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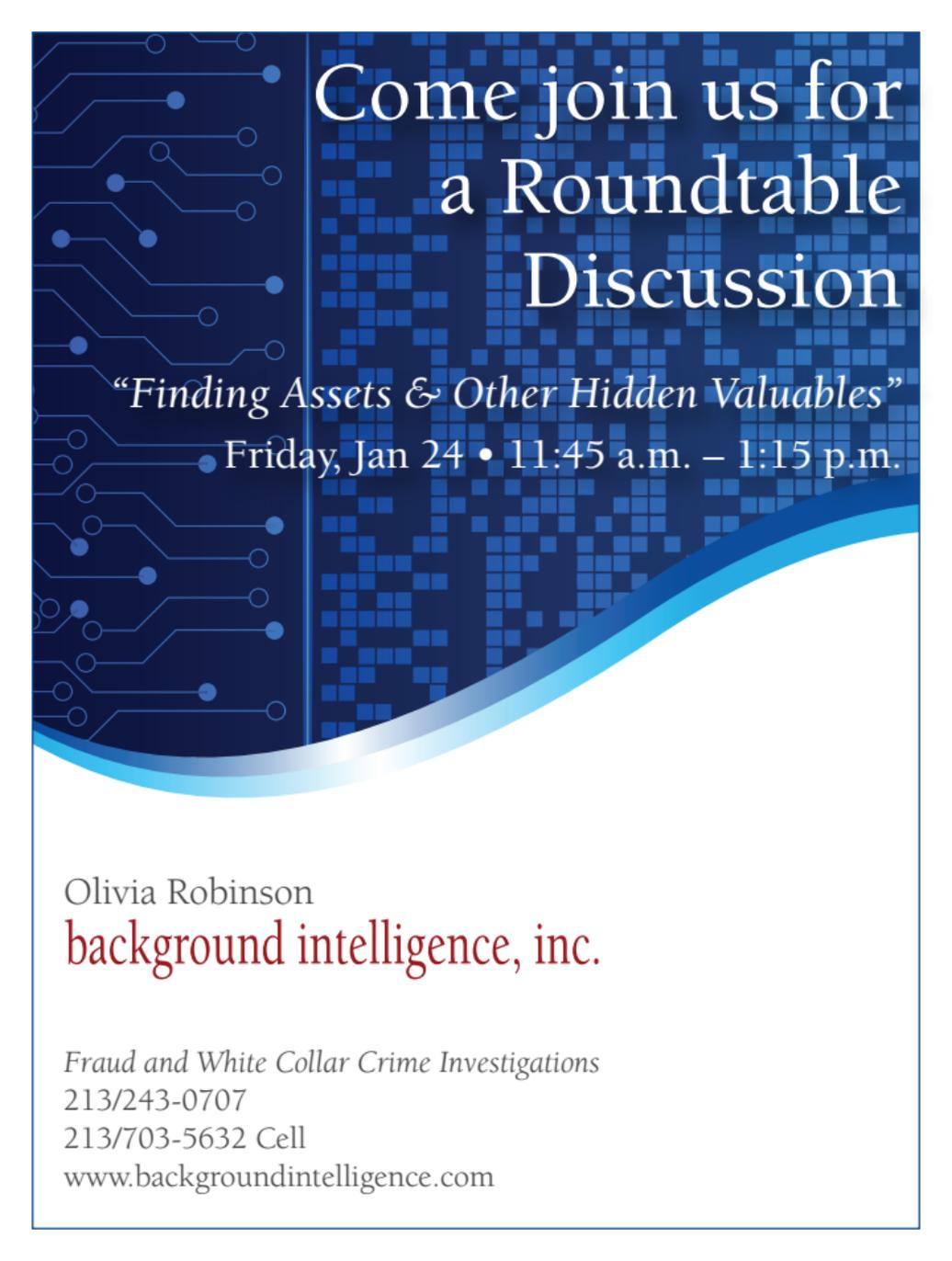
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FINANCIAL RESTRUCTURE FOR BUSINESSES AND GOVERNMENTS

Restructure of State Government Debt Through a Federal Equity Receivership

By Zack A. Clement

Keynote Presentation

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Mr. Clement is currently in private practice as Zack A. Clement PLLC www.zackclement.com

1. What an Insolvent Government Can Do to Restructure its Debt

This paper discusses how an insolvent State of the United States of America can restructure its debt through a federal equity receivership using an approach described generally in the following three documents.

*Government Debt Restructure Principles*¹ describes how to deal with government insolvency by proposing a restructure plan based on reasonable austerity and reasonable use of taxation so that creditors are paid all they can reasonably expect under the circumstances, but more than they would receive by exercising their legal remedies against the government. To use terms of art, this would be a debt restructuring plan that is “fair and equitable” and “in the best interests of creditors.”

*Leading a Government to Solvency*² describes how to employ financial experts to do a study of reasonable austerity and reasonable use of taxation to determine how much of its debt a government entity can reasonably afford to pay, and how much creditors would likely obtain using their non-bankruptcy remedies.

Government Debt Restructure Principles outlines how it might be necessary to use a payment moratorium to encourage agreement to a fair and equitable restructure plan. Additionally, a government that does not have a pre-authorized right to a trial about whether such a plan can be approved over the objection of holdouts, such as in chapter 9 of the U.S. Bankruptcy Code, can improvise a way to have such a trial and obtain an order enforcing the debt reduction proposed by a fair and equitable plan.

*How City Finances Can Be Restructured: Learning From Both Bankruptcy and Contract Impairment Cases*³ gives a short overview of how federal equity receiverships were used from 1880’s to the 1930’s to restructure the debt of railroads, which, like governments, serve the public interest and should not be liquidated. These federal equity receivership proceedings were used during a period when Congress had not enacted any bankruptcy laws applicable to railroads, just as it has not enacted any such laws to apply to Illinois, California

¹ Zack A. Clement, *Government Debt Restructure Principles* was presented at the California League of Cities Annual Convention on September 28, 2014, at the Campbell University Law School Chapter 9 Symposium on October 15, 2014 and at the Duke University Law School Symposium, Modern Municipal Restructurings: Puerto Rico and Beyond, November 10, 2015.

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³ 88 AM. BANKR. L. J. 41, (2014), co-authored with R. Andrew Black.

or other States. Moreover, the “fair and equitable” and “best interests of creditors” principles that were developed in these equity receiverships were later incorporated into federal bankruptcy statutes, including the current U.S. Bankruptcy Code, and could be applied in a federal equity receivership for a State.

This paper discusses the substantial authority supporting use of a federal equity receivership to restructure the debt of a State using such an approach.⁴ It concludes that:

1. There is substantial U.S. Supreme Court and circuit court authority describing how a federal equity receivership can be used to reorganize debt of an entity for which no bankruptcy law has been enacted.
2. Federal *bankruptcy* power permits passage of statutes dealing with the broad subject of restructuring debts between insolvents and their creditors, but that does not preclude (i) federal courts from employing principles of *equity* to restructure debt, or (ii) state legislatures from enacting debt relief statutes in cases when Congress has not enacted an applicable federal bankruptcy statute.
3. The debt of insolvent railroads was restructured in federal equity receiverships for fifty years before the Congress codified the substantive equitable principles developed in those cases into a federal bankruptcy statute applicable to railroads. Also, after the federal municipal bankruptcy statute was ruled unconstitutional in the late 1930's, the U.S. Supreme Court approved a New Jersey state law enacted to restructure unsustainable municipal debt.
4. Power to use a federal equity receivership to deal with insolvency is still present in the U.S. Constitution, the U.S. Code and the Federal Rules of Civil Procedure. Railroad equity receiverships typically had federal jurisdiction based on diversity of citizenship between a western railroad and a New York bond indenture trustee. An equity receivership for a State would have federal jurisdiction because it would involve a dispute between a State and a citizen of another State. In *Zacarias v. Stanford International Bank, Limited*, 931 F. 3d 382 (5th Cir 2019), the Fifth Circuit

⁴ Such an approach might also be used by a foreign sovereign which, like Argentina, which is sued in New York to collect on one series of bonds in default. If all parties necessary for a complete adjudication, including creditors with claims on other bonds, were joined in this suit under FRCP 19, the sovereign would have a forum to prove that it could not pay all such claims in full. In such a case, the sovereign could seek an injunction to stop the original collection action while it joined all necessary parties, formulated and proposed a plan to pay all it could reasonably afford to pay; then ask the court to approve that plan as fair and equitable and in the best interests of creditors, and to enjoin collection except in keeping with debt as restructured pursuant to this plan. A subsequent paper will discuss this.

recently upheld powers of a federal court in an equity receivership, describing in great detail why a receivership is useful to deal with an insolvency, and the broad powers it still possesses in 2019 to bar claims.

5. Initially debt restructure plans for railroads were forced on holdout creditors (who wished to keep their original debt claim and refused to participate in the restructured debt) by selling the railroad's assets to purchasers who agreed to accept restructured debt claims against the sold assets. Holdout creditors were left with their original claims against an empty shell. Those cases protected the purchasers at the sale from original creditor claims if the holdout creditors had been offered participation in the restructured debt and had turned it down. Eventually, however, courts issued injunctions against collections on original debt after a trial about whether the original obligor's proposed restructure plan was fair without the need for a *pro forma* sale structure.
6. Initially federal railroad equity receiverships were initiated as a response to creditor collection actions. Eventually, however, it was common for a railroad debtor facing imminent default to petition for establishment of a receivership to stay foreclosure and preserve its going concern operations pending the restructure of its debt pursuant to a restructure plan that it would propose and submit for confirmation by the court.
7. In *U. S. v. Bekins*, 304 U.S. 27 (1938) the Supreme Court held that a state entity can be authorized to submit itself to federal jurisdiction in a case where the federal court will decide whether its proposed debt restructure plan is fair and should be enforced as long as the state entity retains control over basic public safety and health functions, and retains control over its finances as provided by state law. Bankruptcy Code sections 903 and 904 describe generally what would be an acceptable reservation of state power for a state entity to pursue a case in federal court to restructure its debt.
8. State laws authorizing the appointment of temporary emergency receivers/managers provide a model for a federal equity receivership to restructure the debt of an insolvent state entity. Ideally, these statutes authorize the appointment of a receiver/manager vested with the power to speak for the government, to propose, negotiate and, if necessary, litigate over the approval of a debt restructuring plan that is fair and equitable and in the best interests of creditors. In the interests of preserving a level of local sovereignty, ideally, that statute would provide for consultation with elected officials, giving them some power to approve or veto the restructure leader's proposals. These principles could be applied to the restructure of the debt of Illinois, California and

other States.

9. Federal equity receiverships issued injunctions prohibiting collection against a reorganized debtor's assets, a precursor to the discharge injunction provided in Bankruptcy Code section 1141. By contrast, the section 944 discharge injunction in chapter 9 focuses on creditors rather than municipal assets over which the state has retained control pursuant to section 904. A federal court approving the debt restructuring plan in an equity receivership proceeding could issue a section 944 style injunction prohibiting creditors from attempting to collect on their original, un-restructured claims. There is recent U.S. Circuit court authority for issuance of a strong bar order in a federal equity receivership.
10. FRCP 23 (class action) might be used to join all bond creditor parties in an equity receivership. FRCP 19 (joinder of parties necessary to complete adjudication) provides a better vehicle to join substantial creditor parties in an equity receivership since it does not provide for opt outs. These two federal procedural rules could be used to make a plan confirmation order in a federal equity receivership as effective as a section 944 discharge injunction in a chapter 9 case.
11. The Supreme Court has recognized that governments, like railroads, involve the public interest and ought not to be liquidated. It has explained that plan confirmation standards in municipal government bankruptcy cases should focus on whether the plan is in the best interests of creditors because it pays at least as much as creditors could expect to collect in light of sovereign immunity that does not permit liquidating the government's assets. Circuit courts have explained that such a plan is also fair and equitable if it pays all the government debtor can reasonably afford.
12. Whether a State's debt restructure plan is fair and equitable and in the best interests of creditors can be adjudicated in a federal equity receivership which has the power to enforce its order.

2. **Historically Courts Have Restructured Debt through Federal Equity Receiverships when No Bankruptcy Law was Applicable.**

For over 50 years, federal courts developed and applied equitable principles to reorganize bankrupt railroads. After the Civil War, railroad companies began building a nationwide transportation network, which was important to the United States' national interest. Many of these railroad companies became insolvent during construction of their railroad systems and would have been worth very little if bondholders had simply liquidated the assets in a series of foreclosure sales. The only way to preserve going-concern value and

ultimately get the rail network built was to stay foreclosure actions, restructure the debt, and enforce the terms of that debt restructure.

Beginning in the late 1890's and continuing into the 1930's, the restructuring of the debt of railroads was done through federal equity receiverships, until in 1934 Congress finally passed a bankruptcy law applicable to railroads codifying the equitable debt restructure principles developed in those receiverships.⁵ Many current statutory bankruptcy statute principles thus began as equitable principles in federal equity receiverships.

For example, in *Howard*, the Supreme Court held that "equity regards the property of a corporation held in trust for the payment of debts of the corporation and the rule is well settled that stockholders are not entitled to any share...until the debts of the corporation are paid."⁶ This early statement of an absolute priority rule as a test for what is an equitable reorganization was applied for over 50 years in equity receiverships of railroads conducted by federal courts.⁷

More than 50 years after *Howard*, Congress finally exercised bankruptcy power to enact a uniform federal bankruptcy statute concerning railroads and other corporations and required that their plans of reorganization be fair and equitable.⁸

When it applied the fair and equitable concept incorporated into later-enacted bankruptcy statutes, the Supreme Court was guided by the meaning that had been developed for this concept in the earlier equity receiverships. See e.g., *Case v. Los Angeles Lumber Products*, 308 U.S. 307 (1939), (the Bankruptcy Act's language requiring that a plan be "fair and equitable" were "words of art" which "had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations").

The history of federal equity receiverships for railroads thus makes clear that federal courts can apply reasonable, equitable principles to deal with insolvencies that Congress has not yet chosen to enact a statute to deal with.

The Supreme Court has also upheld an individual state's law providing a mechanism for the adjustment of the debts of an insolvent government entity in the absence of an applicable federal bankruptcy statute. In the mid 1930's, the original federal municipal bankruptcy act was struck down as

⁵ See, e.g., *R.R. Co. v. Howard*, 74 U.S. 392 (1869); *Louisville Trust Co. v. Louisville, New Albany and Chicago Ry. Co.*, 174 U.S. 674 (1899); *Northern Pacific Ry. Co. v. Boyd*, 228 U.S. 482 (1912); *Kansas City Terminal Ry. V. Central Union Trust Co. of N.Y.*, 46 S.Ct. 549 (1926); *Case v. Los Angeles Lumber Products*, 308 U.S. 106 (1939); *Wright v. Union Central Life Ins. Co.*, 311 U.S. 272 (1940); *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510 (1941).

⁶ *Howard*, 74 U.S. at 409-10 (emphasis added).

⁷ See, e.g., *Northern Pacific Railway Co. v. Boyd*, 228 U. S. 482 (1913).

⁸ See, The Bankruptcy Act sec. 77B, Act of June 7, 1934, ch. 424 sec 77B (f).

unconstitutional and Congress had not enacted a replacement law. In the absence of Congressional action on the subject, the state of New Jersey passed its own municipal bankruptcy law which permitted insolvent municipalities to propose a plan of debt adjustment which, when approved by a court, would be binding on all creditors. The U.S. Supreme Court upheld New Jersey's creation of this court-based debt restructuring procedure in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 507-08 (1942).

The Supreme Court in *Asbury Park* and in the railroad reorganization cases upheld the use of the "fair and equitable" and "best interests of creditors" concepts that were originally developed through courts' exercise of the equitable powers. These equitable principles have been codified in every federal bankruptcy statute since the Great Depression.

3. There is Strong Current Authority for Use of Receiverships to Deal With Insolvency

Federal courts continue to be vested with the power to apply equitable principles to deal with insolvency. As pointed out by a prominent representative of insolvent sovereign nations, federal equity receiverships are still authorized.

The equity receivership technique of the late nineteenth and early twentieth centuries evolved over time to meet what the debtors and bondholders of the day saw as a pressing need. Debt rearrangements for corporate and railroad borrowers were occasionally necessary. There was no bankruptcy procedure in place at the time that would accommodate such a workout (short of liquidation) and prevent exploitation by dissident creditors. The equity receivership solution engaged the equity powers of a U.S. court to shield the debtor from piecemeal asset foreclosures while the stakeholders negotiated and implemented the terms of a rearrangement.

Those equity powers still exist in U.S. courts. Indeed, the Federal Rule of Civil Procedure 66, provides for the appointment of receivers 'in accordance with the practice heretofore followed in the courts of the United States.' This article will describe how such a receivership can be used to restructure the debt of many kinds of governments.⁹

In *Zacarias v. Stanford International Bank, Ltd*, 932 F.3d 382 (5th Cir 2019) the Fifth Circuit recently upheld the power of a federal court in an equity receivership, describing in great detail why a receivership is useful to deal with an insolvency,

⁹ L.C. Buchheit and G. Mitu Galati, *Sovereign Bonds and the Collective Will*, 51 Emory Law Journal 1137, 1152 (2002).

and the broad powers it still possesses in 2019 to bar claims. Because *Stanford* describes the reason and method of an insolvency receivership process so well it is quoted at length.

The SEC had sued Stanford for securities fraud and asked the District Court to appoint an equity receiver pursuant to the federal securities statute to take charge of Stanford's assets and allocate them fairly to claimants. The Fifth Circuit upheld the broad power of a federal equity receivership court to approve a settling party's payment to the receivership in return for a bar order providing it immunity from related claims against it that are owned by third parties who were not party to the settlement.

The Fifth Circuit described that the power to order this receivership to deal with insolvency came from a federal securities statute *and* from 28 U.S.C. § 3103 that provides for the appointment of receivers.

In the aftermath of the 1929 financial crash, Congress passed a number of statutes to promote competition and free exchange in our country's securities exchanges and the market for unlisted securities. The "basic purpose" of these laws was "to insure honest securities markets and thereby promote investor confidence." These laws established the SEC, an agency armed "with an arsenal of flexible enforcement powers" to uphold the integrity of securities markets. These same statutes also authorize federal courts' jurisdiction over actions protecting the markets. Specifically, Section 22 of the 1933 Act and Section 27 of the 1934 Act confer jurisdiction on the district courts over enforcement actions, including "suits in equity." The acts grant the SEC access to the courts' full powers, including use of the traditional equity receivership, to coordinate the interests in a troubled entity and ensure that its assets are fairly distributed to investor creditors. These implicit authorizations of receiverships are consistent with the more general express authorization Congress provided in 28 U.S.C. § 3103. Otherwise stated, "[f]ederal equity receiverships, despite the name, have a federal statutory framework."¹⁰

While not cited by the Fifth Circuit, these statutes are grounded in Article III Section 2 of the United States Constitution which provides that:

"The judicial Power shall extend to **all Cases, in Law and Equity**, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, other public

¹⁰ 931 F.3d at 393 (citations omitted).

Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—**between a State and Citizens of another State,—between Citizens of different States,**—between Citizens of the same State claiming Lands under Grants of different States, and **between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.**” [emphasis added]

The *Stanford* Court praised as good public policy the “substitution of orderly, equitable creditor recovery for the chaos and inefficiency of individualized creditor litigation with its irrational allocation of recoveries—one born of necessity.”

Exercising their jurisdiction under the securities laws, federal district courts can utilize the receivership mechanism where a troubled entity will not be able to satisfy all of its liabilities to similarly situated creditors. Where the troubled entity is unable to meet its obligations, creditor-investors encounter a collective-action problem: each has the incentive to bring its own claims against the entity, hoping for full recovery; but if all investors take this course of action, latecomers will be left empty-handed. A disorderly race to the courthouse ensues, resulting in inefficiency as assets are dissipated in piecemeal and duplicative litigation. The results are also potentially iniquitous, with vastly divergent results for similarly situated creditors. So, it is that at the behest of the SEC the district court may take possession of the entity and its assets, and vest control in its officer, the receiver. The court empowers the receiver to “stand in the shoes” of the troubled entity, allowing him to override holdout creditors and reach decisions for the aggregate benefit of creditors under the court’s supervision. If so directed by the court, the receiver will systematically use ancillary litigation against third-party defendants to gather the entity’s assets. Once gathered, these assets are used to satisfy liabilities to the entity’s creditors, not in a disorderly creditor feeding frenzy, but through a court-supervised administrative distribution process. Receivership is thus a substitution of orderly, equitable creditor recovery for the chaos and inefficiency of individualized creditor litigation with its irrational allocation of recoveries—one born of necessity.¹¹

The Fifth Circuit explained why bar orders are important to the receivership process, and have been approved by many circuit courts.

