UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. SACV 09-818 DOC (RNBx) Date: August 3, 2009

Title: SEC v. Medical Capital Holdings, Inc., et al.

DOCKET ENTRY
[I hereby certify that this document was served by first class mail or Government messenger service, postage prepaid, to all counsel (or parties) at their respective most recent address of record in this action on this date.]
Date:____________ Deputy Clerk: ___________________________________

PRESENT:
THE HONORABLE DAVID O. CARTER, JUDGE

Kristee Hopkins
Courtroom Clerk

Not Present
Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS: NONE PRESENT

ATTORNEYS PRESENT FOR DEFENDANTS: NONE PRESENT

PROCEEDING (IN CHAMBERS): GRANTING, IN PART, TRO APPLICATION

On July 16, 2009, Plaintiff Securities and Exchange Commission ("SEC") filed an Application for a TRO (the "Application") to halt alleged securities fraud being perpetrated by Defendants Medical Capital Holdings, Inc. ("MCHI"), Medical Capital Corporation ("MCC"), Medical Provider Funding Corporation VI ("MP VI"), Sidney M. Field ("Field") and Joseph J. Lampariello ("Lampariello")(collectively, "Defendants"). MP VI is a special purpose corporation ("SPC") that is issuing securities in the form of notes; MCHI and its operating subsidiary, MCC, are MP VI's administrator; Field is the CEO and a director of MCHI, MCC, and MP VI; and Lampariello is the COO, president, and a director of MCHI, MCC, and MP VI. The Court finds the Application appropriate for decision without oral argument. FED. R. CIV. P. 78; Local Rule 7-15. After considering the moving, opposing and replying papers, the Court hereby GRANTS the Application.

I. BACKGROUND

Defendants's business operates as follows: MCHI provides financing to healthcare providers by purchasing their accounts receivables and making secured loans to said healthcare providers. MCHI uses special purpose vehicles ("SPV's") to raise money from investors to fund said financings – it has raised approximately $2.2 billion through such note offerings to over 20,000 investors since December 2003. MCHI uses operating subsidiaries to underwrite, monitor, administer, and service said financings. MCC is a wholly-owned subsidiary of MCHI, which operates as the administrator for each of the SPC's. MP VI is a wholly-owned special purpose subsidiary of MCHI, which conducts note offerings and subsequently issues notes to investors (the "Notes"). As of May 2009, MP VI was late on interest payments to investors by several days. The following three entities are all wholly-owned special purpose vehicles of MCHI that have conducted a series of note offerings, thereby raising significant sums from investors: Medical Provider Financial Corporation I ("MP I"), Medical Provider Financial Corporation II ("MP II"), Medical Provider Financial Corporation III ("MP III"), Medical Provider Financial Corporation IV ("MP IV"), and Medical Provider Funding Corporation V ("MP V").

In the instant Application, the SEC argues that Defendants are committing fraud in the offer and sale of MP VI notes, thereby violating, or aiding and abetting, the antifraud provisions of the federal securities laws – specifically Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §77q(a), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5. The underlying basis for the instant Application is the SEC's contention that Defendants have misrepresented the use of offering proceeds to investors and misappropriated millions of dollars of investor funds by paying themselves fees from the offering proceeds.

More specifically, the SEC argues that the SPV's at issue sold notes through registered broker-dealers to accredited investors under Rule 506 of Regulation D. Through their private placement memoranda ("PPMs"), the SPC's allegedly represented to investors that after paying offering expenses (including commissions) of 4% to 8%, they would use the net offering proceeds to purchase healthcare receivables and make investments in other businesses. That is, administrative fees would not be paid out of the offering proceeds. However, the SEC alleges that Defendants have, in fact, misappropriated approximately $18.5 million of investor funds, out of the $76.9 million raised by MP VI, through excessive administrative fee payments to MCC. In addition, in a May 27, 2009 supplemental PPM, Defendants falsely stated that, as of February 28, 2009, less than $4 million of MP VI's offering proceeds had been used for commission and other expenses. When, in fact, Defendants had paid themselves a total of $21.7 million in administrative fees, $16.9 million of which was paid from offering proceeds. The supplemental PPM also allegedly falsely represented that over $65.6 million of investor funds had been used to purchase receivables when in fact only $48.8 million of the offering proceeds were used in that manner. Finally, Defendants also allegedly misrepresented to investors, in the PPM, that SPC's affiliated with MP VI which had conducted similar offerings had not defaulted on, or been late in making payments of, principal or interest – when, in fact, two MP VI-affiliated SPC's began defaulting on interest and/or principal payments in the same month that Defendants began the MP VI offering. Subsequently, two other affiliated SPC's have allegedly made interest payments belatedly; yet, Defendants allegedly continued to solicit investors using the false

PPM through at least May 2009.

