Grant Declaration ¶ 27.) Yet undisclosed to investors, the defendants
27 used substantial amounts of investor proceeds to fund other business ventures and
28 investments, including Friedman's charitable foundation, auction-rate securities,

1 and the acquisition of companies in the healthcare industry. (Yamamoto
2 Declaration ¶ 11; Grant Declaration ¶ 12.) The proposed defendants also omitted
3 to disclose that Friedman used at least \$17 million of investor funds for his
4 personal benefit. (Yamamoto Declaration ¶ 11.) These misrepresentations and
5 omissions are material because they address the very purpose of the investment
6 and the use of investor proceeds, which reasonable investors would consider
7 important in deciding whether to invest.

8 Nor did the defendants disclose Friedman's prior criminal conviction until
9 forced to do so by regulatory and media scrutiny in December 2008. (Grant
10 Declaration ¶ 33, Ex. 15.) A reasonable investor would consider Friedman's prior
11 criminal conviction material in deciding whether to invest with DLG.

12 (2) The Defendants Acted With Scienter

13 Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder
14 require a showing of scienter. *Aaron v. SEC*, 446 U.S. 680, 701-02, 100 S. Ct.
15 1945, 64 L.Ed.2d 611 (1980). Scienter is a "mental state embracing intent to
16 deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193
17 n.12, 96 S. Ct. 1375, 47 L.Ed.2d 668 (1976). In the Ninth Circuit, scienter may be
18 established by a showing of recklessness. *SEC v. Rubera*, 350 F.3d 1094 (9th Cir.
19 2001), *SEC v. Dain Rauscher, Inc.*, 254 F.3d at 856. Proof of recklessness may be
20 inferred from circumstantial evidence. *Herman & MacLean v. Huddleston*, 459
21 U.S. 375, 390-91, n.30, 103 S. Ct. 683, 74 L.Ed.2d 548 (1983); *SEC v. Burns*, 816
22 F.2d 471, 474 (9th Cir. 1987).

23 Friedman acted with scienter. In turn, Friedman's scienter may be imputed
24 to DLG and AEI, which Friedman owned and controlled. *See SEC v. Manor*
25 *Nursing Centers, Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972). As the principal of
26 both DLG and AEI, Friedman knew or was reckless in not knowing that he and the
27 Agents represented to DLG investors orally and in writing that investor proceeds
28 would be used for real estate and mortgage lending ventures when, in reality,

1 investor proceeds were used for other, undisclosed business ventures. (Yamamoto
2 Declaration ¶ 11; Grant Declaration ¶ 28.) In fact, Friedman trained many of the
3 Agents himself, and in doing so instructed them to represent to investors that their
4 money would be reinvested in real property ventures and mortgage loans. (Grant
5 Declaration ¶ 24, Ex. 12.) Additionally, Friedman was the signatory on the DLG
6 bank accounts to which investor proceeds were transferred and then used for
7 undisclosed business dealings. (Yamamoto Declaration ¶ 5.) Finally, as the
8 signatory to DLG's bank accounts, Friedman knew that he was misappropriating
9 investor funds for his personal benefit. In short, Friedman made the material
10 misrepresentations and omissions in this case with full knowledge of their false
11 and misleading nature.

12 **3. There Is A Reasonable Likelihood That The Defendants**
13 **Will Continue Their Fraudulent Scheme Unless Enjoined**

14 To obtain an injunction, the Commission must establish that there is a
15 reasonable likelihood of future violations. *See SEC v. Murphy*, 626 F.2d 633, 655
16 (9th Cir. 1980). Whether a likelihood of future violations exists depends upon the
17 totality of the circumstances. *Id.* The existence of past violations may give rise to
18 an inference that there will be future violations. *See id.*; *see also United States v.*
19 *Odessa Union Warehouse Coop*, 833 F.2d 172, 176 (9th Cir. 1987), *SEC v.*
20 *Koracorp Industries, Inc.*, 575 F.2d 692, 698 (9th Cir. 1978). Courts also consider
21 factors such as the degree of scienter involved, the isolated or recurrent nature of
22 the violative conduct, the defendant's recognition of the wrongful nature of the
23 conduct, the likelihood that, because of the defendant's occupation, future
24 violations may occur, and the sincerity of defendant's assurances (if any) against
25 future violations. *SEC v. Murphy*, 626 F.2d at 655.

26 Because the defendants' statutory violations here are egregious, because they
27 raised approximately \$216 million from hundreds of investors nationwide, and
28 continue with their fundraising efforts and may further dissipate investor funds,

1 imposition of a temporary restraining order, together with an order to show cause
2 why a preliminary injunction should not be entered, is appropriate and necessary.

3 **B. The Court Should Order An Immediate Asset Freeze**

4 Federal courts have inherent equitable authority to issue a variety of
5 ancillary relief measures in Commission injunctive actions. *SEC v. Wencke*, 622
6 F.2d 1363, 1369 (9th Cir. 1980). Included in these powers is the authority to
7 freeze assets, of both parties and nonparties. *SEC v. Hickey*, 322 F.3d 1123, 1131
8 (9th Cir. 2003); *SEC v. International Swiss Investments Corp.*, 895 F.2d 1272,
9 1276 (9th Cir. 1990). Courts use freeze orders to prevent waste and dissipation of
10 assets and to ensure their availability for disgorgement for the benefit of victims of
11 the fraud. *See e.g., SEC v. Hickey*, 322 F.3d at 1132 (affirming imposition of asset
12 freeze over nonparty brokerage firm controlled by the defendant to effectuate
13 disgorgement order against defendant); *SEC v. Manor Nursing Centers*, 458 F.2d
14 at 1105-06. Indeed, the Ninth Circuit specifically has found that “the public
15 interest in preserving the illicit proceeds [of a defendant’s fraud] for restitution is
16 great.” *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir. 1999).
17 Courts have similarly recognized that a disgorgement order will often be rendered
18 meaningless unless an asset freeze is imposed prior to the entry of final judgment.
19 *See SEC v. Unifund SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990); *SEC v. Musella*, 578
20 F. Supp. 425, 429 (S.D.N.Y. 1984).