¹¹ 931 F.3d at 394. (citations omitted).

For this exercise, the federal district courts draw upon “the power ... [to] impose a receivership free of interference in other court proceedings.” The receivership’s role is undermined if creditor-claimants jump the queue, circumventing the receivership in an attempt to recover beyond their pro rata share. Under the securities laws, the district court’s power to determine appropriate relief for a receivership is broad. The court’s powers include “orders preventing interference with its administration of the receivership property.” As we have stated:

Courts of Appeals have upheld orders enjoining broad classes of individuals from taking any action regarding receivership property. Such orders can serve as an important tool permitting a district court to prevent dissipation of property or assets subject to multiple claims in various locales, as well as preventing piecemeal resolution of issues that call for a uniform result.

These can include stays of claims in other courts against the receivership, and bar orders foreclosing suit against third-party defendants with whom the receiver is also engaged in litigation. Accordingly, at an earlier stage in the litigation we affirmed the district court’s order enjoining the Texas Plaintiffs-Objectors’ from prosecuting claims against Willis during the pendency of the receiver’s action. While that stay was temporary and the bar orders here are permanent, it is of no moment here in the calculus of the court’s powers. **Indeed, in both cases the district court, through its control of the receivership, enjoins non-party claims in another court—without exercising jurisdiction over them—to protect the receivership.**

...The district court will exercise its “broad equitable power in this area” in accord with the needs of receivership on the particular facts of each case. *Rishmague, Kaleta, and DeYoung* clarify the breadth and reach of the district court’s power to protect the operation of the receivership and its custody of the receivership res. We find them persuasive.¹²

Based on this, the Fifth Circuit approved a bar order in *Stanford* prohibiting creditors from pursuing lawsuits in other courts against defendants who had settled and paid money to the receiver and demanded such a bar order in return for that settlement payment. It held that the receivership court had the power to make that bar order because of its power over the settlement payment to the receivership estate, and that it was good reorganization policy to require claimants to recover

¹² 931 F.3d at 394-95 (citations omitted)(emphasis added).

through the receivership instead of through their separate claims against settling third parties in other courts.

By entering the bar orders, the district court recognizes the reality that, given the finite resources at issue in this litigation, Stanford's investors must recover Ponzi-scheme losses through the receivership distribution process. The Willis Defendants and BMB contend that the bar orders are preconditions of their respective settlements. The brokers' incentives to settle are reduced—likely eliminated—if each SIB CD investor retains an option to pursue full recovery in individual satellite litigation. Such resolution is no resolution. And the costs of undermining this settlement are potentially large. The receivership—and thus qualifying investor claimants—will be deprived of \$132 million in settlement proceeds. Continued prosecution of the receiver and Investors' Committee's suit against Willis and BMB could result in the same if not greater recovery, but this is sheer speculation. Further, any potential value of the receiver's ultimate recovery must be reduced by the costs of prolonged litigation over the same assets, not only in the receiver's own action but also in the Plaintiffs-Objectors' myriad satellite suits, into which the receivership is likely to be drawn. Supposing that Willis, an allegedly deep-pocketed defendant, remains able to satisfy any judgment against it, the same cannot be said of BMB: continued litigation would eat away at the limited funds available under its "wasting" insurance policy.

...

The bar orders—enjoining these investors' third-party claims—fall well within the broad jurisdiction of the district court to protect the receivership res. The exercise of jurisdiction over a receivership is not an exercise of jurisdiction over other judicial proceedings. It rather permits the barring of such proceedings where they would undermine the receivership's operation.

“[T]he district court has ... wide discretion to determine the appropriate relief in an equity receivership.” Again, **the receivership solves a collective-action problem among the Stanford entities' defrauded creditors, all suffering losses in the same Ponzi scheme. It maximizes assets available to them and facilitates an orderly and equitable distribution of those assets. Allowing creditors to circumvent the receivership would dissolve this orderly process—circumvention must be foreclosed for the receivership to work.** It was no abuse of

discretion for the district court to enter the bar orders to effectuate and preserve the coordinating function of the receivership.¹³

Stanford thus stands as strong, current precedent for (1) the use of federal equity receivership to deal with insolvency, (2) the powers of a receivership court to control claims relating to that insolvency, and (3) the power of the receivership court to issue an order enforcing a debt restructure. The strong bar order entered in *Stanford* performs a function similar to a discharge order entered in a bankruptcy that bars assertion of a claim based on its original, pre-restructured terms; allowing only the restructured claim to be asserted.

4. Basis Used to Discharge Debt of Holdout Creditors in a Federal Equity Receivership

In a debt restructuring plan under the Bankruptcy Code, the proposed plan, once approved by a bankruptcy court, is binding on all creditors.¹⁴ Creditors, including those who voted against the plan, are enjoined from attempting to collect discharged debts from the debtor or its assets.¹⁵

Equity receiverships initially dealt with the problem of holdout creditors by using a foreclosure sale of the debtor's assets to a new entity in which agreeing creditors received an interest. Holdouts who did not agree to take the restructured securities retained their original claims, but those claims were now against a shell company whose assets had all been transferred away in the sale.

The Supreme Court upheld such a *de facto* discharge in the *Boyd* case finding it equitable.

His [creditor] interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come to a just reorganization, could not be heard in a court if equity to attack it. . . . If, however, no such tender was made and kept good he retains the right to subject the interest of the old stockholders in the property to the payment of the [original] debt [claim].¹⁶

A fair and continuing offer of restructured securities was, thus, crucial to the issuance of an equitable discharge.

Eventually, some courts dropped the requirement of a sale and held that, if a debt restructuring plan was found by the court to be fair and equitable it could provide

¹³ 931 F.3d 397-99 9 (citations omitted)(emphasis added).

¹⁴ 11 U.S.C. §§ 943, 944, 1129, and 1141.

¹⁵ *Id.*

¹⁶ *Boyd*, 228 U.S. at 508.

for the return of the assets of the original insolvent debtor to the now-solvent, reorganized debtor with the court to enjoin creditors from collecting on their original, un-restructured claims.¹⁷

The courts in this case had the same power to vest in the reorganized solvent corporation the title to the property of the insolvent corporation free from the claims against and stock in the latter, and to bar actions and suits against the reorganized corporation and against the property they delivered to that corporation, that the courts in the foreclosure cases had and exercised to protect the new corporations and the property which they delivered to them against like claims. And the conclusion of the whole matter is that the decree of the United States District Court of the Northern District of Illinois, whereby that court adjudged that the property of the insolvent railway company should be delivered pre-receivership back to that corporation so reorganized as to be solvent without a sale, and that the unsecured creditors and stockholders of the insolvent company were enjoined and forever barred from interfering with or maintaining claims, actions, or suits against the property so delivered, or against the reorganized company, on account of such claims against or stock in the old insolvent corporation, in any other way than that specified in that decree, *was far within the jurisdiction and power of that court, and was fair, equitable, and just*.¹⁸

For all practical purposes, the injunction issued in *Phipps* acted as a discharge of pre-receivership debts similar to that provided under today's Bankruptcy Code.¹⁹

This still-valid concept from the railroad receivership cases is important for a government using an equity receivership to restructure its debt. For obvious reasons, a transfer of all of a government's assets to some "purchasing" entity in a foreclosure sale is impractical and nonsensical.

Section 7 below discusses the relationship between (i) a *Phipps*-style discharge injunction that focuses primarily on the *assets* of the debtor entity, but inevitably involves creditors (as provided in section 1141 of the Bankruptcy Code), and (ii) another kind of discharge injunction that focuses primarily on the *creditors* of the debtor entity, but inevitably involves the debtor's assets (as provided in section 944 of the Bankruptcy Code governing municipalities). This is the kind of bar order that was entered in *Stanford*.

¹⁷ See e.g., *Phipps v. Chicago R. Co.*, 284 Fed. 945 (8th Cir 1922), *writ of error dismissed* 262 US 762 (1922).

¹⁸ *Phipps v. Chicago R. Co.*, 284 Fed. at 954 (emphasis added).

¹⁹ See, e.g., 11 U.S.C. § 1141 and 944.

Section 8 also discusses the possibility of joining creditor parties to an equity receivership under FRCP 23 (governing class actions but permitting opt outs) and FRCP 19 (joining all parties necessary to a complete resolution, and not permitting opt outs) to make the injunction issued at the end of such a receivership case meaningful.

5. Who can Start a Receivership and what is the Basis to Institute it in Federal Court?

In the earliest railroad receivership cases, receivers for insolvent railroads were appointed in connection with lawsuits seeking to foreclose on mortgages. Mortgage foreclosures were classically brought in federal court based on diversity of citizenship between a midwestern railroad and a New York indenture trustee, not based on a federal statute such as the Securities Act that the Fifth Circuit relied on in *Stanford*.

Writing in the 1933 Virginia Law Review, Robert L. Swaine described this use of diversity jurisdiction very bluntly.

The only escape which a corporation and its creditors have if its financial situation subjects it to such a risk [of insolvency and imminent foreclosure], is to arrange, in advance of such an attack, with one of its creditors, who has an overdue claim and is a resident of a state other than that in which the corporation is domiciled, for the filing of a creditor's bill in a federal court in a district in which the corporation is operating. The action is one designed to subject the assets of the corporation to the payment of, the plaintiff's debt, in the nature of an equitable execution. It seeks such relief on behalf of all creditors similarly situated, in the nature of a bill of peace to avoid multiplicity of actions. The basis for federal jurisdiction is diversity of citizenship. The prayer is for the determination of the rights of the respective creditors, the ultimate sale of the corporation's assets for the benefit of all the creditors and, pending the sale, for the appointment of a receiver. The corporation then answers, admits the allegations of the bill and consents to the appointment of receivers.²⁰

By the late 1800's it had become common for debtor railroads to initiate receivership proceedings themselves when they were insolvent but believed they had going concern value worth preserving, often obtaining the appointment of a receiver close to the management of the railroad.²¹

²⁰ Lloyd K. Garrison, *Corporate Reorganization—An Amendment to the Bankruptcy Act—A Symposium*, Virginia Law Review, Vol XIX, No. 4, pp. 318-19 (Feb 1933).

²¹ See, e.g., *Atkins v. Wabash*, 29 F. 161 (Cir. N.D. Ill. 1886); *Central Trust v. Wabash*, 29 F. 618 (Cir. E.D. Mo. 1886); *Wabash v. Central Wabash, Central Trust Co.*, 22 F. 272 (Cir. E.D. Mo. 1884).

The Harvard Law Review noted that:

Since the Wabash case, many like cases have arisen; and it may now be said that the practice is well established; indeed, that under like circumstances it is the almost invariable practice. By this is meant precisely, that when a railway company is in financial straits, or about to be in a case where under the former practice its creditors would be entitled to bring suit to subject its property to a sale for the payment of its debts, and, pending such suit, to ask the appointment of a receiver, **the recent practice is for the company itself to anticipate the occurrence of such conditions, and, as the creditors cannot move till they do occur, to seek the court in advance of default, file a petition or bill on its own behalf, and ask the appointment of receivers, usually of its own selection, . . . it is certainly true that the practice is actually followed, so far as we know, in nearly all the courts of the United States, as occasions arise.**²²

By 1933, in the depths of the Great Depression, “more than fifty railroad companies owning more than twenty thousand miles of railroad in the United States . . . [were] in receivership.”²³

If a state such as Illinois or California were to initiate an equity receivership as Wabash did, the jurisdictional basis would be US Constitution Article III section 2 jurisdiction over “controversies . . . between a State and citizens of another State.” This would be every bit as good a basis for federal equity jurisdiction as diversity jurisdiction was for 50 years-worth of railroad equity receivership cases.

6. Can a State Pursue an Equity Receivership?

a. Bekins’ Rationale is Broad

In *U.S. v. Bekins*,²⁴ the Supreme Court held that a “state” can exercise its discretion to authorize one of its municipalities to go to a federal court to access federal bankruptcy power in order to discharge unaffordable debt because this intrusion on state sovereignty is consensual and for the limited purpose of seeking a restructuring of unsustainable debt that would be unavailable under state law.

Nowhere in our scheme of government – in the limitations express or implied of our federal constitution – do we find that [a

²² D. H. Chamberlain, *New Fashioned Receiverships*, 10 Harv. L. Rev., 139, 145-46 (1896)(emphasis added).

²³ *Corporate Reorganization—An Amendment to the Bankruptcy Act—A Symposium*, 19 Va. Law Rev., 317, 317-18 (1933).

²⁴ 304 U.S. 27 (1938).

state] is prohibited from assenting to conditions that will assure a fair and just requital for benefits received. ...

In the instant case we have cooperation to provide a remedy for a serious condition in which the states alone were unable to afford relief. Improvement districts, such as the petitioner, were in distress. Economic disaster had made it impossible for them to meet their obligations. As the owners of property within the boundaries of the district could not pay adequate assessments, the power of taxation was useless. **The creditors of the district were helpless. The natural and reasonable remedy through composition of the debts of the district was not available under state law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation. The federal bankruptcy power is competent to give relief to debtors in such a plight** and, if there is any obstacle to its exercise in the case of the districts organized under state law it lies in the right of the State to oppose federal interference. **The State steps in to remove that obstacle.** The State acts in aid, and not in derogation, of its sovereign powers. **It invites the intervention for the bankruptcy power to save its agency which the State itself is powerless to rescue.** Through its cooperation with the national government the needed relief is given. We see no ground for the conclusion that the Federal Constitution, in the interest of state sovereignty, has reduced both sovereigns to helplessness in such a case.²⁵

Bekins held that the Bankruptcy Act was constitutional because the newly enacted municipal bankruptcy provisions permitted the state to retain adequate control over the “governmental” and “fiscal” affairs of its municipality while it was subject to federal bankruptcy jurisdiction in a federal court which could apply bankruptcy power to restructure its debt.²⁶

It was crucial to *Bekins*’ finding of constitutionality that the intrusion of federal power into state sovereignty (a) was consensual, (b) was focused on financial restructure, not the general exercise of police power, (c) permitted the state to continue to control its assets and revenues, and (d) was used for a limited

²⁵ *Bekins*, 304 U.S. at 53-4 (emphasis added).

²⁶ The bill here recommended for passage expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the **fiscal** or **governmental** affairs of a political subdivision is permitted. The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation. No involuntary proceedings are allowable, and no control or jurisdiction over that property and those revenues of the petitioning agency necessary for essential governmental purposes is conferred by the bill. *Bekins* 304 U.S. at 51 (emphasis added).

purpose of restructuring debt pursuant to a plan proposed by the municipality. Indeed, the limitations on a federal bankruptcy court's power in a case involving a state municipal debtor described in *Bekins* were incorporated into sections 903, 904 and 941 of the current Bankruptcy Code.²⁷

b. A State Could Pursue a Federal Equity Receivership Under *Bekins*' Broad Rationale

Congress has the power to enact statutes that provide for uniform laws concerning bankruptcy throughout the United States.²⁸ However, the current Bankruptcy Code does not empower a State or Territory to file a federal bankruptcy case to restructure and discharge its own debt; it only makes provision for States to authorize their municipalities to use federal bankruptcy law in a chapter 9 case.²⁹ Moreover, the Bankruptcy Code specifically excludes Puerto Rico and its municipalities, political subdivisions, public agencies or instrumentalities from the list of entities given access to proceedings under chapter 9 of the Bankruptcy Code.³⁰ As described above, in the absence of a federal bankruptcy statute permitting the restructure of railroad debt in a bankruptcy case, federal courts restructured that debt for fifty years by using equity powers in receiverships.

Bekins' rationale for the constitutionality of the exercise of federal jurisdiction over matters normally the subject of state sovereignty supports a State authorizing one of its government instrumentalities or agencies to pursue a federal equity receivership to restructure its debts if this does not "materially restrict its control over fiscal affairs." It supports a State legislature authorizing one of its governmental entities to submit to federal court jurisdiction for a limited period of time to litigate about and obtain approval of a reasonable allocation of insufficient

²⁷ 11 U.S.C. § 903 ("This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, . . .").

¹¹ U.S.C. § 904 ("Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property.")

²⁸ U.S. Const. art I, § 8, cl. 4.

²⁹ A debtor is eligible to file a chapter 9 case if it (i) is a **municipality**, (ii) is specifically authorized under state law to be a chapter 9 debtor, (iii) is insolvent, (iv) desires to effect a plan to adjust its debts, and (v) either (a) has obtained majority approval of creditors in each class for the proposed plan of reorganization, (b) has negotiated in good faith with creditors and failed to obtain such a majority, (c) is unable to negotiate further because such negotiations are impracticable, or (d) reasonably believes a creditor may attempt to obtain a preferential transfer. 11 U.S.C. § 109(c)(1)-(5) (emphasis added). "Municipality" is defined in 11 U.S.C. § 101(40) as a "political subdivision or public agency or instrumentality of a State."

³⁰ "State" as it is currently defined "includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under Chapter 9 of this title." 11 U.S.C. § 101(52).

State resources pursuant to a restructure plan that pays all the entity can reasonably afford after reasonable austerity and reasonable use of taxation, that is still more than creditors would receive by exercising their limited remedies.

Bekins also supports a State legislature appointing *de facto* chief restructuring officer to lead the State through a federal equity receivership. The state legislature could propose such a person to act as a receiver to lead the debt restructuring effort and give that person power over the State necessary to carry out that role. Ideally, a state statute would authorize the appointment of a receiver/manager vested with the power to speak for the government, to propose, negotiate and, if necessary, litigate over the approval of a debt restructuring plan that is fair and equitable and in the best interests of creditors. Ideally, in the interests of preserving a level of local democracy, that statute would provide for consultation with elected officials, giving them some power to approve the restructure leader's proposals.

The Michigan Emergency Manager statute³¹ provides one model of the powers that the state could give to an appointed official to control the finances of a state entity and use federal equitable powers while still respecting state control as required in Bankruptcy Code sections 903 and 904. That statute leaves little control for local elected officials, which worked out well for Detroit but poorly for Flint, Michigan.

Under the Michigan statute, the governor essentially appointed a Chief Restructure Officer for Detroit and gave him two years to finish restructuring Detroit's debt, using federal bankruptcy law if necessary, to accomplish the task. The Emergency Manager was given broad powers over city finances, including the power to formulate a restructure plan, to start a federal bankruptcy case to restructure Detroit's debt pursuant to a plan that he proposed, and to control city revenue and expenditure decisions as they might affect the debt restructure. Although Michigan's statute provides for very little consultation with elected officials, the exercise of emergency manager control resulted in a positive outcome for Detroit.

In contrast, in Flint, Michigan, the emergency managers' short-sighted focus solely on financial austerity rather than the greater public welfare led to a health crisis from a poisoned public water system. Local elected officials were largely powerless to protect public health from his actions. This illustrates the importance of continued consultation with elected officials by a person who might be appointed under a state statute to have sufficient power to lead a government in restructuring through a federal equity receivership.

³¹ Mich. Comp. Laws § 141.1541 et seq.

7. **What Kind of Discharge Order could be Entered in an Equity Receivership for a State?**

If a federal equity receivership can handle the restructuring of the debt of a State, what power does it have to enforce its ruling restructuring and partially discharging the State's debt against holdouts who do not agree to the proposed restructuring plan and who wish to ignore the restructure? Two ways of dealing with this issue emerged over time, one focusing on the debtor's assets, the other focusing on the creditors' claims against a government, both currently appear in the Bankruptcy Code.

a. **Immunize Assets**

In *Phipps, supra*, the court held that a federal receivership court could use equitable power to immunize the assets of a reorganized debtor from claims made by a holder of an original "unrestructured" claim. See section 4 above.

Similarly, as described in a leading treatise concerning sovereign debt restructure,³² after Saddam Hussein was deposed from power, the United Nations Security Council supported Iraq's restructure of its sovereign debt by immunizing Iraq's oil assets from collection actions by unrestructured bond claimants.

The exit consent that re-immunized Uruguayan assets from attachment by holdout creditors in 2003 prefigured a much more sweeping action by the United Nations Security Council (UNSC) following the ousting of Saddam Hussein in that same year. By the time he was asked to leave office, Saddam had accumulated a debt stock, most of it in default, equal of about US\$140 billion. Iraq's economic recovery following the removal of the Saddam regime depended critically upon a satisfactory resolution of that gargantuan debt stock. UNSC Resolution 1483 (22 May 2003) was the instrument by which the international community sought to facilitate this debt restructuring.