Two private individuals – Field and Lampariello – are allegedly implicated by the conduct at issue. According to the SEC, they both reviewed and approved MP VI's PPM; they both directly or indirectly supervise MCC's private capital markets department, which administers broker-dealer relations; and, therefore, they either knew or were reckless in not knowing (1) about the representations in the PPM that investor funds would not be used to pay fees to MCC and that affiliates of MP VI had never defaulted or been late on payments to noteholders, (2) that MP VI's affiliates had defaulted on interest and principal payments to their investors, and (3) that MP VI was using millions of dollars of investor funds to pay administrative fees to MCC. Further, both Field and Lampariello were senior officers and directors of MCHI and its subsidiaries, including MCC and MP VI, causing them to directly or indirectly supervise MP VI's and MCC's CFO. Finally, Lampariello determined the amount of administrative fees MCC withdrew from each MP entity and signed at least one document authorizing the transfer of administrative fees from MP VI to MCC.

As a result of the aforementioned alleged conduct, the SEC seeks a temporary restraining order and preliminary injunction freezing the assets of MCHI, MCC, and MP VI; appointment of Thomas A. Seaman as receiver over Defendants MCHI, MCC, and MP VI, and their subsidiaries and affiliates; an order prohibiting the Defendants from destroying documents; an order granting expedited discovery; and an order requiring that the Defendants provide accountings.

On June 22, 2009, Defendants filed an opposition to the instant Application (the "Opposition"), believing the Application to be based on a manifest misunderstanding of their business operations. In the Opposition, Defendants argue that they have (1) completely cooperated with the SEC's requests for information, (2) suspended further sales of notes, (3) are working "diligently" to marshall enough assets to pay its obligations to existing investors, and (4) placed their investors' funds under the control of two independent trustees – Wells Fargo Bank and Bank of New York Mellon. Defendants state that, in fact, each of their SPV's have financial institution trustees who control the investor funds, meaning that no investments of funds, and no payments of expenses (including administrative fees) can be made without approval of the appropriate trustee. Thus, Defendants argue that the SEC's showing of alleged irreparable harm is non-existent as there are no ongoing sales to investors and there is no evidence of dissipation of assets.

More specifically, Defendants aver that their administrative fees are paid under an Administrative Services Agreement upon the approval of a trustee. Defendants also argue that the PPM fully discloses the process by which the administrative fees are calculated and paid and that, under the Administrative Services Agreement (the "ASA Agreement"), the administrative fee that may be paid to MCC must be such that the Collateral Coverage Requirement (the "CCR")[1] remains in excess of 100%.

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[1] The CCR is calculated under the MP IV Trust Agreement, which provides the following means of calculating the CCR: add the cash in each fund to the Expected Net

Additionally, Defendants argue that the $25 million which the SEC alleges Defendants' misappropriated improperly includes other expenses that are properly payable under the ASA Agreement, including brokers commissions and other expenses. Finally, Defendants attempt to rebut the SEC's contention that they misrepresented their default status by stating that (1) the original PPM's statement that its affiliates had never defaulted on their obligations was true as of the date that it was prepared and (2) once the current recession made it impossible for Defendants to conduct the necessary refinancing, Defendants instructed their broker dealers to cease sales of MP IV notes.

II. LEGAL STANDARD

Generally, courts grant equitable relief in the event of irreparable injury and the inadequacy of legal remedies. *See Stanley v. Univ. of S. Cal.*, 13 F.3d 1313, 1320 (9th Cir. 1994); *see also Weinberer v. Romero-Barcelo*, 456 U.S. 305, 312, 102 S. Ct. 1798 (1982) ("[T]he basis for injunctive relief in the federal courts has always been irreparable injury and the inadequacy of legal remedies."). Plaintiffs must satisfy additional requirements in order to be granted preliminary relief. Plaintiffs have the burden of showing that they are entitled to preliminary relief. The "traditional test" requires non-governmental plaintiffs to demonstrate (1) a strong likelihood of success on the merits; (2) a significant threat of irreparable injury; (3) greater hardship to Plaintiffs than Defendants; and (4) that the public interest favors granting the injunction. *See American Motorcyclist Ass'n v. Watt*, 714 F.2d 962, 965 (9th Cir. 1983).

The standard for governmental plaintiffs, such as the SEC, is different. Under Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Section 21(d) of the Exchange Act, 15 U.S.C. 78u(d), the SEC may, upon a proper showing, obtain a permanent or temporary injunction or restraining order without a bond. To obtain such relief, the SEC must demonstrate: (1) a prima facie case that a violation of the securities laws has occurred and (2) a reasonable likelihood that the violation will be repeated. *See e.g., S.E.C v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 n.2 (11th Cir. 1999). Further, because the federal securities statutes at issue authorize injunctions, the SEC appears before this Court "not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws." *S.E.C. v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (1975). Thus, unlike private litigants, if the government can show a probability of success on the merits in a statutory enforcement case, the courts presume irreparable injury and inadequacy of other remedies in SEC enforcement actions in which injunctive relief is sought. *See, e.g., S.E.C. v. Management,* 515 F.2d at 808; *U.S. v. Nutri-cology, Inc.*, 982 F.2d 394, 398 (9th Cir. 1992).