21 To obtain an asset freeze, the Commission need only establish the mere
22 possibility that dissipation of assets exists. *FSLIC v. Sahni*, 868 F.2d at 1096-97,
23 citing *FTC v. H.N. Singer, Inc.*, 668 F.2d at 1112. It is unnecessary for the Court
24 to find that dissipation of funds is likely. *Id.* Here, the defendants are violating the
25 antifraud provisions and are misusing and misappropriating investor funds.
26 Because the defendants have already misappropriated at least \$17 million of
27 investor assets (Yamamoto Declaration ¶ 11.) and are seeking to raise new investor
28 funds, an asset freeze is necessary to prevent further misappropriation.

1 An asset freeze is also necessary to prevent relief defendant Placourakis from
2 spending or secreting any more funds so that such funds are available to satisfy any
3 judgment against the defendants. A defendant may be joined as a party defendant
4 notwithstanding the fact that she is not alleged to have violated the securities laws,
5 to aid in obtaining relief where the defendant possesses illegally obtained profits but
6 has no legitimate claim to them. *See SEC v. Cavanaugh*, 153 F.3d 129, 136 (2d Cir.
7 1998); *SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998). A district court can
8 freeze a defendant's assets to protect any ill-gotten gains. *See Cavanaugh*, 153 F.3d
9 at 136; *SEC v. Heden*, 51 F.Supp.2d 296, 299 (S.D.N.Y. 1999). Here, Placourakis
10 received over \$275,000 in investor funds. (Yamamoto Declaration, ¶ 11) The
11 Commission should request a freeze of Placourakis' assets (up to the total amount of
12 the improper transfers) and those funds should be subject to disgorgement.

13 **C. Appointment Of A Receiver Is Necessary And Appropriate**

14 The Court has broad discretion to appoint an equity receiver in Commission
15 enforcement actions. *SEC v. Wencke*, 622 F.2d at 1365. A receiver plays a crucial
16 role in preventing further dissipation and misappropriation of investors' assets.
17 *SEC v. Wencke*, 783 F.2d 829, 836-37 n.9 (9th Cir. 1986).² Factors such as the
18 integrity of management and the likelihood of future misuse of assets are critical in
19 determining whether a receiver should be appointed. *See SEC v. Fifth Ave. Coach*
20 *Lines, Inc.*, 289 F. Supp. 4, 42 (S.D.N.Y. 1968).

21 There is no question a receiver over defendants DLG and AEI is necessary in this
22 case. Because DLG and AEI's current management – defendant Friedman – is
23 committing an ongoing and egregious fraud against investors involving misuse of
24 investor funds, he should not continue to have control over what remains of
25 investor funds. In addition, a receiver is needed to ensure that the distribution of

26
27 ² Because posting of a bond by the receiver would only serve to deplete
28 further the resources available to investors, the Commission requests that the Court
not require the receiver to post a bond. *See SEC v. Universal Financial*, 760 F.2d
1034, 1039 (9th Cir. 1985).

1 investor funds is done equitably and in an orderly fashion. *SEC v. Credit First*
2 *Fund, LP*, 2006 U.S. Dist. Lexis 96697, at *49-*50 (C.D. Cal., Feb. 13, 2006).

3 **D. Orders Prohibiting the Destruction Of Documents, Expediting**
4 **Discovery, And Requiring Accountings Are Necessary And**
5 **Appropriate**

6 The Court's broad equitable powers in Commission enforcement actions
7 include the ability to order ancillary relief to prohibit document destruction, expedite
8 discovery, and require accountings. *SEC v. Wencke*, 622 F.2d at 1369. An order
9 prohibiting the destruction of documents is necessary because of the possibility that
10 the defendants will destroy evidence of their ongoing fraud. Expedited discovery,
11 which is further authorized by Rules 30, 33 and 34 of the Federal Rules of Civil
12 Procedure, is appropriate here in order to develop additional evidence regarding the
13 defendants' violative conduct, money transfers, and the relationship between the
14 defendants and relief defendant Placourakis, and to ensure that any asset freeze is
15 fully implemented. Finally, it is necessary to identify all available assets to help
16 ensure that funds and assets are frozen properly and available to satisfy any future
17 order of disgorgement or civil penalties against the defendants. *SEC v. International*
18 *Swiss Investment Corp.*, 895 F.2d at 1276. Accountings are appropriate here because
19 it is unclear what happened to millions of dollars in investor monies.

20 **IV. CONCLUSION**

21 For the foregoing reasons, the Court should grant the Commission's *Ex Parte*
22 Application.

23
24 Dated: March 4, 2009

Respectfully submitted,

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26 
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28 Attorney for Plaintiff
Securities and Exchange Commission