Among other things, Resolution 1483 strongly encouraged both Iraq and its Saddam-era creditors (official and private) to set about a comprehensive restructuring of those debts. Recognizing that holdouts in such a restructuring could significantly undermine its effectiveness, however, the Security Council immunized all petroleum assets of Iraq against 'any form of attachment, garnishment, or execution', and clothed the proceeds of Iraqi oil sales (as well as the bank account into which the proceeds of all such oil sales were to be directed) with privileges and immunities identical to those enjoyed the United

³² R. Lastra and L. Buchheit, *Sovereign Debt Management*, (Oxford Univ. Press 2014).

Nations itself. The obvious and intended effect of immunizing Iraqi assets in this way was to deflate any expectation on the part of prospective holdout creditors that a better recovery might follow litigation and enforcement of a judgment. The UNSC-mandated immunities for Iraq remained in place through the middle of 2011--long enough for Iraq to complete a successful restructuring of its Saddam-era debt stock that imposed an 89.75 percent net present value loss on the affected creditors. Resolution 1483 was later described by the US Congressional Research Service as "a stay on the enforcement" of debt claims.³³

Indeed, Sovereign Debt Management suggests that other government entities might have the power to issue such injunctions in support of a government debt restructure.

It has been proposed elsewhere that the 2012 Treaty Establishing the European Stability Mechanism might be amended to immunize, within the Eurozone, the assets of a debtor country receiving financial support from the European Stability Mechanism (ESM--the European bailout fund) against attachment by a creditor who was invited to participate in an ESM-approved debt restructuring, but declined to do so. The objective of such a measure would be similar to UNSC Resolution 1483 for Iraq: to encourage creditor participation in debt restructurings by dimming the outlook for a successful alternative litigation strategy.³⁴

Such an injunction, whether issued in an equity receivership, by the United Nations or an E.U. entity, is the functional equivalent of the discharge injunction issued in a federal equity receivership in *Phipps*. It is currently provided in chapter

³³ *Id.* p. 20 (internal references omitted). Note also that the US Congressional Research Service observed that:

The Iraq case thus illustrates that the United States and the international community are willing to shield a debtor from its creditors bankruptcy regime. This can be accomplished multilaterally through U.N. Security Council Resolutions or bilaterally, on a case-by-case basis, through executive orders. Since these measures were not taken on other recent financial crises-afflicted countries, such as Argentina or Brazil, it appears that policymakers are only willing to use such measures selectively, and for countries that exhibit a perceived threat to U.S. and international security. This understanding is made more explicit by implementing the stay through the United Nations, a political institution seen principally as focused on international security, rather than the International Monetary Fund, which is primarily a financial institution. Sovereign Debt Management suggests that other government entities might have the power to issue such injunctions in support of a government debt restructure.

³⁴ Sovereign Debt Management, pp. 20-21. (internal references omitted)

11 cases by Section 1141 of the Bankruptcy Code which protects the property of the reorganized debtor.³⁵

The foundation for a section 1141 discharge injunction is 28 U.S.C. § 1334(e) which gives a federal district court handling a bankruptcy case “exclusive jurisdiction . . . [over] (1) all of the property, wherever located, of the debtor as of the commencement of the case. . . .” Based on this section, 11 U.S.C. § 541 creates a debtor’s “estate” as of the commencement of the case. The discharge injunction of section 1141 applies to all “property” of the chapter 11 debtor’s “estate” as defined in section 541.

b. Enjoin Creditors

By contrast, Bankruptcy Code sections 904 and 941 permit a municipality, as a state entity, to keep control over its “assets” and “revenues,” and to be the only entity that can propose a plan to adjust its debts. Such provisions make chapter 9 constitutional under the Supreme Court’s analysis in *Bekins*.

Section 541 regarding “property of the estate” is not incorporated into chapter 9 pursuant to 11 U.S.C. § 901 because, unlike in chapter 11, there is no “estate” consisting of the municipal debtor’s assets that is theoretically given over to the bankruptcy court during the reorganization case. Rather, the state entity debtor keeps control of its assets as provided by section 904. Consequently, a discharge injunction such as imposed pursuant to section 1141, based on the federal

- ³⁵ (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.
- (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
- (c) Except as provided in subsection (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and or general partners in the debtor.
- (d) (1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—
- (A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not—
- (i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;
- (ii) such claim is allowed under section 502 of this title; or
- (iii) the holder of such claim has accepted the plan.

...
11 U.S.C. § 1141. (emphasis added).

bankruptcy court's control over the debtor's assets, was not included in chapter 9 of the U.S. Bankruptcy Code. 11 U.S.C. § 901.

Rather, chapter 9 contains section 944 which binds "creditors" who were or could have been active parties in the case, rather than focusing on the property of the government entity.³⁶ This is in keeping with Bankruptcy Code section 904.³⁷

There should be no conflict between a sovereign state's control over its assets and the power of a restructure court to issue an injunction immunizing a government debtor's assets from claims except claims that have been restructured by a court-approved reorganization plan. Still section 944 suggests that court control over creditor parties is an important part of the analysis in a government insolvency case.

c. A Section 944 Discharge Injunction and Sovereignty

Section 944 provides an alternate theory for a federal equity receivership court to enforce its judgment that the government debtor's plan to restructure its debt is fair and equitable and should be enforced. Section 944 focuses on the essence of sovereignty, the ability of a government to control claims against itself and its assets asserted by creditors claiming some kind of waiver of sovereign immunity.³⁸ Everyone who deals with a sovereign government knows, or should know, that a sovereign has the power to decide whether and to what extent to

³⁶ (a) The provisions of a confirmed plan bind the debtor and any creditors, either or not—

- (1) a proof of such creditor's claim is filed or deemed filed under section 501 of this title;
- (2) such claim is allowed under section 502 of this title; or
- (3) such creditor has accepted the plan.

(b) Except as provided in subsection (c) of this section, the debtor is discharged from all debts as of the time when—

- (1) the plan is confirmed;
- (2) the debtor deposits any consideration to be distributed under the plan with a disbursing agent appointed by the court; and
- (3) the court has determined--

(c) The debtor is not discharged under subsection (b) of this section from any debt—

- (1) excepted from discharge by the plan or order confirming the plan; or
- (2) owed to an entity that, before confirmation of the plan, had neither notice nor

knowledge of the case. 11 U.S.C. § 944

³⁷ Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with

- (1) any of the political or governmental powers of the debtor;
- (2) any of the property or revenues of the debtor; or
- (3) the debtor's use or enjoyment of any income-producing property.

11 U.S.C. § 904. (emphasis added)

³⁸ See, e.g., *Asbury Park*, 316 U.S. at 510-12.

waive its sovereign immunity; and, a sovereign has the inherent police power to protect the welfare of its citizens.³⁹

As the Supreme Court said in *Asbury Park*,

The principal asset of a municipality is its taxing power and that, unlike an asset of a private corporation, cannot be available for distribution.

... A city cannot be taken over and operated for the benefit of its creditors, nor can its creditors take over the taxing power. Indeed, so far as the Federal Constitution is concerned, the taxing power of a municipality ... is wholly subordinate to the unrestrained power of the State over political subdivisions of its own creation.

...

In effect, therefore, the practical value of an unsecured claim against the City is inseparable from reliance upon the effectiveness of the city's taxing power.

The only remedy for enforcement of such a claim is a mandamus to compel the levying of authorized taxes. The experience of the two modern periods of municipal defaults, after the depressions of '73 and '93, shows that the right to enjoin claims against the city through mandamus is the empty right to litigate.⁴⁰

Section 944 goes to the heart of these issues when it aims a discharge injunction at creditors who assert claims against the debtor government, rather than at the government's assets over which government retains control.

8. Joining all Parties Necessary to Make a Discharge Order Effective

It would help to enforce a bar order approving a plan of reorganization in an equity receivership if all bond creditors were a party to the proceeding as they would be in a chapter 9 case.

A leading sovereign debt restructure lawyer suggested that the mandatory class action mechanism contained in the US Federal Rules of Civil Procedure FRCP 23(b)(1)(B) might provide a procedure to deal with holdouts in a restructure.⁴¹ The FRCP mandatory class action mechanism could provide for a ratable allocation

³⁹ *Id.*

⁴⁰ *Asbury Park*, 316 U.S. 509-11.

⁴¹ Buchheit and Gulati (n. 23), 1352-7. "The true successor to the old equity receivership technique, however, may lie in the federal class action procedures. FRCP 23 contains the rules for the commencement, certification, and settlement of class actions in U.S. federal courts. The prerequisites to a class action in a federal district court are set out in FRCP 23(a):"

of the sovereign's debt servicing capacity.⁴² But it permits opt outs from settlements, precisely the kind of loophole that holdouts could exploit to maximize their returns to the detriment of the debtor and settling creditors.

FRCP 19 concerning joinder of necessary parties could address the holdout problem more comprehensively.⁴³ While it might be more difficult to implement, requiring service and joinder of all affected bond debt parties, it could be more effective as it does not permit holdouts to opt out.⁴⁴

The plain words of FRCP 19 support the joinder of all a debtor government's major creditors if:

- (A) in that person's absence, the court cannot accord complete relief among existing parties; or
- (B) that person claims an interest relating to the subject of the action and is so situated that disposing of the action in the person's absence may:
 - (i) as a practical matter impair or impede the person's ability to protect the interest; or
 - (ii) leave an existing party subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations because of the interest.

The Fifth Circuit's rationale for an equity receivership in *Stanford* describes persuasively why these Rule 19 standards require joinder of all bond creditors to avoid incomplete, inconsistent and unfair results.

⁴² R.M. Lastra and L. Buchheit, *Sovereign Debt Management*, at p. 22 (Oxford Press 2014).

⁴³ Required Joinder of Parties

(a) Persons Required to Be Joined if Feasible.

⁴⁴ F. R. Civ. P. Rule 19. Required Joinder of Parties provides as follows:

(a) Persons Required to Be Joined if Feasible.

(1) Required Party. A person who is subject to service of process and whose joinder will not deprive the court of subject-matter jurisdiction must be joined as a party if:

- (A) in that person's absence, the court cannot accord complete relief among existing parties; or
- (B) that person claims an interest relating to the subject of the action and is so situated that disposing of the action in the person's absence may:
 - (i) as a practical matter impair or impede the person's ability to protect the (ii) leave an existing party subject to a substantial risk of incurring double, interest; or multiple, or otherwise inconsistent obligations because of the interest.

(2) Joinder by Court Order. If a person has not been joined as required, the court must order that the person be made a party. A person who refuses to join as a plaintiff may be made either a defendant or, in a proper case, an involuntary plaintiff.

...[F]ederal district courts can utilize the receivership mechanism where a troubled entity will not be able to satisfy all of its liabilities to similarly situated creditors.

Where the troubled entity is unable to meet its obligations, creditor-investors encounter a collective-action problem: each has the incentive to bring its own claims against the entity, hoping for full recovery; but if all investors take this course of action, latecomers will be left empty-handed. A disorderly race to the courthouse ensues, resulting in inefficiency as assets are dissipated in piecemeal and duplicative litigation. The results are also potentially iniquitous, with vastly divergent results for similarly situated creditors.

So it is that at the behest of the SEC the district court may take possession of the entity and its assets, and vest control in its officer, the receiver. The court empowers the receiver to “stand in the shoes” of the troubled entity, allowing him to override holdout creditors and reach decisions for the aggregate benefit of creditors under the court’s supervision.

If so directed by the court, the receiver will systematically use ancillary litigation against third-party defendants to gather the entity’s assets. Once gathered, these assets are used to satisfy liabilities to the entity’s creditors, not in a disorderly creditor feeding frenzy, but through a court-supervised administrative distribution process.

Receivership is thus a substitution of orderly, equitable creditor recovery for the chaos and inefficiency of individualized creditor litigation with its irrational allocation of recoveries—one born of necessity.⁴⁵

A subsequent paper will discuss in greater detail the use of FRCP 19 (joinder of necessary parties) and FRCP 23 (class action) to add to the power of a U.S. federal court to enforce its decision that a government debtor’s plan of reorganization is fair and equitable and in the best interests of creditors, and to enforce restructure of claims pursuant to that plan, including reduction of claims.

9. Substantive Standards for Debt Restructure in a Federal Equity Receivership for a State

Were a State to initiate a federal equity receivership, it could rely upon fundamental principles such as *fair and equitable* and *best interests of creditors* that were both originally developed in railroad equity receiverships. As one noted bankruptcy scholar observed:

The Court’s 1939 decisions in *Taylor v. Standard Gas and Electric Co.*, 306 U.S. 307 (1939) and *Case v. Los Angeles Co.*, 308 U.S. 106 (1939), extended the principles of the fair and equitable test

⁴⁵ 931 F.3d at 394. (citations omitted).

formed in the railroad equity receivership cases to the reorganization of non-railroad businesses.⁴⁶

Bankruptcy Act §77B(f)'s words requiring that the plan be "fair and equitable" were "words of art" which "had acquired a fixed meaning through judicial interpretation in the field of equity receivership reorganizations" ...⁴⁷

Fair and equitable and best interests of creditors are both common sense principles of equity. When applied to a government, one focuses on how much a government debtor can reasonably afford to pay. The other focuses on how much the creditor could collect using its limited remedies against a government debtor. Federal courts have the power to apply these principles in a federal equity receivership for a government entity, and they should govern the approval of a debt restructuring plan for a government entity in such a proceeding.

a. Governments, Like Railroads, Should Not Be Liquidated.

The Supreme Court has recognized that governments, like railroads, should not be liquidated to pay creditors. Both are important to the public. Accordingly, reorganizations for both ought to be based on projected cash flows, not the hypothetical liquidation value of assets that ought not be sold. In *Kelley v. Everglades Drainage District*, 319 U.S. 415 (1943), the Supreme Court noted:

. . . [T]he reorganization of properties which cannot readily be liquidated requires resort to "practical adjustments, rather than a rigid formula," *Consolidated Rock Products Co. v. DuBois, supra*, 529. Hence, we concluded that findings of the future earnings of the reorganized railroad distributable to each class of security holders and creditors were an adequate substitute for findings of asset value in terms of dollars and cents, which we held could be dispensed with as affording no more than a delusive appearance of a certainty which the subject matter did not warrant.

Delusive exactness of findings is likewise not demanded in cases of municipal bankruptcy. But where future tax revenues are the only source to which creditors can look for payment of their claims, considered estimates of those revenues constitute the only available basis for appraising the respective interests of different classes of creditors.⁴⁸

b. Best Interests of Creditors.

⁴⁶ K. KLEE, *BANKRUPTCY AND THE SUPREME COURT*, p. 377 (2005).

⁴⁷ *Id.* At 380.

⁴⁸ *Id.* At 419-20.

“[B]est interests of creditors” has a different meaning in chapter 9 concerning governments than it does in chapter 11 concerning corporations. In chapter 11, this test is set forth in section 1129(a)(7)(A)(ii) and focuses on a hypothetical liquidation of the debtor’s assets. It requires that each holder of a claim receive under the plan “not less than the amount such holder would so receive ... if the debtor were liquidated under chapter 7.”

This plan confirmation requirement is, however, not included in the list of section 1129(a) subsections that are made applicable in chapter 9.⁴⁹ The legislative history of chapter 9 shows that Congress intended this explicit exclusion.

“...The best interests of creditors test does not mean liquidation value as under Chapter XI of the Bankruptcy Act. In making such a determination, it is expected that the court will be guided by standards set forth in *Kelley v. Everglades Drainage District*, 319 U.S. 415 (1943) and *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d 563 (9th Cir. 1940)...”⁵⁰

Both of the cases cited in the legislative history assumed that the municipal debtor’s assets would not be sold.

In *Kelley v. Everglades*, the Supreme Court held that the findings supporting confirmation of the plan were so inadequate that it vacated the confirmation order and remanded for additional findings.⁵¹ However, in setting guidelines for the remand, the court noted that since a municipal bankruptcy case, like a railroad equity receivership case, involves “reorganization of properties that cannot readily be liquidated,”⁵² when a reorganization plan proposes to pay a secured creditor’s claim from future earnings rather than from sale of collateral, the court need not determine the value of the collateral.⁵³ Rather, it is only necessary to evaluate the future cash flows which were the source of funding for the plan.⁵⁴

⁴⁹ 11 U.S.C. § 901(a).

⁵⁰ Statement of the Hon. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, upon Introducing the House Amendment to the Senate Amendment to H.R. 8200, 124 *Cong. Rec.* H 11089 (Sept. 28, 1978) (footnotes omitted); Statement by the Hon. Dennis DeConcini, Chairman of the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary, upon Introducing the Senate Amendment to the House Amendment to H.R. 8200, 124 *Congressional Record* S 17406 (Oct. 6, 1978).

⁵¹ *Kelley v. Everglades*, 319 U.S. at 422.

⁵² *Id.* at 419.

⁵³ *Id.* (“Hence we concluded that findings of the future earnings of the reorganized railroad distributable to each class of security holders and creditors were an adequate substitute for findings of asset value in terms of dollars and cents, which we held could be dispensed with as affording no more than a delusive appearance of a certainty which the subject matter did not warrant.”).

⁵⁴ *Id.* (“[W]here future tax revenues are the only source to which creditors can look for payment of their claims, considered estimates of those revenues constitute the only available basis for appraising the respective interests of different claims of creditors.”).

In *Fano*,⁵⁵ the other case cited in the chapter 9 legislative history concerning the best interests test, an objecting bondholder appealed a plan in which the debtor proposed to reduce by one-third the principal amount of bonds it had issued to build an irrigation system. The Ninth Circuit noted that the debtor had spent twice what was needed to refurbish its equipment and had failed to show why it was unable to use its taxing power to enact the small tax increase that would have permitted it to make its bond payments.⁵⁶ The court concluded that, in view of this evidence, the plan was not “equitable” and “fair” and for the “best interests of creditors.”⁵⁷

In reversing the confirmation of the debtor’s plan, the court’s “best interests of creditors” analysis focused not on any hypothetical liquidation value of the debtor’s assets, but on (i) whether the municipality had spent its money reasonably and (ii) whether it had made adequate use of taxation. As will be shown below, this particular formulation of best interests of creditors is what the courts developed under the fair and equitable standard.

A year before its decision in *Kelley v. Everglades*, the Supreme Court made a “best interests of creditors” analysis the centerpiece of its opinion in *Asbury Park*.⁵⁸ In that case, bondholders asserted that a reduction in the bond interest rate implemented in a plan remedying a municipal insolvency had impaired their contract rights. The Supreme Court explained that, when considering how a municipal restructuring plan can best resolve the claims of unsecured creditors, the focus should be on how “the municipality is to be kept going as a political community and, at the same time, [realize] the utmost for the benefit of the creditors.”⁵⁹ The Supreme Court observed that:

The principal asset of a municipality is its taxing power and that, unlike an asset of a private corporation, cannot be available for distribution. An unsecured municipal security is therefore merely a draft on the good faith of a municipality in exercising its taxing power. The notion that a city has unlimited taxing power is, of course, an illusion. A city cannot be taken over and operated for the benefit of its creditors, nor can its creditors take over the taxing power.⁶⁰

The opinion highlighted the distinction between the broader remedies available to creditors with claims against private entities and the much more limited mandamus remedy available to unsecured municipal bondholders who cannot

⁵⁵ *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d 563 (9th Cir. 1940).

⁵⁶ *Id.* At 565-66.

⁵⁷ *Id.* at 566.

⁵⁸ *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942).

⁵⁹ *Id.* At 510.

⁶⁰ *Id.* At 509.

seize the city's assets.⁶¹ It found that, in light of the poor remedies available to the unsecured bondholders,⁶² the debt composition plan had actually made the bonds worth more than when default was looming, and, thus, there was no actual impairment of the bondholders' rights.⁶³ It was, in essence, in the best interests of creditors because it paid them more than they would receive by exercising their weak mandamus remedy. *Fano, Kelley v. Everglades* and *Asbury Park* confirm that a municipality should not be liquidated and that a municipality's debt restructuring plan should be premised on what the entity's revenues can support. The "best interest of creditors" analysis in those cases complemented the law that had developed during the Great Depression concerning what is "fair and equitable," directing the focus away from what could be recovered by stripping a governmental entity of its assets, toward how much a governmental entity could reasonably pay as it continues to operate and serve its citizens.

More recent cases have reached the same conclusion, noting that "Courts generally agree that the best interests of creditors test in §943(b)(7) requires 'that a proposed plan provide a better alternative for creditors than what they already have.'"⁶⁴ In the chapter 9 bankruptcy of Stockton, California, the appellate panel recognized that "[a] municipality cannot be liquidated, its assets sold, and the proceeds used to pay its creditors, ... Creditors cannot expect that all excess cash go to the payment of their claims. The debtor must retain sufficient funds with which to operate and to make necessary improvements in and to maintain its facilities. [Courts] must apply the test to require reasonable effort by the municipal debtor that is a better alternative to its creditors than dismissal of the case."⁶⁵

c. Fair and Equitable

⁶¹ 25 In effect, therefore, the practical value of an unsecured claim against the city is inseparable from reliance upon the effectiveness of the city's taxing power. The only remedy for the enforcement of such a claim is a mandamus to compel the levying of authorized taxes. The experience of the two modern periods of municipal defaults, after the depression of '73 and '93, shows that *the right to enforce claims against the city through mandamus is the empty right to litigate. Id.* at 509-10 (emphasis added).