Receivable value of the existing receivable portfolio to calculate the total assets in the fund, then divide the total assets by total liabilities (existing interest and principal repayment obligations).

III. DISCUSSION

In this case, there can be little question that the Notes are securities under the federal securities laws as Section 2(a)(1) of the Securities Act, 15 U.S.C. §77b(a)(1) and Section 3(a)(1) of the Exchange Act, 15 U.S.C. §78(a)(10), define the term "security" to include any "note" or "investment contract" and, under *Reves v. Ernst & Young*, 494 U.S. 56, 65-67 (1990), there is a "presumption that every note is a security" that can only be rebutted upon a showing that the note bears a strong "family resemblance" to instruments not recognized as securities.

Additionally, the SEC did not file the instant Application prematurely. Defendants admit that they have "been the subject of a wide-ranging investigation by the SEC for over a year ... producing hundreds of thousands of pages of documents and making its senior management available for both informal meetings and formal, sworn testimony." Moreover, the SEC has submitted two substantial depositions, with numerous corresponding exhibits, in support of their contentions.

While Defendants vociferously argue that the SEC is simply misunderstanding their business, Defendants do not contest that (1) MCC extracted $25 million in administrative fees from MP VI and that at least $18.5 million of those fees were paid from investor funds (except to state that this includes some fees that were provided for under the ASA Agreement) or that (2) at least $18.5 million of those fees were paid from MP VI investor funds, contrary to the express representations in the relevant PPMs. Defendants' argument that the ASA Agreement provided for the excessive administrative fees in the form of start-up fees and commissions is of no avail for the following reasons: Defendants admit that the MP VI PPM expressly states that (1) offering expenses are limited to approximately $500,000 and sales commissions will not exceed 6.0% of the principal amount of the notes sold, and (2) administrative fees would not be paid from the proceeds of the sale of notes, but rather only from amounts collected from accounts receivable and other investments. Defendants do not dispute that MP VI collected only $6.5 million on receivables through June 19, 2009. Under the representations made in the PPM, were entitled to only $5.1 million in commissions and start-up costs on sales of $76.9 million in notes. Finally, the ASA Agreement does not contradict the clear restriction on the use of proceeds stated in the PPM, defining, instead, the administrative fee "which *may* be paid to MCC." Thus, it was impermissible for MCHI and MCC to have caused MP VI to pay approximately $25 million in administrative fees to MCC from September 2008 through June 2009.

In their Opposition, Defendants make much of the argument that trustees have been appointed to oversee various operations, including the payment of administrative fees from investor funds. However, the trustees appear to have little, if any, discretion to prevent Defendants from continuing to commit the fraud herein alleged. For example, the Note Issuance and Security Agreement provides that, absent any event of default, the trustee "shall" pay any requested administrative fees that are accompanied by the appropriate certification from MCC. Additionally, the SEC avers that the trustee for MP III and MP V reported that MCC employees failed to provide accurate information during an investigation into MCC's business methods and processes, including that MCC's employees were instructed to delete emails containing certain reports.

Defendants' argument concerning their failure to disclose prior defaults is also unavailing. The MP VI PPM that was issued expressly represented that Defendants' affiliates "ha[d] never defaulted in the payment of their obligations to investors" – a statement that was admittedly untrue at the time it was made. This representation was clearly material as it related directly the quality of Defendants' management, experience and business model. The economic recession that followed, while certainly unfortunate, is of no import to the determination as to whether Defendants made false disclosures in the PPMs provided to investors.

In sum, the SEC has presented cogent allegations, supported by numerous documents, that meet the standard of *S.E.C v. Unique Fin.*, 196 F.3d 1195, as they demonstrate that a prima facie violation of the antifraud provisions of the federal securities laws has occurred as well as a reasonable likelihood that they will be repeated. The evidence, much of which is admitted to be Defendants, indicates that Defendants have made material misrepresentations to investors in the MP VI PPM – allegations which Defendants have not directly opposed. Further, as the issuance of an injunction in cases of this nature has statutory sanction, Defendants' arguments that it is in the best position to protect its investors, even if meritorious, is of no import as, in such cases "it [is] enough if the statutory conditions for injunctive relief [are] made to appear. *S.E.C. v. Management*, 515 F.2d at 808. Because the SEC has made out a prima facie case that Defendants effectively commingled funds between and among MP VI and other SPC's, the Court will also appoint a receiver over MCC to protect investors in MP VI. However, expedited discovery will not be granted as the Complaint in this case filed on July 16, 2009 and Defendants may not have had time to procure adequate legal counsel.

IV. OUTCOME

For the foregoing reasons, the TRO Application is HEREBY GRANTED EXCEPT TO THE EXTENT THAT IT REQUESTS EXPEDITED DISCOVERY AND NO NOTICE TO THE DEFENDANTS OF THE TRO APPLICATION. The TRO's contents will be outlined and issued by separate order.

The Clerk shall serve this minute order on all parties to the action.