⁶² *Id.* at 514 ("The question whether the remedy on this contract was impaired materially is affected not only by the precarious character of the plaintiff's right, but by considerations of fact – of what the remedy amounted to in practice. To say that the right of the Asbury Park bondholders in 1935 was of precarious character is pure understatement. And we have already seen how empty was the remedy with which to enforce that right.").

⁶³ *Id.* at 515-16. ("Here we have just the opposite – no security whatever except the effective taxing power of the municipality; the effective taxing power of the municipality prostrate without state intervention to revive the famished finances of the city; state intervention, carefully devised, worked out with scrupulous detail and with due regard to the interests of all the creditors, and scrutinized to that end by the state judiciary with the result that that which was a most depreciated claim of little value has, by the very scheme complained of, been saved and transmuted into substantial value.").

⁶⁴ *In re City of Detroit*, 524 B.R. 147, 213 (Bankr.E.D.Mich.2014), quoting *In re Pierce County Housing Auth.*, 414 B.R. 702, 718 (Bankr.W.D.Wa.2009)

⁶⁵ *City of Stockton (In re City of Stockton)*, 542 B.R. 261, 284-5 (B.A.P. 9th Cir. 2015)

The Bankruptcy Code provides that unsecured creditors who are not paid in full are treated fairly and equitably under a plan as long as “any claim or interest that is junior . . . will not receive or retain under the plan or on account of such junior claim or [equity] interest any property.”⁶⁶ This is generally referred to as the “absolute priority rule” and, in corporate chapter 11 cases, it means that shareholders, the most junior class of claims or interests, cannot retain any equity ownership interests unless all holders of allowed unsecured claims are paid in full.⁶⁷ Often, when there is not enough value in a corporate chapter 11 case to pay creditors in full, existing corporate stock is cancelled and newly issued shares in the reorganized company are distributed to unsecured creditors under the chapter 11 plan.

Since there are no “equity owners” of a municipality, the literal terms of the absolute priority rule contained in section 1129(b)(2)(B)(ii) can easily be met in a municipal case even if unsecured creditors are not paid in full. One case decided under current chapter 9, *Corcoran Hospital*,⁶⁸ applied the absolute priority rule by its literal terms. It relied on bankruptcy cases of not-for-profit organizations in reaching its conclusion that it was permissible for a municipal debtor to “continue in existence and in possession of its property even though . . . unsecured creditors will not be paid in full.”⁶⁹ It held that “control [of the debtor’s assets] alone, divorced from any right to share in corporate profits or assets, does not amount to an equity interest.”⁷⁰

However, the *Corcoran Hospital* analysis did not end there. The court went on to apply what it called a “good faith” standard under section 1129(a)(3)⁷¹ citing to two Great Depression era cases that had analyzed whether a plan was fair and equitable by considering whether spending had been reasonably limited or taxes reasonably increased.⁷²

Cases analyzing whether a plan is “fair and equitable” have focused on a wide range of facts and theories.⁷³ A salient consideration has been whether a chapter

⁶⁶ 11 U.S.C. § 1129(b)(2)(B)(ii).

⁶⁷ See, e.g., *Case v. L. A. Lumber Prods.*, 308 U.S. 106 (1939).

⁶⁸ *In re Corcoran Hosp. Dist.*, 233 B.R. 449-58 (Bankr. E.D. Cal. 1999).

⁶⁹ *Id.* at 458.

⁷⁰ *Id.* (“The mere fact that . . . [citizens] are benefited by . . . [the municipality’s] operations and might be disadvantaged by its demise also does not give them an ‘interest cognizable in bankruptcy.’” “[T]he present group retaining control over the debtor entity does not give them anything. . . . Certainly not a favored position over the dissenting creditors. It gives them problems and great anguish ahead.”).

⁷¹ *Id.*, at 459.

⁷² *Id.*, at 460-61, citing *Fano*, 114 F.2d at 565-66 and *Newhouse v. Corcoran Irrigation Dist.*, 114 F.2d 690, 691 (9th Cir. 1940).

⁷³ 35 For example, under chapter IX of the old Bankruptcy Act, the fair and equitable standard was held also to include a feasibility requirement. *Kelley v. Everglades Drainage Dist.*, 319 U.S. 415 (1943). Fair and equitable has been held to mean that the plan must embody a “fair and equitable

9 plan proposes to pay unsecured creditors “all that they ‘can reasonably expect in the circumstances.’”⁷⁴ Applying this standard, some courts have denied confirmation when the debtor governmental entity did not sufficiently cut expenditures or did not make adequate use of taxation.⁷⁵ Other courts have determined that a plan is fair and equitable if it provides creditors with “the maximum ... [the municipality] could reasonably pay.”⁷⁶

The analysis of whether “[creditors] are receiving all that they can reasonably expect” and whether the governmental entity is paying “the most ... it could reasonably pay” has included the following inquiries: (i) has the municipality acted reasonably in reducing the scope and cost of the services it provides, (ii) has the municipality taxed its residents in a reasonable and adequate fashion,⁷⁷ and (iii) does the municipality have adequate funds to carry out its chapter 9 plan. The statute suggests, and courts have held, that a governmental debtor’s business judgment on these issues is entitled to deference.⁷⁸

bargain openly arrived at and devoid of overreaching.” *Town of Belleair, Fla. v. Groves*, 132 F.2d 542, 542 (5th Cir. 1942), *cert. denied*, 318 U.S. 769 (1943). Fair and equitable has also been interpreted as requiring that there is no unfair discrimination in favor of any creditor or class of creditors. *Am. United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 147 (1940).

⁷⁴ *Lorber v. Vista Irrigation Dist.*, 127 F.2d 628, 639 (9th Cir. 1942); COLLIER ON BANKRUPTCY §943.03 [1][f][i][B] (Alan N. Resnick et al. eds., 16th ed. rev. 2010).

⁷⁵ See, e.g., *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d at 565-66 (Confirmation denied where the debtor had spent twice what was needed on capital expenditures to improve facilities that had been in bad repair and, even with that, would only have had to raise taxes a small amount to meet existing bond obligations). However, taxes need not be increased where there is evidence that this would not be feasible. *In re Corcoran Hosp. Dist.*, 233 B.R. at 461 (Bankr. E.D. Cal. 1999) (“[I]n these cases under Chapter IX, the Ninth Circuit Court of Appeals looked at the insolvency of the debtor and whether the debtor could, in fact, raise taxes sufficient to pay the bondholders in full. Here the court has found that the debtor Hospital District could not raise taxes sufficient to pay more to Class 5.”).

⁷⁶ See, e.g., *Lorber v. Vista Irrigation Dist.* 143 F.2d 282, 284 (9th Cir. 1942), *cert. denied*, 323 U.S. 784 (1944). (“[H]eavy delinquencies in meeting assessments . . . an increase of taxes and assessments would make this matter worse . . . the need for large expenditures in the restoration to good working conditions of the District irrigation pipelines . . . the District bonds were listed on exchange at 18 cents; while RFC offered to refinance at 55¢ . . . substantial evidence that the District had been unsuccessful in obtaining a loan from sources other than RFC. We hold that the findings are a sufficient basis for the concluding paragraph IX to the effect that 55¢ on the dollar was the maximum that the District could reasonably pay on outstanding bonds.”).

⁷⁷ The use of the power of taxation is within the discretion of the municipality. The U.S. Supreme Court has stated: The principal asset of a municipality is its taxing power and that, unlike an asset of a private corporation, cannot be available for distribution. An unsecured municipal security is therefore merely a draft on the good faith of a municipality in exercising its taxing power. The notion that a city has unlimited taxing power is, of course, an illusion. A city cannot be taken over and operated for the benefit of its creditors, nor can its creditors take over the taxing power. *Asbury Park*, 316 U.S. at 509.

⁷⁸ See 11 U.S.C. § 904; see also *In re Corcoran Hosp. Dist.*, *supra*; *In re Sanitary & Improvement Dist. No. 7*, 98 B.R. 966 (Bankr. D. Neb. 1989).

Conclusion

There is thus substantial authority for a State to use a federal equity receivership to restructure its debt using the approach described in *Leading a Government to Solvency*.

A subsequent paper will describe how that approach might be used by a foreign sovereign, such as Argentina, whose debt is governed, in large part, by New York law with Southern District of New York as an agreed venue.

Zack A. Clement, PLLC

FINANCIAL RESTRUCTURE FOR BUSINESSES AND GOVERNMENTS

Practice Overview

Zack Clement has led all kinds of financial restructure transaction and litigation matters in 40 years of law practice.

- Restructured the debt of major companies out of court and in Chapter 11 cases.
- Led a municipality to restructure its debts in a Chapter 9 case.
- Been responsible as bankruptcy counsel for (i) cash collateral use and DIP loans, (ii) purchase and sale of substantially all assets and (iii) exit financings for plans of reorganization, representing (a) debtors, (b) secured lenders and (c) new capital providers.
- Handled precedent setting Chapter 15 and cross border involuntary bankruptcy cases.
- Acted as lead trial counsel concerning all these kinds of issues involving billions of dollars.

Representations

Successfully Completed Chapter 11 Cases

- Continental Airlines
- Metals USA
- Coho Energy
- Sam Houston Race Park
- SpectraCell
- Global Marine

Successfully Completed Chapter 9 Case

- The Town of Mammoth Lakes, California

Foreign Clients

- Yukos Oil Company in U.S. Chapter 11 and Chapter 15 cases
- Major Mexican banks in US involuntary bankruptcy case

Education and Personal

Princeton University, A.B. 1970

Woodrow Wilson School for Public Affairs

University of Virginia, J.D. 1975

U.S. Navy Air Intelligence Officer 1970 to 1972

Houston Livestock Show and Rodeo

Lifetime Member and contributor

Wife is an Executive Director

Honorary Organizations and Listings

American College of Bankruptcy

International Insolvency Institute

Listed in **Chambers USA**, Texas Leaders

Listed as one of **100 Best Lawyers in Houston**

Legal Career

Fulbright & Jaworski, Partner, 1991 to 2014, retired

Weil, Gotshal & Manges, 1985 to 1990

Sidley & Austin, 1975 to 1985

Bar Admissions

Texas, Illinois, New York, District of Columbia, Virginia



Details of Some Major Representations

- Represented **Continental Airlines** in its Delaware Chapter 11 case, successfully reorganizing this \$9 billion company.
- Represented **Metals USA** in its Houston Chapter 11 case where this billion dollar company converted \$400 million of debt to equity, and emerged from bankruptcy in less than a year with the best balance sheet in its industry.
- Represented the **Town of Mammoth Lakes, California** in a **Chapter 9 case** that was successfully completed in four months.
- Represented a **successful competing bidder** that purchased substantially all the assets of **Stone & Webster** for over \$700 million in an auction conducted in the Delaware Bankruptcy Court.
- Represented **Yukos Oil Company** in its effort to stop expropriation of its assets and reorganize through a **U.S. Chapter 11 case** in Houston, and to resist liquidation and propose a plan of reorganization in connection with a **U.S. Chapter 15 case** in New York.
- Represented a number of major foreign banks in a successful trial and appeal through the U.S. Supreme Court of a **U.S. involuntary bankruptcy petition against foreign citizens**, who defaulted on over \$300 million of debt in their country of origin, then came to live in the U.S.
- Represented the **Indenture Trustee for \$750 million of bonds** secured by income producing real estate.

Professional Papers, Publications and Activities

Paper: Overview of a Financial Reorganization

Paper: Providing Capital to a Chapter 11 Company

Paper: Leading a Government to Solvency

American College of Bankruptcy ("ACB")

- Four years **Chairman of ACB Distinguished Service Award Committee**
- Four years **ACB Fifth Circuit Regent**
- **Government Debt Restructure Principles**, Duke Law Symposium, November 2015
- **How City Finances Can Be Restructured in the Shadow of a Chapter 9 Case**, published BloombergBNA, October, 2013.
- **How City Finances Can Be Restructured**, published American Bankruptcy Law Journal, April 2014
- **What Can Puerto Rico Do?** Published Puerto Rico Federal Bar Association Journal, May 2014
- Speaker at numerous **ACB Chapter 9 Seminars**

International Insolvency Institute ("III")

- **III Delegate to UNCITRAL** regarding Arbitration of Insolvency Issues
- **Revised Proposal for Arbitration of Sovereign Financial Restructure**, III Annual Conference, June 2014
- **Restructuring Sovereign Government Finances In Public and in Less Than a Year**, published Insolvency Intelligence, August 2013.

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Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar**

Tuesday, April 23, 2019

Hearing Room 1568

10:00 AM

2:19-12760 The Sunshine Group, LLC

Chapter 11

#7.00 HearingRE: [16] Motion to Dismiss Case for Abuse and Notice of Motion (BNC) City of Dana Point's Motion to Dismiss Chapter 11 Case With Prejudice

Docket 16

Matter Notes:

4/23/2019

**The tentative ruling will be the order.
Court to prepare the order.**

POST PDF OF TENTATIVE RULING TO CIAO

Tentative Ruling:

4/22/2019

For the reasons set forth below, the Dismissal Motions are GRANTED and this case is dismissed with a 180-day refiling bar.

Pleadings Filed and Reviewed

1. Creditor and State Court Receiver California Receivership Group's Emergency Motion to Dismiss, or in the Alternative Excuse Turnover and Confirm Exemption From Stay, or in the Alternative Shorten Time [Doc No. 13] (the "Receiver's Dismissal Motion")
2. City of Dana Point's Notice of Motion and Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 16] (the "City's Dismissal Motion")
3. City of Dana Point's Request for Judicial Notice Filed in Support of City's Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 17]
4. Jennifer Farrell's Declaration in Support of City of Dana Point's Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 18] (the "Farrell Decl.")
5. Order Setting Hearing on Receiver's Motion to Dismiss or Excuse Turnover for

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- April 12, 2019, at 10:00 a.m. [Doc. No. 20]
6. Receiver's Certificate of Service [Doc. No. 23]
 7. Debtor's Omnibus Opposition to: (1) State Court Receiver California Receivership Group's Motion to Dismiss, or in the Alternative to Excuse Turnover and Confirm Exemption From Stay; and (2) City of Dana Point's Notice of Motion and Motion to Dismiss Case with Prejudice [Doc. No. 37] (the "Debtor's Omnibus Opposition")
 8. Creditor and Receiver Mark S. Adams' Reply to Debtor's Omnibus Opposition to State Court Receiver California Receivership Group's Motion to Dismiss, or, in the Alternative to Excuse Turnover and Confirm Exemption From Stay [Doc. No. 44] (the "Receiver's Reply")
 9. City of Dana Point's Reply in Support of City's Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 46] (the "City's Reply")
 10. City of Dana Point's Request for Judicial Notice Filed in Support of City of Dana Point's Reply in Support of City's Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 47]
 11. City of Dana Point's Objections to Evidence Offered by Sunshine Group LLC in Support of Its Opposition to the City's Motion to Dismiss Chapter 11 Case With Prejudice [Doc. No. 48] (the "City's Evidentiary Objections")

I. Facts and Summary of Pleadings

Summary of Relevant Background Facts [Note 1]

Debtor-in-possession, The Sunshine Group, LLC (the "Debtor"), filed this voluntary chapter 11 case on March 14, 2019 (the "Petition Date"). The Debtor's primary asset is commercial real property with a 28-unit motel located at 34862 Pacific Coast Highway, Capistrano Beach, CA 92624, known as the Capistrano Seaside Inn (the "Property" or "Motel"). The Debtor's schedules value the Property at \$3,000,000 [Doc. No. 1, Schedule A]. Despite its current condition, the Property is listed as a historic resource on the City of Dana Point's Historic Resource Inventory and on the California Register of Historic Resources.

In 2016, the City of Dana Point (the "City") red-tagged and closed the Motel based upon its determination that the Motel posed an immediate health and safety risk to the public and issued a notice of violation requiring the Debtor to fix the issues by

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December 5, 2016. In 2017, after the Debtor failed to address any of the cited issues, the City initiated an action in Orange County Superior Court (the "State Court"), bearing the caption *The City of Dana Point v. The Sunshine Group, LLC, et al*, Case No. 30-2017-00915900-CU-PT-CJC (the "Nuisance Action"). On April 25, 2017, the State Court granted the City's *ex parte* application for the appointment of a receiver, appointed California Receivership Group (the "Receiver"), and delegated the Receiver with the task of abating all public nuisance conditions existing at the Property.

In an effort to address the existing health and safety violations, the Receiver requested and was authorized to issue a certificate with a first-priority lien against the Property in the approximate amount of \$1,000,000 to fund the initial expenses for the remediation work. The Debtor's managing member, Dr. Ramesh Manchanda, personally funded \$998,000 of that amount to avoid encumbering the Property with a third-party lien.

The Receiver then developed a comprehensive remediation plan that would preserve the historical character of the Property, maintain the low-cost affordable accommodation status, and allow for competitive bidding on the ultimate remediation (the "Receiver's Plan"). The Receiver estimated that the total cost would be approximately \$5,000,000. The Debtor opposed the Receiver's Plan and argued that the project would be financially infeasible because the income from a restored 1940's style affordable motel could not service the approximately \$6,000,000 in debt required for the renovation. The Debtor instead argued that it should be permitted to demolish the Motel and use the adjacent parcels of land, owned by Dr. Manchanda and one of Debtor's other members, to build a new luxury hotel (the "Debtor's Plan"). The Debtor also requested that the State Court terminate the receivership. After extensive briefing, the State Court overruled the Debtor's opposition, denied its request to terminate the receivership, and approved the Receiver's Plan by an order entered October 26, 2018 (the "October 26, 2018 Order").

The Debtor appealed the October 26, 2018 Order and petitioned the Third Division of the Fourth Appellate District for the California Court of Appeal (the "Court of Appeal") for a writ of supersedeas and immediate stay of the effectiveness of the order. The City and Receiver opposed the motion. The Court of Appeal granted a temporary stay of all activity other than work needed to be performed to stabilize the hillside adjacent to the Property to prevent public safety concerns posed

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by a possible landslide. After considering initial briefing, on December 24, 2018, the Court of Appeal dissolved the temporary stay.

In connection with the Receiver's efforts to address the dangers posed by the hillside, the Receiver sought and obtained junior loans secured by receiver certificates against the property from Glan Investment, LLC ("Glan") and Miken Construction ("Miken") somewhere in the approximate range of \$796,000 to \$1,000,000 and completed the necessary work to build a retaining wall. The Receiver has also removed debris and chemicals, stripped the Motel of all furniture and fixtures, and removed the electrical system. Accordingly, the Motel is currently a shelled-out structure.

Due to a lack of funding, on February 4, 2019, the Receiver filed an *ex parte* application for an order subordinating Mr. Manchanda's \$1,000,000 receiver's certificate lien so that the Receiver could obtain the necessary \$4,000,000 in funding from third-party lenders to complete the Receiver's Plan. At the *ex parte* hearing, the parties negotiated a temporary resolution wherein Debtor purportedly agreed to advance a portion of the costs incurred to build the retaining wall, which prompted the State Court to continue the hearing to March 15, 2019. However, the Receiver asserts that shortly after the hearing the Debtor reneged on its agreement which forced it to scramble to ensure that contractors did not walk off the job and to file supplemental briefing in support of its subordination request. Before the State Court could re-hear the matter, the Debtor filed this bankruptcy case.

On March 29, 2019, the Receiver filed a request for its Dismissal Motion to be heard on shortened notice [Doc. No. 14]. On April 1, 2019, this Court issued an order denying that request and setting the matter for hearing on April 23, 2019, to be heard concurrently with the City's Dismissal Motion [Doc. No. 20]. The Court also excused the Receiver from any obligations to turn over the Property prior to the hearing. *Id.*

Summary of the City and Receiver's Dismissal Motions

The City seeks an order dismissing this case with a 180-day refiling bar pursuant to §§ 105, 349(a), and 1112(b). The City argues that the Debtor filed this case in bad faith to interfere with the Nuisance Action and to thwart the City and Receiver's remediation efforts because it did not like the rulings of the State Court and Court of

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The City asserts that several indicia of a bad faith filing are present: (i) the Debtor's primary asset consists of the Property and the Debtor does not have any ongoing business it can reorganize; (ii) the Debtor does not have sufficient cash flow to fund a plan of reorganization or to make adequate payments to the Receiver; (iii) the longer the remediation is delayed, the greater likelihood of a substantial and continuing loss of value to the estate and the Debtor has thus far been responsible for the mismanagement of the Property and delays in remediating the Property; (iv) this is essentially a two-party dispute that can be easily resolved in the Nuisance Action; (v) the debtor does not have any "real creditors" other than the City and insiders and its own professionals – all of which arise out of the Nuisance Action.

The City submits that dismissal, rather than conversion, is in the best interest of the estate because the Debtor has completely abdicated its responsibility to properly maintain the safety and integrity of its only asset. The City also contends that dismissal will enable the Nuisance Action to proceed without interference and enable the Receiver to continue remediating the Property to protect the public's health and safety. The City asserts that conversion to a chapter 7 would be of no benefit to any party because a trustee would have to undertake the tasks that the Receiver is currently performing.

In the alternative, the City argues that the Court should abstain from exercising its jurisdiction over this case and dismiss it pursuant to § 305(a)(1). The City argues that, based upon the totality of circumstances, dismissal is in the best interests of the Debtor and its creditors. The City also argues that the Nuisance Action is exempt from the automatic stay pursuant to § 362(b)(4) because it is an action brought to enforce the City's police or regulatory powers.

The Receiver seeks dismissal on similar bad faith grounds. **[Note 2]** The Receiver argues that there is no legitimate reason for the parties to be before this Court and it is clear that the Debtor filed this case in an attempt to forum shop. In addition to the arguments advanced by the City, the Receiver highlights that the Debtor's Plan is impossible because the Debtor fails to address the historical character of the Property and the regulations imposed by the California Coastal Act. The Receiver highlights that on at least three occasions the State Court has denied the Debtor's request to

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terminate the receivership so that it can proceed with demolishing the Property. The Receiver also contends that the automatic stay does not apply pursuant to § 362(b)(4).

In the alternative, the Receiver argues that if the Court is not inclined to dismiss this case, the Court should issue an order excusing it from turning over the Property pursuant to § 543. The Receiver contends that the interests of creditors would be better served by permitting it to stay in control to complete the State Court approved remediation.

Summary of the Debtor's Omnibus Opposition

The Debtor filed a timely omnibus opposition arguing that the Dismissal Motions should be denied because the Debtor filed this case in good faith in an effort to preserve assets of the estate and to pay its creditors in full. The Debtor argues that the City and Receiver (together, the "Moving Parties") attempt to mislead this Court into believing that the Property presents a current threat to health and safety when, in fact, those hazards have been abated. The Debtor further argues that the remaining issues center on the parties' disagreement over the future redevelopment of the Property and that under the Receiver's Plan, the Receiver will incur an unsustainable amount of secured debt against the Property that will ultimately lead to foreclosure. The Debtor also argues that the Receiver's inability to obtain normal funding demonstrates that the Receiver's Plan is not feasible. Therefore, the Debtor argues that the only party that will benefit if the redevelopment proceeds is the City because it will have the motel that it wants, and the Debtor and creditors will pay the price.

The Debtor instead asks this Court to grant its concurrently-filed motion to sell the Property under § 363, which will enable the Debtor to pay the Receiver in full and pave the way for a substantial hotel development project. The Debtor states that such a construction was in the planning stages when the City filed the Nuisance Action. The Debtor submits that its proposed sale is in the best interest of creditors because they will be paid in full and that the new development will be out of the Debtor's control and managed by experienced developers to ensure that the project is a success and does not present any future healthy and safety concerns.

The Debtor responds to the Moving Parties' contentions regarding the existence of indicia of bad faith as follows: (i) if approved, the Debtor's pending sale motion will

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permit the Debtor to reorganize by paying all claims in full; (ii) the Court should not consider whether the Debtor has the ability to make adequate payments to the Receiver because the Debtor should not be forced to fund an infeasible project that will likely result in foreclosure; (iii) this is not a typical two-party dispute, the Debtor sought bankruptcy protection in good faith to avoid continuing down a path towards a potential foreclosure and because the Receiver has accomplished its mandate to remediate existing health and safety risks; (iv) there will not be a substantial and continuing loss to the value of the estate without reasonable likelihood of rehabilitation because the Property has been remediated and no existing health and safety risks remain; (v) the Debtor does not have the precise amounts of debt owing to its creditors, but it does have creditors as a result of the Receivership's appointment and will be able to repay those debts in full through a sale of the Property.

The Debtor also disputes the Moving Parties' contention that it filed this case in an attempt to forum shop. Instead, the Debtor argues that it filed bankruptcy to protect assets of the estate from being burdened with \$6,000,000 in debt to the detriment of creditors because the Receiver's redevelopment plans are infeasible. The Debtor does not intend to relitigate the money already spent on abatement work and to secure the hillside and proposes to pay those costs in full through this case.

Similarly, the Debtor contends that the totality of the circumstances weighs against the Court abstaining pursuant to § 305(a). The Debtor also argues that the Nuisance Action is not excepted from the automatic stay under § 362(d)(4) because the Receiver's actions have gone beyond the auspices of health and safety and that the Receiver should be ordered to turn over the Property pursuant to § 543.

Summary of the City and Receiver's Replies

The City filed a timely reply arguing that the Debtor's unsupported claims that the nuisance conditions have been remedied are simply false and misleading. The City asserts that it is up to the State Court, not the Debtor, to determine when such conditions have been remedied and the State Court has not yet come to that conclusion. The City contends that under the applicable Dana Point Municipal Code § 6.14.002 the public nuisance has not been abated because the Motel is nothing more than a shelled-out structure that must be renovated. The City also reiterates that the State Court has considered and rejected the Debtor's proposal to demolish the

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Property and concluded that demolition would not further the goals of abating the substandard conditions, maintaining the property's historical character, and remaining in compliance with the Coastal Act requirements. The City argues that the Debtor should not be allowed to use this case to circumvent the State Court's rulings.

The City also highlights that the Debtor devotes significant attention to trying to convince this Court that the Receiver is incurring too many costs to remediate the Property but notes that the Receiver is acting under the express authority of the State Court. The City also argues that allowing this case to continue will further stall remediation efforts and permit the Property to fall into greater disrepair. The City also restates its position that dismissal is in the best interest of the estate and argues that the Debtor has waived its right to challenge this argument by failing to address it in its opposition. Furthermore, the City restates its belief that the dismissal is warranted under § 305(a).

The Receiver also filed a timely reply with similar arguments as those advanced by the City. The Receiver asserts that the Debtor has mischaracterized the existing nuisance issues and its accusations that the Receiver has exceeded his authority are without merit. The Receiver argues that the Debtor's behavior underscores why the Receiver was appointed in the first place and demonstrates that this petition was filing in a bad faith attempt to circumvent the State Court's orders. The Receiver also argues that the history of the Debtor's conduct makes clear that the Debtor has never fully appreciated the dangerous conditions it created and has allowed to continue. The Receiver states that the Property remains a nuisance and the structural deficiencies affecting the Property persist. Accordingly, the Receiver reiterates its request that the Court dismiss this case or, if it is not inclined to do so, excuse the Receiver from any turnover obligations and confirm that the Receivership is exempt from the stay so that the Receiver can complete his duties.

II. Findings of Fact and Conclusions of Law

A. Evidentiary Rulings

The City submits evidentiary objections to the declaration of Dr. Ramesh Manchanda on multiple grounds including, among others, that the testimony lacks foundation and contains legal argument and legal conclusions. For example, Dr.

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Manchanda testifies that: the Debtor filed the bankruptcy proceeding in good faith (¶ 1); the Receiver's actions have gone far beyond abatement to such an extreme that the Receiver is actively interfering with property of the bankruptcy estate (¶ 1), the Receiver is attempting to completely redevelop the Property by incurring an unsustainable amount of debt that will likely lead to foreclosure (¶ 1); the Receiver has already abated the health and safety concerns for which he was appointed (¶ 2); the Receiver is unable to obtain normal financing for the renovation (¶ 6), as the health and safety issues have been resolved, any further actions by the City and Receiver are not to protect health and safety of the public, but for the City's own benefit (¶ 11).

The Court agrees that much of Dr. Manchanda's declaration contains legal conclusions and argument, not evidence. The Court also finds that Dr. Manchanda has not established his personal knowledge of the matters set forth in his declaration. Accordingly, the Court declines to strike these paragraphs, but construes them only as legal argument, not evidence.

The City also submits evidentiary objections to the declaration of attorney Deborah M. Rosenthal on multiple grounds including, among others, that Ms. Rosenthal is acting as an improper expert witness pursuant to California Rules of Professional Conduct Rule 3.7 ("Rule 3.7"), because she represents the Debtor in the Nuisance Action. Rule 3.7 provides that a "lawyer shall not act as an advocate in a trial in which the lawyer is likely to be a witness" unless certain exceptions exist. However, the official comments state that the "rule applies to a trial before a jury, judge, administrative law judge or arbitrator" and "does not apply to other adversarial proceedings." The City does not cite any authority for this Court to conclude that Rule 3.7 is applicable in this bankruptcy proceeding.

Accordingly, the City's objections to the admissibility of Ms. Rosenthal's testimony are overruled (with one exception discussed below), and the Court will treat Ms. Rosenthal as an expert witness under FRE 702. In her declaration, Ms. Rosenthal states that she has been member of the College of Fellows of the American Institute of Certified Planners (AICP) since 1992 and that admission requires an average of 14-18 years of extensive experience in planning. Rosenthal Decl. at ¶ 2. Ms. Rosenthal has worked extensively with the State Historic Building Code and has represented clients before the California Coastal Commission since 1988. *Id.* at ¶¶ 3-4. Mr. Rosenthal

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also testifies that she visited the Property on several occasions and has reviewed the relevant pleadings, notices and reports upon which her testimony relies. *Id.* at ¶¶ 5, 11, 12-15, 18, 26-28.

Federal Rule of Evidence ("FRE") 702 provides:

- A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:
- a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
 - b) the testimony is based on sufficient facts or data;
 - c) the testimony is the product of reliable principles and methods; and
 - d) the expert has reliably applied the principles and methods to the facts of the case.

Under FRE 702, an expert may be qualified by "experience" or "training." Here, Ms. Rosenthal's declaration sufficiently establishes her qualifications to testify as an expert in the areas of commercial planning and development. Notwithstanding this finding, the Court notes that Ms. Rosenthal is the Debtor's proposed special litigation counsel in this bankruptcy proceeding. Rosenthal Decl. at ¶ 1. As such, Ms. Rosenthal has an incentive to provide testimony that will materially advance the Debtor's interests and defeat dismissal of this case. Therefore, the Court does not attribute significant weight to Ms. Rosenthal's testimony.

The City's objection to paragraph 7 of the Rosenthal Declaration is sustained. Ms. Rosenthal's testimony does not lay a proper foundation to establish that she has the requisite knowledge to testify as to the condition of the Property prior to the Receiver's appointment.

B. Cause Exists to Dismiss This Case

"Under § 1112(b)(1), a court may dismiss a Chapter 11 bankruptcy case 'for cause,' based on a finding that the petition was filed in bad faith." *Prometheus Health Imaging, Inc. v. UST – United States Tr. (In re Prometheus Health Imaging, Inc.)*, 705

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F. App'x 626, 627 (9th Cir. 2017) (citing *In re Marshall*, 721 F.3d 1032, 1047 (9th Cir. 2013)); see also *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994) ("Although section 1112(b) does not explicitly require that cases be filed in 'good faith,' courts have overwhelmingly held that a lack of good faith in filing a Chapter 11 petition establishes cause for dismissal"). "While § 1112(b)(4) provides a list of what circumstances may constitute 'cause' for dismissal, the list is non-exhaustive, and 'courts may consider any factors which evidence an intent to abuse the judicial process and the purposes of the reorganization provisions,' to make the bad faith determinations." *In re Prometheus Health Imaging, Inc.*, 705 F. App'x at 627. The existence of good faith "does not depend on one factor alone, but . . . is to be judged by looking at the totality of the circumstances surrounding the case." *In re WLB-RSK Venture*, 296 B.R. 509, 514 (Bankr. C.D. Cal. 2003).

The Ninth Circuit Bankruptcy Appellate Panel has expanded on this concept as follows:

To determine whether a debtor has filed a petition in good faith, courts weigh a variety of circumstantial factors such as whether: (1) the debtor has only one asset; (2) the debtor has an ongoing business to reorganize; (3) there are any unsecured creditors; (4) the debtor has any cash flow or sources of income to sustain a plan of reorganization or make adequate protection payments; and (5) the case is essentially a two-party dispute capable of prompt adjudication in state court.

In re WLB-RSK, 296 B.R. at 514 (quoting *In re St. Paul Self Storage Ltd. P'Ships*, 185 B.R. 580, 582-83 (B.A.P. 9th Cir. 1995)).

Additionally, courts have found bad faith to exist where the debtor has filed bankruptcy as a litigation tactic, e.g., to forum shop. *In re WLB-RSK*, 296 B.R. at 515 (citing *In re St. Paul Self Storage Ltd. P'Ships*, 185 B.R. at 583 ("[t]he timing of the petition and the unsuccessful progress in the Minnesota litigation strongly suggests Debtor's intent to use the bankruptcy code as a means to escape to a forum which it perceived to be more friendly"); *In re Siberkraus*, 253 B.R. 890, 902-03 (Bankr. C.D. Cal. 2000)). And while bankruptcy filings arising out of a two-party dispute are not per se bad faith, "[c]ourts that find bad faith based on two-party disputes do so where 'it is an apparent two-party dispute that can be resolved outside of the Bankruptcy

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Court's jurisdiction.'" *Sullivan v. Harnisch (In re Sullivan)*, 522 B.R. 604, 616 (B.A.P. 9th Cir. 2014) (internal citations and emphasis omitted).

The Court finds that "cause" exists within the meaning of § 1112(b) based upon the Debtor's bad faith filing. First, the Debtor concedes that it filed this case as a litigation tactic to avoid implementation of the Receiver's Plan. *See* Debtor's Omnibus Opposition, p. 15, lines 7-9 ("[t]he bottom line is the bankruptcy was filed to protect Debtor's assets from an additional \$4 million in encumbrances for a redevelopment project that has nothing to do with remediating health and safety issues or a public nuisance").

Second, the Court finds that this case is essentially a two-party dispute over the future development of the Property and that competing plans have already been the subject of significant argument and briefing before the State Court. The Debtor offers no legitimate reason for why this dispute cannot and should not be resolved by the State Court. Instead, the Debtor repeats arguments made to the State Court that the purpose of the Nuisance Action has been achieved – i.e. the Receiver has remediated all health and safety issues – and the Receiver should not be permitted to over-encumber the Property to the detriment of the Debtor and its alleged creditors. *See* Debtor's Omnibus Opposition, p. 13, lines 27-28 & p. 14, lines 1-9. The City and Receiver appear to acknowledge that the immediate threats to public safety have been remediated but highlight that the Property remains a public nuisance under applicable Dana Point Municipal Code section 6.14.002.

While it is unclear whether the State Court has recently been asked to make a determination regarding the existence of nuisance conditions, the record demonstrates that the State Court has considered and rejected the Debtor's arguments regarding the infeasibility of the Receiver's Plan and the feasibility of its own development plans. In denying the Debtor's request to terminate the receivership and approving the Receiver's request for an increased certificate to fund the Receiver's Plan, the State Court implicitly found that nuisance conditions would exist until the Receiver's proposed rehabilitation of the Property was complete. The Debtor offers no persuasive argument for why this Court should step in to resolve this two-party dispute or substitute its judgment in place of the State Court's.

Additionally, the Court finds that all of the factors enumerated by the Bankruptcy

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Appellate Panel in *In re St. Paul Self Storage Ltd. P'Ships* are present. The Debtor's Schedules and March Monthly Operating Report confirm that the Debtor is not operating, and the Property is the only valuable asset of the estate [Doc. Nos. 1 & 43]. To the extent the Debtor has general unsecured creditors, such claims appear to have arisen solely out of the Nuisance Action and it is undisputed that this is a two-party dispute. The Court notes that the Debtor concurrently-filed a motion to approve a sale of the Property pursuant to §§ 363(b) and (f), which the Debtor argues will provide a legitimate source of funding for it to reorganize and pay all claims in full. However, the Court finds that, like the filing of this petition, the proposed sale is brought in bad faith in furtherance of the Debtor's objective of divesting control from the Receiver and regaining control of the Property.

All of the foregoing findings lead this Court to conclude that the Debtor filed this case in an attempt to forum shop its way into a potentially friendlier venue. The Court finds this to be an abuse of the judicial process and inconsistent with the spirit of the Bankruptcy Code. Therefore, the Court finds that the City and Receiver have established that "cause" exists within the meaning of § 1112(b) based upon the Debtor's lack of good faith in filing this case.

Having determined that cause exists, the Court must next determine whether conversion, dismissal or appointment of a chapter 11 trustee serves the best interests of creditors or the estate. *In re Products Int'l Co.*, 395 B.R. 101, 107 (Bankr. D. Ariz. 2008) (citing *In re Nelson*, 343 B.R. 671 (9th Cir. 2006)). "[W]hen deciding between dismissal and conversion under 11 U.S.C. § 1112(b), the court must consider the interests of all of the creditors." *Shulkin Hutton, Inc. v. Treiger (In re Owens)*, 552 F.3d 958, 961 (9th Cir. 2009) (emphasis in original) (quoting *Rollex Corp. v. Associated Materials, Inc. (In re Superior Siding & Window, Inc.)*, 14 F.3d 240, 243 (4th Cir. 1994)).

In view of the pending Nuisance Action and ongoing receivership, the Court finds that dismissal is in the best interest of creditors because appointment of a bankruptcy trustee will only serve to increase costs and delay remediation efforts. Next, because this Court has determined that the Debtor filed this case in bad faith to interfere with the Nuisance Action, the Court finds cause exists to dismiss this case with a 180-day refiling bar pursuant to § 349(a). Absent such a bar, the Court is not convinced that the Debtor will not immediately re-filing a second bankruptcy petition.

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Finally, because the Court finds that cause exists to dismiss this case, the Court need not determine the merits of the parties' arguments with respect to §§ 305, 362, and 543.

III. Conclusion

For the reasons set forth above, the Dismissal Motions are GRANTED and this case is dismissed with a 180-day refiling bar.

The Court will prepare the order.

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Daniel Koontz or Jessica Vogel at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Note 1: Except where noted, these facts appear to be undisputed.

Note 2: The Receiver states that it seeks dismissal pursuant to § 1307, but since this is a chapter 11 proceeding, that section is inapplicable. The Court presumes that such a request was made in error due to the Receiver's unfamiliarity with bankruptcy law and notes that after the filing of its motion, the Receiver retained bankruptcy counsel to assist it in this case. Therefore, the Court will consider the Receiver's arguments in favor of dismissal within the context of the City's request for relief under § 1112(b). The Receiver also raises a number of other arguments in favor of dismissal. However, because the Court finds that dismissal is appropriate under § 1112(b), the Court need not determine whether the Receiver's other arguments have merit.

Party Information

Debtor(s):

The Sunshine Group, LLC

Represented By

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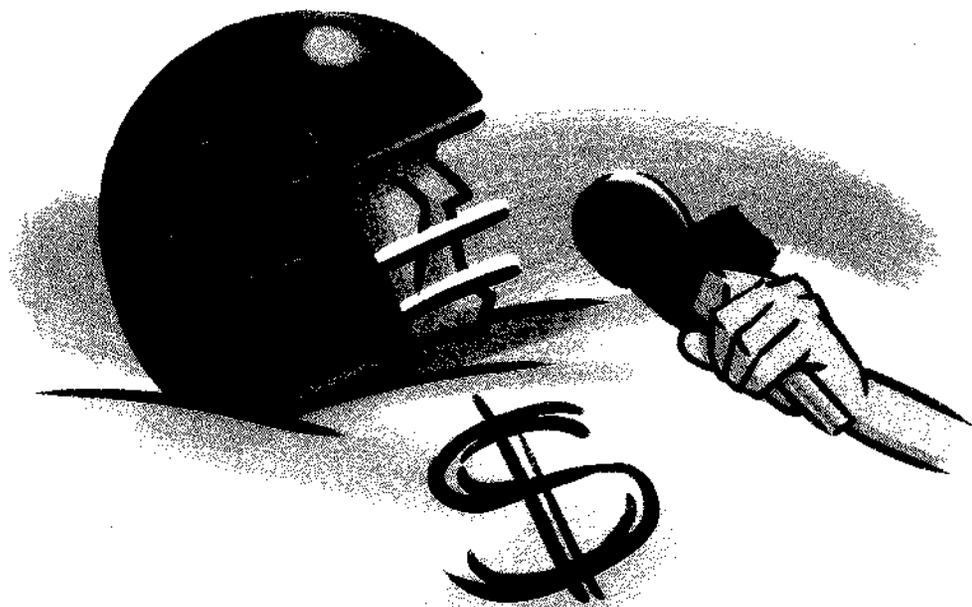
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PETER A. DAVIDSON

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DEPARTMENT 85 LAW AND MOTION RULINGS

Case Number: BC575092 **Hearing Date:** July 12, 2018 **Dept:** 85

CSMC 2006-C5 North Azusa Avenue, LLC, and CSMC 2006-C5 North Barranca Street, LLC v. Eastland Tower Partnership, et al., BC 575092

Tentative decision on motion discharging receiver, approving receiver's final report and accounting, and exonerating bond: granted

Receiver Terri Riker ("Riker") moves the court for an order discharging the Receiver, approving the Receiver's Final Report and Accounting, and exonerating the bond. Defendant Hassen Real Estate Partnership ("Hassen") opposes. The court has read and considered the moving papers, opposition, and reply, and renders the following tentative decision.

A. Statement of the Case

Plaintiffs CSMC 2006-C5 North Azusa Avenue, LLC ("Azusa Avenue") and CSMC 2006-C5 North Barranca Street, LLC ("Barranca Street") commenced this proceeding on March 11, 2015 seeking specific performance for appointment of a receiver and injunctive relief. The Complaint alleges in pertinent part as follows.

On November 21, 2006, Defendant Eastland Tower Partnership ("Eastland") executed a Promissory Note ("Eastland Note") payable to Column Financial Inc. ("Column") in the principal amount of \$41 million. The Eastland Note is secured by, *inter alia*, a Deed of Trust executed for the benefit of Column ("Eastland Deed of Trust") pertaining to real property commonly known as Wells Fargo Bank Tower and located at 100 North Barranca Street, West Covina, CA 91791 ("Wells Fargo Tower"). Through a series of assignments and allonges, Barranca Street is the beneficiary under the Eastland Deed of Trust and holder of the Eastland Note. On the same date, Defendant Hassen executed a Promissory Note ("Hassen Note") payable to Column in the principal amount of \$41 million. The Hassen Note is secured by, *inter alia*, a Deed of Trust executed for the benefit of Column ("Hassen Deed of Trust") pertaining to real property commonly known as West Covina Village Community Shopping Center and located at 301-477 North Azusa Avenue, West Covina, CA 91791 ("WCVC"). Through a series of assignments and allonges, Azusa

Avenue is the beneficiary under the Hassan Deed of Trust and holder of the Hassan Note.

On April 10, 2011 Eastland and Hassen both filed Chapter 11 bankruptcy petitions in district court (“Bankruptcy Cases”). In the Bankruptcy Cases, the lenders and Defendants agreed to a consensual Chapter 11 plan of reorganization dated January 17, 2013. On May 21, 2013, pursuant to this plan, the lender and Defendants entered into certain Loan Modification Agreements.

In January 2014, Defendants deposited insufficient funds in the accounts established for the Properties under the controlling loan documents. Plaintiffs’ representative demanded that Defendants cover the shortfall in these payments but Defendants failed to do so. At the time of the Complaint’s filing, the monthly loan payments owed to Plaintiffs on the Eastland Loan Documents had been delinquent since April 11, 2014 and on the Hassen Loan Documents since July 11, 2014.

On July 28, 2014, Plaintiffs sent Defendants a Notice of Default. As of January 11, 2014, the total indebtedness due under the Eastland loan is in excess of \$62,042,259.60 and under the Hassan loan is \$62,733,200.21.

Plaintiffs requested immediate appointment of Receiver Riker so that she could take control and manage the real property collateral to collect and pay to Plaintiffs the rental income generated from such property as well as to protect and preserve the collateral from loss, destruction, or waste.

B. Governing Law

A receiver holds property as a representative of the court, for the benefit of the property’s owners, their creditors, and others in whose favor claims may arise against the receivership estate. Chiesur v. Superior Court, (1946) 76 Cal. App. 2d 198, 200-01. Possession of the property by the receiver is deemed to be possession of the owner with respect to any duties owed to tenants. Id. at 201. A receiver is liable in his official capacity to those without an interest in the estate for negligence in the performance of his authorized duties, and any recovery is a charge upon the receivership estate. Ibid. “Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands.” Ibid. (citing McNulta v. Lochridge, (1891) 141 U.S. 327).

Even if he mismanages the receivership, a court-appointed receiver enjoys quasi-judicial immunity for damage claims arising from performance of his/her receivership duties. McClintock v. West, (2013) 219 Cal.App.4th 540, 551. The receiver cannot be liable for negligence as a tortfeasor for an act performed within the scope of the powers granted by the court. Tapscott v. Lyon, (1894) 103 Cal. 297, 308-09, 312. *See also* Howard v. Drapkin, (1990) 222 Cal.App.3d 843, 853 (persons who act in quasi-judicial capacity are entitled to immunity, including *pro tem* judges and state bar examiners, who are arms of the court). Therefore, a receiver, acting as agent of

the court and properly functioning pursuant to the court's subject matter jurisdiction by receiving and managing assets, is absolutely immune from suit. New Alaska Development Corporation v. Guetschow, ("New Alaska") (9th Cir. 1989) 869 F.2d 345, 351.

This does not mean that a receiver is entirely immune from responsibility for his acts. A receiver can be sued for acts outside the court's subject matter jurisdiction and his judicial immunity, including theft of assets and defamation. New Alaska, supra, 869 F.2d at 351 (although receiver was entitled to judicial immunity from suit for mismanagement, receiver was not absolutely immune from claims that he stole assets and slandered plaintiff). To limit the harassment of receivers as quickly as possible, a plaintiff is required to allege the absence of judicial immunity. New Alaska, supra, 869 F.2d at 351.

Additionally, a receiver's bond is designed to protect the parties from the receiver's failure to discharge his duties. As case law has well-established, a receiver may still be surcharged for losses to the receivership estate based upon her misconduct or mismanagement. Southern California Sunbelt Developers, Inc. v. Banyan Limited Partnership, ("Banyan") (2017) 8 Cal.App.5th 910, 926 (citing Aviation Brake Systems, Ltd. v. Voorhis, ("Aviation") (1982) 133 Cal.App.3d 230, 233). Just like any fiduciary, the receiver can be surcharged and his or her bond held liable for a failure to properly carry out the duties imposed by his appointment. Stewart v. California, (1969) 272 Cal.App.2d 345, 351. The receiver in his personal capacity^[1] may be surcharged for losses to the receivership estate caused by misconduct or mismanagement. Aviation, supra, 133 Cal.App.3d at 235. This includes, instances where the receiver exceeds her authority, causes injury to others, or acts negligently in operating the estate. Banyan, supra, 8 Cal.App.5th at 926. A party must make such a claim in response to a receiver's request for final accounting and may not file an independent action to address the receiver's liability. Id.

A receiver can be sued by a third party only with permission of the appointing court. Ostrowski v. Miller, ("Ostrowski") (1964) 226 Cal.App.2d 79, 84 (citation omitted). This rule is established to protect receivers from unnecessary litigation. Id. The court ordinarily has wide discretion in granting leave to sue the receiver in an independent action, or in denying leave and requiring the claimant to intervene in the receivership proceedings to assert his claim, equitable or legal. Id. at 85 (citing De Forrest v. Coffey, (1908) 154 Cal. 444). The court may not deny leave to sue where it cannot afford the same relief in intervention as could be obtained in an independent action, or where a statute or constitutional provision requires a particular kind of action to be brought in a different jurisdiction. Id. A receivership court does not have discretion to deny a motion to intervene and motion to sue by summarily determining that the movant's claims lack merit. Jun v. Myers, (2001) 88 Cal.App.4th 117, 125.

“The rule that claimants must apply to the court before suing a receiver is founded upon notions of judicial economy. In most cases a claimant can obtain appropriate relief in the receivership action; therefore an independent action will not be necessary. By refusing permission to sue, the appointing court can require a claimant to intervene in the receivership proceedings to assert his claim, thus protecting the receiver from a proliferation of lawsuits. But the court may not refuse permission where the effect would be to cut off plaintiffs’ rights. If the court cannot afford plaintiff the same relief in intervention as he is entitled to in an independent action, refusal to permit the lawsuit to proceed will constitute an abuse of discretion. For example, if plaintiffs claim contemplates a jury trial, the court may not require plaintiff to try the claim before the court sitting in equity in the receivership action.” Vitug v. Griffin, (1989) 214 Cal. App. 3d 488, 493 (citations omitted).

C. Statement of Facts

1. Receiver’s Evidence

a. Overview

On December 14, 2015, the court appointed Riker as Receiver in the instant action (“Appointment Order”) to take possession of Wells Fargo Tower and WCVF (“Property”). Riker Decl. ¶3, Ex. 1.

On December 31, 2015, Riker took possession of the Property and performed her obligations as set forth in the Appointing Order. Riker Decl. ¶5. She also established bank accounts (“Receivership Accounts”) for the Receivership Estate consisting of rents and profits received from tenants at the Property. Riker Decl. ¶18.

On January 8, 2016, the court modified the Appointing Order pursuant to the parties’ joint stipulation. Riker Decl. ¶4, Ex. 2.

On April 19, 2016, Riker received a copy of a recorded Trustee’s Deed upon Sale indicating that the Wells Fargo Tower property had been foreclosed and conveyed to Barranca Street. Riker Decl. ¶6, Ex. 3. Upon receipt of this deed and pursuant to the appointing order, Riker surrendered possession of Wells Fargo Tower to Barranca Street. Riker Decl. ¶7.

On August 4, 2016, the court approved the parties’ stipulation regarding disbursement of funds held by Riker. Riker Decl. ¶20, Ex. 6. Pursuant to the order, Riker disbursed \$566,746.66 to Barranca Street. Riker Decl. ¶21.

On February 9, 2018, the court approved the parties’ stipulation authorizing Riker to turn over WCVF to Hassen (“WCVF Turnover Order”). Riker Decl. ¶8, Ex. 4.

Pursuant to this order, Riker disbursed \$4,630,110 to a lockbox account designated by Plaintiffs (“Lockbox Account”) on February 9, 2018 and an additional \$193,501.28 to the Lockbox Account during the period of February 13, 2018 through April 15, 2018. Riker Decl. ¶23.

On February 13, 2018, in accordance with the WCVV Turnover Order, Riker returned possession of WCVV to Hassen. Riker Decl. ¶9. Riker also turned over to Hassen security deposits in the amount of \$78,893.69. Riker Decl. ¶24. Having turned over all of the Property under the Receivership, Riker no longer performs any management functions or receivership duties. Riker Decl. ¶10. During Riker's administration of the Receivership Estate, she served 25 monthly reports on the parties detailing the financial condition of the receivership estate and the income and expenses incurred from December 2015 through December 2018. Riker Decl. ¶28. No party filed an objection to these monthly reports. Riker Decl. ¶29.

b. Distribution

As of May 30, 2018, Riker is in possession of Receivership Accounts in the amount of \$119,092.42 consisting of the following: (1) \$30,299.65 related to Wells Fargo Tower, (2) \$88,777.95 related to WCVV, and (3) \$14.82 in accrued interest in the security deposit account related to WCVV. Riker Decl. ¶25. Riker is also in possession of \$8,230.96 related to tenant rent collections received after the Final Distribution Date as set forth in the WCVV Turnover Order. Riker Decl. ¶¶ 25, 27.

(i) Outstanding Expenses

Receiver's Fees

Pursuant to the Appointing Order, Riker was authorized to charge an hourly fee of \$250 per hour. Riker Decl. ¶33. The Appointing Order also authorizes Riker to reimburse herself for all actual costs incurred in connection with the receivership. Riker Decl. ¶34. As of May 30, 2018, \$164,325 of Receiver's fees and \$744.60 of her costs have been paid. Riker Decl. ¶36. There is a remaining balance of \$19,550 in fees and will be paid, if approved, as follows: \$3,325 from the Wells Fargo Tower Receivership Account and \$16,225 from WCVV Receivership Account. Riker Decl. ¶37, Ex. 7.

Counsel's Fees

Pursuant to the Appointing Order, Riker was authorized to employ and compensate Jennifer R. Tullius ("Tullius") as counsel to assist her as needed in this litigation and for general receivership advice. Riker Decl. ¶47. The total estimated amount of Tullius' fees and costs will be \$104,666.90, which includes estimated time to prepare a reply to any objections to the instant motion. Riker Decl. ¶48. To date, \$87,794.55 of Tullius' fees and costs have been paid. Riker Decl. ¶49. The outstanding balance of \$16,872.35 will be paid to Tullius out of the following accounts: \$5,185 from the Wells Fargo Tower Receivership Account and \$11,687.35 out of the WCVV Receivership Account. Riker Decl. ¶51.

Pursuant to the Appointing Order, Riker was also authorized to employ Allen Matkins Leck Gamble Mallory & Natsis ("Allen Matkins") as legal counsel to

represent Riker for transactional purposes. Riker Decl. ¶55. The total amount of Allen Matkins' fees incurred during the Receivership is \$89,553.16. Riker Decl. ¶45. To date, \$84,548.16 of Allen Matkins' fees and costs have been paid leaving an outstanding balance of \$5,005. Riker Decl. ¶58. This balance will be paid out of the WCVC Receivership Account. Riker Decl. ¶60.

Property Manager Fees

Pursuant to the Appointing Order, Riker was authorized to employ Transwestern as property manager to assist Riker in managing the Property. Riker Decl. ¶61. All of Transwestern's fees and costs through February 13, 2018 have been paid. Riker Decl. ¶62. A balance of \$7,293.65 remains due to Transwestern for the period of February 14 through February 28, 2018 and will be paid out of the WCVC Receivership Account. Riker Decl. ¶65.

(ii) Remaining Balance

Riker expects that once all outstanding invoices have been paid out, the following amounts will remain in the Receivership Estate and should be distributed as follows: \$21,789.65 to Barranca Street and \$56,812.73 to the Lockbox Account. Riker Decl. ¶¶ 30, 68, 70.

c. Bond

Riker posted a \$250,000 bond with the court pursuant to the Appointing Order. Riker Decl. ¶45. Riker seeks exoneration of the bond. Riker Decl. ¶44.

2. Defendant's Evidence

a. Greenfield Steak House

Immediately following Riker's appointment, Mohammed Tarif Alhassen ("Alhassen"), general partner of Hassen, met with Riker to discuss issues concerning WCVC and its tenants. Alhassen Decl. ¶3. Alhassen informed Riker that Greenfield Steak House ("Greenfield") had been a tenant since 1997 but, in the last five years, was often late on rent and had to be pressed to remain current. *Id.* Prior to Riker's appointment, Greenfield made weekly payments to Hassen to remain current on the rent, and Alhassen would instruct his attorney to send letters to Greenfield threatening eviction whenever Greenfield fell behind on said payments. *Id.*; Tuck Decl. ¶3.

For over two years prior to the Receivership, Greenfield paid Hassen an average of \$20,082.50 per month which covered its monthly base rent and common area maintenance ("CAM") charges. Barth Decl. ¶3, Ex. H.

At the end of December 2015, immediately prior to Riker's appointment, Greenfield was only \$5,000 behind in rent. Alhassen Decl. ¶3. Greenfield was behind because it presented Hassan with a check which was returned for insufficient funds. *Id.* Greenfield made up this shortfall in January 2016. *Id.*

During the Receivership, Greenfield paid an average of only \$8,126 per month to Riker, including some months where no payments were made. Barth Decl. ¶3. Greenfield's payments never equaled its monthly base rent and CAM charges. Id. On April 21, 2017, Hassen's financial consultant, Gerald Barth ("Barth"), sent an email to Riker inquiring about what actions she would take with respect to Greenfield's outstanding rent and CAM charges. Barth Decl. ¶4, Ex. A. On April 30, 2017, Greenfield's lease expired. Alhassen Decl. ¶4. Yet, Greenfield was not evicted. Id. In February 2018, when WVCV was returned to Hassen, Greenfield remained at WVCV and owed \$538,270 in back rent and hold-over rent. Alhassen Decl. ¶4; Barth Decl. ¶3; Tuck Decl. ¶3. Hassen filed an unlawful detainer action and was awarded a judgment of eviction and damages against Greenfield. Alhassen Decl. ¶4; Tuck Decl. ¶3. Greenfield immediately filed for bankruptcy following entry of the judgment. Id. For the past few months, Hassan has been marketing the former Greenfield location and has received three offers to pay full market rent and CAM charges. Alhassen Decl. ¶4; Tuck Decl. ¶3.

b. Suite 409

In late 2015, prior to Riker's appointment, Jeffrey Tuck ("Tuck"), WVCV's property manager, negotiated a lease with Christine Wahba ("Wahba") for rental of Suite 409. Tuck Decl. ¶2. Wahba intended to open a salon and to take over equipment that the former tenant owned and left in the suite. Id., Ex. E. Wahba paid the first month's rent and a security deposit. Id. Under her lease, monthly rent and CAM charges for the suite was \$2,049.50. Id.

When Riker was appointed, she changed the locks on the suite and removed all the equipment. Tuck Decl. ¶2. As a result, Wahba terminated the lease. Id. To date, Suite 409 remains empty and Hassen lost \$51,237.50 in rent and CAM charges. Id.; Barth Decl. ¶9.

c. Amaron Construction

Riker and Transwestern hired Amaron Construction ("Amaron") to perform demolition work and install electrical service to WVCV's Suite 437. Barth Decl. ¶5; Tuck Decl. ¶4. Riker paid \$34,563 for this work. Id., Ex. B.

Tuck contacted the City of West Covina and learned Amaron had failed to obtain permits for the demolition and electrical work. Tuck Decl. ¶4. In Tuck's experience, work performed without permits may result in the City charging significantly more for a permit or requiring work revisions. Id. Barth complained to Plaintiffs about this issue, and Barth's complaint was forwarded to Riker. Barth Decl. ¶5, Ex. C.

d. UEI Colleges

In late 2017, Riker entered into a lease with UEI College (“UEI”) that provided for \$1.4 million in tenant improvements. Barth Decl. ¶6.

Tuck inspected the completed work. Tuck Decl. ¶5. Tuck determined that Riker had hired a non-architect Hoskins + Hoskins, Inc. (“Hoskins”) to draw up plans for improvements of the suite and that these plans failed to account for a Building Code-compliant fire wall separating two sections of the premises. *Id.* Subsequently, UEI had to install an adequate fire wall and employ a licensed architect to inspect Hoskins’ plans to determine whether any other deficiencies existed. *Id.* No other deficiencies were spotted. *Id.* Hassen also had to hire an attorney to negotiate an indemnity agreement with UEI covering the legal exposure of a non-architect preparing the plans. Barth Decl. ¶6. Hassen incurred \$4,012.50 in legal costs for this work. *Id.*

e. Newmark and Grubb

Riker paid a commission of \$3,149.50 to a broker Newmark and Grubb (“Newmark”) related to the execution of the Fourth Amendment to an Automated Teller Machine Facility Lease. Barth Decl. ¶7, Ex. D. The lease, however, expressly states that no brokers were used. *Id.*

f. Cat Café

In June 2015, prior to Riker’s appointment, Tuck obtained a tenant for Suite 329 which had been vacant for several years. Tuck Decl. ¶6. This tenant intended to operate a “Cat Café,” a café with adoptable cats roaming free. *Id.* The tenant executed a letter of intent to lease the space, obtained all necessary health permits, and was ready to execute the lease just before Riker was appointed. *Id.*, Ex. F. Riker and her broker decided that a Cat Café was inappropriate for WCVC and refused to sign the lease. *Id.* To date, the suite remains vacant and Hassen has lost \$136,620 in rent and CAM charges. Tuck Decl. ¶6.

g. Roof Replacement Work

In 2017, Riker notified Hassen that she intended to replace the roofs on Buildings A, C, D, F, and G of WCVC. Barth Decl. ¶8; Tuck Decl. ¶7. The roofs were old and leaky and needed replacement. Tuck Decl. ¶7.

Hassen asked Riker to allow Hassen to replace the roofs with its own contractors, but Riker refused. Tuck Decl. ¶7. Hassen also asked that Riker delay the roof replacement work because Hassen was negotiating reinstatement of the loan and termination of the Receivership. Barth Decl. ¶8. Riker did not delay beyond September 15, 2017 and proceeded to contract for roof replacement at a cost of approximately \$450,000. Barth Decl. ¶8; Tuck Decl. ¶7. Transwestern received a fee in the amount of \$25,152.77 for overseeing this work. Barth Decl. ¶8.

In February 2018, following return of WCVC to Hassen, Tuck inspected the roofs after a substantial rain storm and determined that the roofs were susceptible to

significant ponding. Barth Decl. ¶8; Tuck Decl. ¶7. Tuck reviewed the warranty and learned that it does not cover leaks from ponding. Tuck Decl. ¶7, Ex. G. Tuck was also informed that Riker had elected not to slope the roofs to minimize ponding. Id.

3. Reply Evidence

During the Receivership, Riker was able to significantly increase occupancy at WCVC — the premises became 88% leased — and increase rental revenue at WCVC by more than \$1.3 million per year. Riker Supp. Decl. ¶4.

Throughout the Receivership, Riker served the parties with monthly reports containing a detailed summary of leasing, operations, maintenance, collections and comprehensive property financial statements. Riker Supp. Decl. ¶6, Ex. 1. Hassen and its agents routinely asked questions about her activities and offered suggestions about how she should operate the Property. Riker Supp. Decl. ¶7, Ex. 2. Riker always exercised her independent judgment in determining whether to incorporate these suggestions. Id. Riker always quickly responded to Hassen's questions and suggestions, and Hassen never once followed up on any of her responses with a formal objection to a course of action adopted. Riker Supp. Decl. ¶8. Instead, Hassen appeared to accept Riker's explanation. Id.

a. Greenfield

Riker and her property manager made extensive efforts to collect all amounts due under the Greenfield lease. Riker Supp. Decl. ¶10. A large portion of the Greenfield receivable — at least \$265,000 — is attributable to Riker's decision to bill Greenfield for items which Hassen had not previously billed. Riker Supp. Decl. ¶10. These items included certain taxes, insurance, late fees, and/or holdover charges. Id. A summary comparison of what Hassen would have billed Greenfield as opposed to what Riker billed Greenfield reflects that Riker billed Greenfield for additional charges leading to a total rent increase of \$268,120.32. Id. Riker made sure to bill Greenfield these amounts to preserve the ability to pursue them in future collection actions. Riker Supp. Decl. ¶11.

In any given month, Transwestern had 15-20 emails or phone calls with Greenfield in an effort to collect the amounts owed. Riker Supp. Decl. ¶11. Greenfield made it clear that it would vacate the premises if served with a 3-Day Notice. Id. Riker exercised her business judgment in determining that (1) collecting some rent for the location was prudent until a suitable replacement tenant could be identified and (2) suing a current tenant possessing a limited prospect of collectability would be detrimental to her ability to collect the outstanding amounts. Riker Supp. Decl. ¶12. Riker also discerned that creating a vacant building along the major property frontage would be detrimental to WCVC. Id.

In January 2017 and periodically thereafter, Hassen informed Riker and Tullius that a loan modification was imminent and that she should just preserve the status quo and,

thus, not incur additional expenses. Riker Supp. Decl. ¶13. This information factored into Riker's decision not to file litigation against Greenfield. Id. During the Receivership, Riker's broker actively marketed the Greenfield space to prospective tenants. Riker Supp. Decl. ¶14. Riker forwarded two proposals to rent the space to the parties in this lawsuit for their review. Id., Ex. 3. These proposals fell through because Riker never received the necessary approvals from the parties. Id.

Riker addressed the status of Greenfield's payments and collection activity in every monthly report over the course of the Receivership. Riker Supp. Decl. ¶15. At no point did Hassen seek court intervention to address what they presently allege as a substantial issue. Id.

Riker was able to collect a significant amount of other tenants' delinquent balances which were on Hassen's books when Riker took possession of the premises. Riker Supp. Decl. ¶16. Following WCVC's turnover to Hassen, Riker and her agents assisted Hassen free-of-charge in their eviction action against Greenfield. Riker Supp. Decl. ¶17.

b. Suite 409

Riker believes that Hassen delivered the fully-executed lease of Suite 409 to Wahba after Riker took possession of the Property. Riker Supp. Decl. ¶18. Hassen had no authority to do so, and Hassen even informed Wahba of this fact when it gave her the keys. Id.

Consequently, Riker evaluated whether to move forward with the lease. Id. Riker ultimately decided that the lease was not in the best interest of the Receivership Estate because (1) the unit was torn apart and left in a deplorable condition, which would require Riker to undertake substantial renovations to make it ready for Wahba, (2) the abandoned equipment which Wahba claimed to have purchased could not be released to her without resort to statutory procedures for abandoned personal property of a former tenant, and (3) Hassen was directly communicating with Wahba during the pendency of the Receivership and these communications appeared to catalyze her termination of the lease. Riker Supp. Decl. ¶19; Tullius Decl. ¶3, Ex. 15.

Upon the lease's termination, Riker executed a settlement agreement to document the termination in light of the peculiar timing and delivery of the lease and Wahba's claim to the abandoned property. Riker Supp. Decl. ¶20.

c. Amaron

Riker concedes that permits for this demolition and electrical work were not obtained during the Receivership. Riker Supp. Decl. ¶21. She believes that this business decision was reasonable. Id. Riker reasons that (1) a permit would likely have triggered ADA and/or Title 24 upgrades increasing the cost of the work significantly, (2) the work performed was cleanup and safety work necessary to market the space and was completed by fully licensed contractors, and (3) a delay in pulling permits

for the work would only result in minimal additional fees in the range of \$1,000 to \$1,500. Riker Supp. Decl. ¶21, Ex. 4.

In Riker's experience, property owners often delay pulling of permits for similar reasons. Riker Supp. Decl. ¶23.

d. UEI

The UEI lease expressly requires UEI and its general contractor to ensure compliance with all laws and regulations. Riker Supp. Decl. ¶24, Ex. 5. Given UEI's indemnification obligations under the lease, Riker relied on representations by UEI and its general contractor that Hoskins was a licensed architect. Riker Supp. Decl. ¶25. She also relied on the City's issuance of permits and the temporary Certificate of Occupancy in determining that UEI had completed its improvements in accordance with all applicable building codes and regulations. Riker Supp. Decl. ¶26.

Riker believes that it would have been inappropriate for her to inspect and approve each element in a tenant buildout where the tenant is responsible for construction; it would be prohibitively expensive to retain experts to double-check the work and would shift the liability risk to the landlord. Riker Supp. Decl. ¶27.

Plaintiffs and Hassen reviewed and approved the UEI lease prior its execution. Riker Supp. Decl. ¶29, Ex. 6. At no point did Hassen raise an objection to UEI's use of Hoskins as an architect. Id.

e. Newmark and Grubb

The ATM lease renewal appears to contain a drafting omission. Riker Supp. Decl. ¶31. Newmark should have been listed as the landlord's broker in the amendment. Riker Supp. Decl. ¶32. Newmark was actively involved in the negotiation of this lease amendment. Id., Ex. 7. Riker sent Newmark's letter of intent for the renewal to Hassen, and Hassen did not object to payment of a commission to Newmark. Riker Supp. Decl. ¶32, Exs. 7-8.

f. Cat Café

When Riker took over possession of WCVC, there was a large population of stray cats roaming the Property. Riker Supp. Decl. ¶34. Tuck was apparently feeding these cats and enabling them to reside on the Property. Id. Riker determined that the Cat Café was detrimental to the image and cleanliness of the Property in part for this reason. Id.

Riker's leasing agents evaluated the proposed lease and advised her that this lease was inconsistent with the strategic marketing plan for the property. Id.

g. Roofing Replacement Work

Upon taking possession of WCVC, the roofs at issue were in dire condition with immediate replacement recommended. Riker Supp. Decl. ¶37. Riker believed that Hassen had failed to maintain the roofs for many years. Id.

Prior to beginning the roof replacement work on WCVC, Riker provided numerous notices to the parties and an opportunity to ask questions and/or raise concerns. Riker Supp. Decl. ¶35, Ex. 11. Riker informed Hassen of the exact scope of the work and the nature of the warranty covering the work. *Id.* Hassen did not object to the scope of the work. *Id.* Based upon multiple contractors' recommendations, Riker determined re-roofing to be appropriate. *Id.*

Some ponding on a flat roof after rain is normal and not typically an issue if the roof is properly maintained on a regular basis. Riker Supp. Decl. ¶36.

h. Interference

Throughout the Receivership, Hassen and its agents repeatedly interfered with Riker's operation of WCVC and failed to deliver material information and documents about the property despite numerous requests. Riker Supp. Decl. ¶38. For instance, Hassen required Riker to pay Gerald Barth (Hassen's CFO) as a consultant before Hassen would hand over court-mandated files. *Id.*

Hassen's unwillingness to fully comply with the court's orders and otherwise facilitate the smooth operation of the Property caused significant additional costs. Riker Supp. Decl. ¶38.

i. Additional Fees

Riker spent an additional 15.5 hours on this matter than was contemplated in the moving papers. Riker Supp. Decl. ¶39. Riker requests additional fees of \$3,875. *Id.*, Ex. 13.

Tullius spent an additional 16.5 hours preparing a reply brief and an additional \$91.02 in costs totaling \$7,103.52 in additional fees and costs. Tullius Decl. ¶4, Ex. 16.

D. Analysis

Riker seeks an order discharging her as Receiver, approving her Final Report and Accounting, and exonerating the bond posted for the Receivership.

Hassen seeks a disallowance of Riker's Receivership fees and a surcharge of her bond on the ground that Riker exceeded her receivership authority and caused injury to Hassen by negligently operating the Receivership Estate. Opp. at 2. Hassen alleges seven discrete grounds to substantiate this objection.

1. Good Cause

Hassen concedes that it did not object to Riker's 25 interim monthly reports in accordance with CRC 3.1183(b) ("Unless good cause is shown, objections to a receiver's interim report and accounting must be made within 10 days of notice of the report and accounting...."). Opp. at 1. Hassen argues that good cause existed to wait to object until the Final Report was filed because Hassen was in default on its loan and Plaintiffs threatened to foreclose on WCVC. Opp. at 1-2. Hassen states that this

process continued until January 2018 at which time the parties executed a loan modification agreement and WCVC was turned over to Hassen. Opp. at 2. Hassen has shown motive but not good cause. As Riker points out (Reply at 1), Hassen was in the same situation as every defendant borrower in a rents and profits receivership. The borrower is in default and is looking for a way to avoid foreclosure, including loan modification and reinstatement. The good cause requirement of CRC 3.1183(b) contemplates more than a loan default and negotiation with the lender to excuse a failure to object. Hassen's correspondence with Riker during the Receivership undermines its good cause claim because it was intimately involved. Riker Supp. Decl. ¶7, Ex. 2 (Hassen and its agents routinely asked Riker questions about her activities and offered her suggestions about how to operate WCVC). Hassen could have and should have raised timely objections, and its failure to do so is not good cause. Accordingly, Hassen's objections are time-barred.

2. Immunity

Riker contends that she has quasi-judicial immunity and was acting within the scope of her authority as a receiver. Reply at 2. According to Riker, she can only be held liable and surcharged if she was acting outside the scope of her receivership authority. Reply at 3.

Riker is correct to a certain extent. As a court-appointed receiver, she enjoyed quasi-judicial immunity for damage claims arising from her performance of duties in connection with the judicial process. McClintock v. West, (2013) 219 Cal.App.4th 540, 551 (citing Howard v. Drapkin, (1990) 222 Cal.App.3d 843, 860). But Riker overextends this privilege. This immunity does not apply to surcharges. As case law has well-established, a receiver may still be surcharged for losses to the receivership estate based upon her misconduct or mismanagement. Southern California Sunbelt Developers, Inc. v. Banyan Limited Partnership, (2017) 8 Cal.App.5th 910, 926 (citing Aviation Brake Systems, Ltd. v. Voorhis, (1982) 133 Cal.App.3d 230, 233). This includes, instances where the receiver exceeds her authority, causes injury to others, or acts negligently in operating the estate. Id. A party must make such a claim in response to a receiver's request for final accounting and may not file an independent action to address the receiver's liability. Id. Hassen makes claims of negligence against Riker's bond.

3. Objections

a. Greenfield

Hassen asserts that Riker failed to pursue collection or eviction of Greenfield causing damages to Hassen in the amount of \$538,270. Opp. at 5. According to Hassen, Greenfield paid only \$8,126 per month in rent during the Receivership, whereas it had paid an average of \$20,082.50 per month in rent prior to the Receivership. Opp. at 5. This change allegedly increased the accounts receivable for Greenfield from

\$5,000 to \$538,270. Hassen also alleges that Riker negligently allowed Greenfield to continue using the premises even after its lease was not renewed. Opp. at 5-6. Riker presents a multitude of reasons which reasonably explain her business decisions about Greenfield. First, approximately half of the increased accounts receivable is attributable to Riker's decision to bill Greenfield for items which Hassen had not billed. Riker Supp. Decl. ¶10. Apart from providing an opportunity to generate more rental revenue, these items preserved the Receivership's ability to pursue these amounts in future collection actions. Riker Supp. Decl. ¶11. Second, Riker did attempt to collect these outstanding sums. Riker Supp. Decl. ¶11. Transwestern on behalf of Riker had 15-20 emails or phone calls with Greenfield in any given month on this subject. Id. Third, Greenfield threatened to vacate the premises if given an eviction notice. Riker Supp. Decl. ¶11. Riker prudently concluded that collecting some, albeit not all, rent was better than collecting no rent at all while Riker looked for a replacement tenant. Riker Supp. Decl. ¶12. Riker also observed that a vacant building along the property frontage would not be good for business. Id. Fourth, by January 2017 (approximately a year into the Receivership), Hassen told Riker to preserve the status quo because Hassen expected to repossess the Property. Riker Supp. Decl. ¶13. This factor warranted against an eviction of Greenfield. Fifth, Riker actively marketed the space to prospective tenants. Riker Supp. Decl. ¶14. She was simply unsuccessful in procuring one, in part because necessary approvals from the parties fell through. Id. Sixth, Riker presents evidence that Hassen is simply cherry-picking. In other scenarios, Riker collected delinquent tenant balances where Hassen had previously failed. Riker Supp. Decl. ¶16. Individually and collectively, these reasons show that Riker did not negligently handle Greenfield.

b. Suite 409

Hassen contends that Riker caused Wahba to terminate its lease for Suite 409 and damaged Hassen in the amount of \$51,237.50. Opp. at 6.

Riker persuasively explains why she concluded that the lease with Wahba would not be in the best interest of the Receivership Estate. Riker Supp. Decl. ¶19. The lease was not economically viable for the Estate because the unit required substantial renovations. Id. If she signed the lease with Wahba, Riker would have had to pursue statutory procedures related to abandoned personal property of a former tenant. Id. These time and cost expenditures, particularly the renovation cost, are sound justifications for Riker's decision.

Hassen also disputes the \$3,697.50 which Riker paid to her counsel for negotiating a termination of the Wahba lease. Opp. at 10. Hassen maintains that instead of receiving regular monthly rent checks, Hassen lost money in this transaction. Id.

Hassen's point is not well-taken. Riker prudently concluded that she should execute a settlement agreement with Wahba to limit legal exposure in this peculiar

lease situation which was improperly catalyzed by Hassen during the Receivership. Riker Supp. Decl. ¶¶ 19-20.

c. Amaron

Hassen contends that Riker negligently hired Amaron to perform demolition and construction work without permits at a cost of \$34,563. Opp. at 6.

Riker acknowledges that this work was unpermitted. Riker Supp. Decl. ¶21. Riker weighed the risks and costs, and she presents three reasons why she decided not to obtain permits. Riker Supp. Decl. ¶¶ 21-22. First, an electrical permit would have triggered costly ADA and/or Title 24 upgrades. *Id.* Second, the work related to cleanup and safety and was contracted to market the space. *Id.* Riker planned to obtain permits and perform additional tenant improvement work when she found a suitable tenant. *Id.* Riker estimated that additional fees for subsequent permits would be minimal — e.g., in the \$1,200 range. *Id.*, Ex. 4.

Riker’s rational, discretionary business decision is not negligent and not subject to surcharge.

d. UEI

Hassen asserts that Riker approved the use of Hoskins as an architect for the UEI suite improvements even though Hoskins is not a certified and licensed architect. Opp. at 7. As a result, Hassen incurred unnecessary legal fees in negotiating with UEI to have a certified architect review the improvements for legal conformity and obtaining additional indemnity from UEI with respect to this work. Opp. at 8.

This objection is invalid. As Riker explains, she relied on the lease between WCVC and UEI which (1) mandates that UEI “will comply with all Legal Requirements” with respect to maintenance, repairs, and alterations at its own cost (Riker Supp. Decl. ¶¶ 24-25, Ex. 5, p.23) and (2) contains an indemnification clause protecting WCVC from any claims relating to the improvements (Riker Supp. Decl. Ex. 5, p.28). Riker also points out that it would have been prohibitively expensive for her to hire experts to double-check UEI’s work. Indeed, doing so might have inadvertently exposed WCVC to legal liability. Riker Supp. Decl. ¶27. Finally, Hassen reviewed and approved the UEI lease and raised no objections to this arrangement. Riker Supp. Decl. ¶29.

Riker’s acceptance of Hoskins as an architect, given the lease’s allocation of liability and Hassen’s implicit acquiescence, was non-negligent.

e. Newmark

Hassen contends that Riker damaged Hassen by paying broker Newmark a commission in the amount of \$3,149.50 even though the instrument at issue states that no broker was used. Opp. at 8.

Hassen is incorrect. As Riker explains, this instrument simply contains a drafting error. Riker Supp. Decl. ¶31. Newmark was actively involved in negotiation of this amendment, and deserved a commission. Hassen was on adequate notice of Newmark's broker status for the renewed lease. Riker Supp. Decl. ¶32, Exs. 7-10.

f. Cat Café

Hassen complains that Riker damaged the partnership by terminating a letter of intent with Cat Café for Suite 329. Opp. at 8. Hassen complains that the Appointing Order did not authorize Riker to change the nature of WCVC or its tenants. Opp. at 9. According to Hassen, Riker's failure to sign the lease cost Hassen \$136,620 over the course of the Receivership. *Id.*

The Appointing Order is broad and provides Riker with power, *inter alia*, to "do all the things, and incur the risks and obligations, ordinarily done or incurred by owners, managers, and operators of businesses." Riker Decl. Ex. 2, p.4. A decision not to enter into a lease which a manager finds to be detrimental to the image and cleanliness of the Property as well as inconsistent with the strategic marketing plan is consistent with Riker's authority. Riker Supp. Decl. ¶34.

g. Roofing Replacement Work

Hassen asserts that Riker damaged Hassen by paying Transwestern \$25,152.77 in project management fees for roof replacement work. Opp. at 9. According to Hassen, it did not have the opportunity to review the contract or warranty governing such work and it was dismayed to learn that (1) the newly-replaced roofs are susceptible to "significant ponding" and (2) the roofer's warranty does not cover this issue. Opp. at 10. Hassen asserts that Transwestern breached its supervisory duties by not requiring the roofing contractor to install new roofs which drained properly. *Id.*

Hassen's assertions are dubious. Hassen failed to maintain the roofs and they were undisputedly old and needed replacement. Tuck Decl. ¶7. Riker resolved this issue by replacing the roofing. There is insufficient evidence to indicate that construction of a flat roof susceptible to ponding is negligence by the roofing contractor, the project manager Transwestern, or Riker. Riker asserts, and Hassen does not dispute, that ponding after rain is normal on a flat roof and is not typically an issue with regular maintenance checks. Riker Supp. Decl. ¶36. Riker points out that Hassen should have been fully aware of the contemplated roofing work as Riker submitted to Hassen the contract documents showing the scope of work and nature of the warranty. Riker Supp. Decl. ¶35, Ex. 11. Riker's need to take action and Hassen's failure to object to the design or warranty mean that Riker's discretionary business decision must be upheld.

E. Conclusion

All of Hassen's objections and efforts to surcharge Riker's bond are meritless. Riker's Final Report and Accounting, including additional fees and costs incurred for preparation of the reply brief, is approved in its entirety. After payment of final fees and expenses, Riker is authorized to distribute the balance of the funds to Plaintiffs. Riker is discharged as Receiver, and the bond that she posted for the Receivership is ordered exonerated.

The court will sign a modified order that includes the additional fees sought in reply. As the court has no personal knowledge of Receiver's actions, she is relieved of liability only where misconduct could have been discovered by the final accounting. *See Aviation, supra*, 133 Cal.App.3d at 234-35. Therefore, the order will be modified to exonerate Receiver and her staff from liability where the misconduct could have been discovered.

[1] The reference to "personal capacity" simply means that the bond posted by the receiver is subject to the surcharge.

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Superior Court of California
County of Los Angeles

JUL 12 2018

Sherri R. Carter, Executive Officer/Clerk
By: Jennifer De Luna, Deputy

1 JENNIFER R. TULLIUS (BAR NO. 222763)
2 TULLIUS LAW GROUP,
3 a Professional Corporation
4 515 S. Flower Street, 36th Floor
5 Los Angeles, California 90071
6 Telephone: 213-787-5958
7 Facsimile: 213-674-4364
8 jtullius@tulliuslaw.com

9 Attorneys for Receiver
10 TERRI RIKER

11 SUPERIOR COURT OF THE STATE OF CALIFORNIA
12 COUNTY OF LOS ANGELES

13 CSMC 2006-C5 NORTH AZUSA AVENUE,
14 LLC, a Delaware limited liability company; and
15 CSMC 2006-C5 NORTH BARRANCA
16 STREET, LLC, a Delaware liability company,

17 Plaintiffs,

18 vs.

19 EASTLAND TOWER PARTNERSHIP, a
20 California limited partnership; HASSEN REAL
21 ESTATE PARTNERSHIP, a California limited
22 partnership; and DOES 1 through 20, inclusive,

23 Defendants.

Case No. BC575092

Hon. James C. Chalfant/Dept. 85

**ORDER ON MOTION FOR ORDER
DISCHARGING RECEIVER, APPROVING
RECEIVER'S FINAL REPORT AND
ACCOUNTING AND EXONERATING
BOND**

Hearing Date: July 12, 2018

Hearing Time: 9:30 a.m.

Dept. No.: 85

24 This Court, having considered receiver Terri Riker's ("Receiver") MOTION FOR ORDER
25 DISCHARGING RECEIVER, APPROVING RECEIVER'S FINAL REPORT AND
26 ACCOUNTING AND EXONERATING BOND (the "Motion"), the declarations and evidence
27 submitted in support thereof, and the pleadings and other documents on file herein, and having
28 heard oral argument of counsel and/or and interested parties:

IT IS HEREBY ORDERED that:

- 1 1. The Motion is GRANTED;
- 2 2. The Receiver has complied with the Court's Orders in this case and has
- 3 satisfactorily completed all of her duties except such matters as will be concluded after the
- 4 hearing on the Motion;
- 5 3. All of the Receiver's acts and transactions as the Receiver herein, including the
- 6 actions of her attorneys, employees and agents, are ratified, confirmed and approved;
- 7 4. The Final Report and Accounting of the Receiver are approved;
- 8 5. The final fees and costs of the Receiver and her professionals as set forth in the
- 9 Motion are approved;
- 10 6. All distributions for fees and costs made during the receivership to the Receiver
- 11 and the Receiver's counsel are ratified, confirmed and approved;
- 12 7. The Receiver is authorized to pay any unpaid fees and expenses owed to her and
- 13 her professionals through the service of the Order requested herein out of the remaining
- 14 receivership funds. These unpaid amounts are as follows:
- 15 a. The Receiver's fees and costs for January 2018 through discharge in the amount
- 16 of \$23,375.00, with \$3,325.00 to be paid from the property known as Wells
- 17 Fargo Tower and ~~\$20,101.00~~ to be paid from the property known as West
- 18 Covina Village; \$20,050.00 *deal*
- 19 b. Receiver's counsel's fees and costs for January 2018 through discharge in the
- 20 amount of \$28,980.87, with \$5,185.00 to be paid from the property known as
- 21 Wells Fargo Tower and \$23,795.87 to be paid from the property known as West
- 22 Covina Village;
- 23 c. Receiver's property manager's fees and costs for February 14, 2018, through
- 24 February 28, 2018, in the amount of \$7,293.65, with all of such amount to be
- 25 paid from the property known as West Covina Village;
- 26 8. Following the payment of all remaining invoices, fees and costs of the
- 27 receivership estate, the Receiver is authorized to distribute all remaining funds held by the
- 28

1 Receiver related to the property known as Wells Fargo Tower in the amount of \$21,789.65 to
2 Plaintiff pursuant to their unified foreclosure on Wells Fargo Tower;

3 9. Following the payment of all remaining invoices, fees and costs of the
4 receivership estate, the Receiver is authorized to distribute all remaining funds held by the
5 Receiver related to the property known as West Covina Village in the amount of \$37,603.25 to
6 a lockbox account designated by Plaintiffs pursuant to Paragraph 2 of the Order on Stipulation
7 and Order Authorizing Release of Funds entered by this Court on February 9, 2018;

8 10. The Receiver is authorized to distribute \$8,230.96, plus any additional amounts
9 received after the filing of the Motion related to tenant rent collections received by the
10 Receiver after the "Final Distribution Date", to a lockbox account designated by Plaintiffs as
11 set forth in Paragraph 2 of the Order on Stipulation and Order Authorizing Release of Funds
12 entered by this Court on February 9, 2018;

13 11. The Receiver and her professionals, at the expense of the Receivership Estate,
14 are authorized to abandon and/or destroy any and all business records relating to the
15 receivership or to this action that are in their possession, control or custody, if not claimed by a
16 party entitled thereto, in writing, within sixty (60) days of service of a Notice of Entry of the
17 Order on the Motion. Any party claiming such records must pay for all costs of taking
18 possession of and delivery of such records;

19 12. The receivership is hereby terminated, the Receiver is discharged from her
20 official duties, and the Receiver, her bond, sureties, accountants, attorneys, employees and
21 agents, and each of them, are fully exonerated from all liability as provided by law and in
22 furtherance thereof, all persons and entities are enjoined and restrained from commencing or
23 prosecuting any action or proceeding against the Receiver and/or her agents on account of
24 debts, claims and obligations of the receivership;

25 13. The Receiver is not liable in any manner for any claims, demands or causes of
26 action that may have directly or indirectly arisen from the Receivership Estate prior to, during
27 or after the receivership period that were not brought before the Court prior to the hearing on
28 the Motion, to the extent such claims could have been discovered prior to the hearing on the

1 Motion. The Receiver is not liable to any taxing authority or any person or entity, including
2 but not limited to any persons or entities upon whom notice of the Motion was served, based
3 on the Receiver having given notice of the hearing on the Motion to said parties;

4 14. Each Plaintiff and Defendant shall jointly and severally indemnify, defend and
5 hold the Receiver and the Receivership Estate harmless from any and all claims that may arise
6 in the future that relate to the receivership;

7 15. Should the Receiver, her agents, professionals, counsel or employees be called
8 as a witness in any future proceeding or be required to respond to a document subpoena in
9 connection with the Receiver's services in this matter, the requesting party shall pay the
10 Receiver or other subpoenaed person's then current billing rate for the time and reimburse all
11 fees and expenses in connection therewith;

12 16. This Court reserves exclusive jurisdiction over any claim or claims that may be
13 asserted against the Receiver or her professionals for their respective services herein and all
14 issues that were a part of the subject matter of the receivership and this Order, or that have
15 arisen or may arise therefrom;

16 17. Notice of the Motion was proper; and

17 18. This Order is effective immediately. Notice of performance of any of the foregoing
18 orders is not required to make this Order effective.

19
20 **IT IS SO ORDERED**

21 DATED: 7/12/15


22 HON. JAMES C. CHALFANT
23 JUDGE OF THE SUPERIOR COURT
24
25
26
27
28

Biographies

Byron Moldo

Byron Z. Moldo is a Partner in the Bankruptcy, Receivership and Creditors' Rights Department at Ervin Cohen & Jessup.

Born and raised in Los Angeles, Byron's entire legal career has specialized in bankruptcy, receivership, assignments for the benefit of creditors and all aspects of insolvency. He regularly serves as a Receiver in state and federal court cases, as assignee for the benefit of creditors and as a fiduciary in other court-supervised matters. In addition, a substantial portion of his work consists of serving as general or special counsel to receivers, bankruptcy trustees and other fiduciaries. He also represents creditors' committees and secured creditors, and has been appointed as a Disbursing Agent, Chapter 11 Plan Confirmation Agent and to serve in other fiduciary capacities.

Byron previously served as a Chapter 7 and 11 Bankruptcy Trustee in the Central District of California for approximately ten years. He also serves as a mediator for the Bankruptcy Mediation Program of the Central District of California, and the United States District Court for the Central District of California. He regularly speaks at, and writes materials for continuing legal education seminars related to bankruptcy and receivership. He is admitted to practice in all state and federal courts in California.

Terri Riker

Ms. Riker is President of Lee Ventures Realty, Inc. and offers Asset Management, Advisory, Underwriting, Acquisition Due Diligence and Loan Servicing/ REO services for Commercial Real Estate assets. Ms. Riker has served as a Receiver for rents, issues and profit cases, involving both direct and securitized commercial real estate loans. As a Court-Appointed Receiver, Ms. Riker brings over 25 years of experience in financial, operational and leasing oversight of commercial real estate portfolios. She has successfully transferred the management and operations of nationwide commercial property portfolios, established internal financial controls, audit and operational standards and handled a variety of work-outs and dispositions of underperforming assets. Her expertise encompasses all product types, and investment structures (debt and equity), through all phases of the real estate life cycle.

Randy Michelson

Randy Michelson focuses her practice on complex business bankruptcy and receivership cases, restructuring, assignments for the benefit of creditors, and

consideration of bankruptcy issues in sophisticated corporate transactions. For nearly 25 years, she has represented creditors, creditors' committees, trustees, receivers and purchasers of distressed assets in virtually every type of insolvency matter.

In addition to her role as counsel, she has been a mediator, been designated an expert witness, and served as a Chapter 11 trustee. She has appeared on CNN and CourtTV to provide expert legal analysis on insolvency topics. She lectures frequently.

Ms. Michelson represented the prevailing parties in *Perlman v. Catapult Entertainment, Inc (In re Catapult Entertainment, Inc.)*, 163 F.3d 747 (9th Cir.), *cert. dismissed*, 120 S.Ct. 369 (U.S.1999), the leading Ninth Circuit case on the treatment of intellectual property in bankruptcy cases.

Ms. Michelson is vice president of the Bay Area Receivers Forum and a director of the International Women's Insolvency & Restructuring Confederation (IWIRC), Northern California chapter. She was president of the California Bankruptcy Forum and the Bay Area Bankruptcy Forum, and she chaired the Commercial Law and Bankruptcy Section of the Bar Association of San Francisco. She is a resolution advocate on the Bankruptcy Dispute Resolution Panel of the United States Bankruptcy Court for the Northern District of California. She serves as a mediator in disputes between citizens and police officers for San Francisco's Office of Citizen Complaints.

ERVIN COHEN & JESSUP^{LLP}

Bankruptcy, Receivership and Creditors' Rights Department

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- *State and Federal Court Receiverships – Appointments as Receiver and as counsel for receivers;*
- *Partition – Appointments as partition referee;*
- *Bankruptcy – Representation of debtors, creditors, trustees and creditor committees;*
- *Assignments for the Benefit of Creditors – Appointments as Assignee and as counsel for assignees; and*
- *Commercial Litigation – State and Federal court*

9401 Wilshire Blvd., 9th Floor, Beverly Hills, CA 90212

www.ecjlaw.com



Peter Davidson

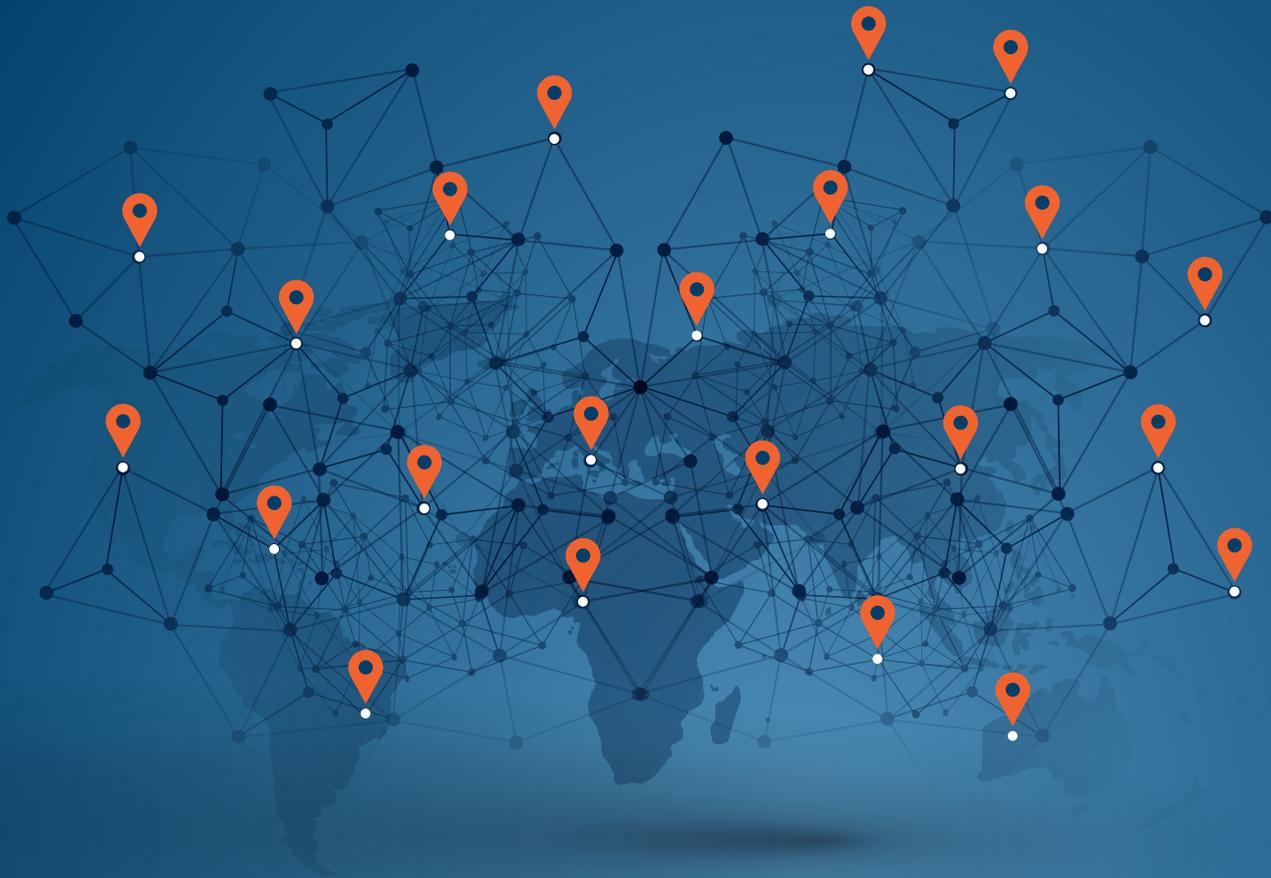


Byron Moldo



Howard Camhi

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Q3: Quarterly Industry Update

As of September 30, 2019



Ancillary Cannabis Company Study

INDUSTRY SUMMARY

SINGERLEWAK valuation identified ancillary publicly traded companies, IPOs, and recent M&A transactions within the Ancillary Cannabis industry, which provides a basis for market and transaction pricing that can be used by your firm in estimating market sentiment and its impact on your firm's value. Over the last year since September 30, 2018, the median 52-week share price return of the Ancillary Cannabis industry was -66.7%. As this industry is new and many companies trade through over-the-counter markets, multiples varied widely.

Median Public Company Key Statistics

	52-Week Return	YTD Return	P/Rev.	MVIC/GP	P/GP	P/Earnings	MVIC/Rev.	MVIC/Earnings
More than \$1 million	-54.7%	-13.2%	2.59x	9.47x	8.31x	-1.30x	3.36x	-1.80x
Less than \$1 million	-68.7%	-47.6%	26.33x	34.90x	7.28x	-1.35x	66.99x	-2.10x
Cumulative*	-66.7%	-37.7%	5.50x	9.56x	7.83x	-1.30x	6.64x	-2.02x

* Aggregated medians for ALL companies under Ancillary

Summary of Additions from Q1-Q3 2019

Q1

- Added section for public companies with more than \$1 million in revenue.
 - 11 Public Companies added.
- Added section for Reverse Merger/Backdoor IPO.
 - 14 Reverse Mergers added.

Q2

- Nine public companies added.
 - 6 companies with revenues above \$1 million.
- One delisted company - Synergetics, Inc.

Q3

- Six public companies added.
- One IPO added.
- Eliminated mergers and acquisitions beyond calendar year 2019.
 - Contact vspualding@singerlewak.com for a comprehensive list of cannabis mergers and acquisitions.

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
4Front Ventures Corp.	-23.9%	-53.0%	-20.5%	N/A	\$13.94	\$9.34	(\$43.62)	67.0%	-313.0%	9.26x	13.82x
Agrios Global Holdings Ltd.	-12.5%	-22.2%	N/A	N/A	4.62	3.67	(4.73)	79.4%	-102.4%	6.50x	8.18x
Akerna Corp.	N/A	-72.5%	N/A	\$64.98	\$11.81	\$6.85	(\$3.46)	57.9%	-113.9%	5.50x	9.49x
American Cannabis Company, Inc.	-13.2%	-6.7%	-54.7%	13.79	2.08	1.19	(0.35)	57.4%	-16.7%	6.64x	11.56x
Blue Line Protection Group, Inc.	-77.3%	-58.3%	-90.7%	0.28	3.83	1.48	(2.35)	38.7%	-61.5%	0.07x	0.19x
Cannabis Growth Opportunity Corporation	12.4%	-36.6%	-38.8%	17.53	10.16	0.00	8.81	0.0%	86.7%	1.73x	1.73x
Cannabiz Mobile, Inc.	60.0%	-4.0%	-4.0%	0.00	1.21	0.62	(1.25)	51.4%	-103.2%	0.00x	0.00x
CannaGrow Holdings, Inc	-55.0%	-44.9%	-78.7%	0.57	1.66	(0.20)	(1.97)	-12.1%	-119.3%	0.34x	-2.84x
Canopy Rivers Inc.	-29.3%	-32.0%	-65.8%	408.39	18.08	18.08	(7.78)	100.0%	-43.0%	22.59x	22.59x
DigiPath, Inc.	-1.6%	-17.4%	-28.3%	5.21	2.56	0.72	(1.68)	28.2%	-65.5%	2.03x	7.21x
EVIO, Inc.	13.6%	-4.8%	-55.5%	11.14	4.08	0.30	(13.40)	7.3%	-328.8%	2.73x	37.50x
FinCanna Capital Corp.	54.5%	17.2%	-34.6%	16.78	1.18	1.07	0.18	90.5%	15.2%	14.19x	15.68x
General Cannabis Corp	-54.0%	-14.3%	-82.0%	27.25	5.69	1.37	(14.29)	24.0%	-251.1%	4.79x	19.93x
GrowGeneration Corp.	88.9%	28.8%	-1.2%	155.77	63.41	17.38	(0.06)	27.4%	-0.1%	2.46x	8.96x
Helix TCS, Inc.	-33.3%	-43.4%	-51.6%	55.52	14.46	6.24	(10.31)	43.1%	-71.3%	3.84x	8.90x
Innovative Industrial Properties, Inc.	103.5%	-25.2%	91.5%	1050.05	31.78	30.76	16.24	96.8%	51.1%	33.04x	34.14x
Leafbuyer Technologies, Inc.	-73.3%	-84.8%	-93.6%	9.43	1.89	1.89	(7.23)	100.0%	-381.9%	4.98x	4.98x

 International

Multiple year periods are calculated as the average annual return.

(Continued on next page)



Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Lifeloc Technologies, Inc.	16.5%	33.3%	11.3%	14.72	8.72	4.02	0.47	46.1%	5.4%	1.69x	3.66x
Lift & Co. Corp.	-39.6%	-38.5%	-67.3%	11.22	6.94	4.39	(5.56)	63.3%	-80.1%	1.62x	2.56x
Monarch America, Inc.	-50.0%	-66.7%	-66.7%	0.01	4.32	1.28	(2.40)	29.7%	-55.5%	0.00x	0.01x
POSaBIT Systems Corporation	N/A	-80.3%	N/A	4.96	3.92	0.66	(5.27)	16.9%	-134.5%	1.27x	7.48x
PotNetwork Holdings, Inc.	-55.3%	-40.1%	-82.8%	26.63	24.07	8.37	0.05	34.8%	0.2%	1.11x	3.18x
Sugarmade, Inc.	-87.3%	-64.4%	-87.8%	8.44	4.37	1.00	(12.23)	22.9%	-280.0%	1.93x	8.45x
THC Global Group Limited	-3.2%	4.7%	-17.4%	60.64	3.52	0.75	(11.18)	21.4%	-317.3%	17.20x	80.38x
The Yield Growth Corp.	10.6%	-35.0%	N/A	24.94	4.51	1.26	(12.32)	28.0%	-273.1%	5.53x	19.74x
Water Ways Technologies Inc.	N/A	-28.6%	N/A	8.94	9.97	1.28	(1.86)	12.8%	-18.6%	0.90x	7.00x
Median	-13.2%	-33.5%	-54.7%	\$14.26	\$4.57	\$1.33	(\$3.57)	36.7%	-75.7%	2.59x	8.31x

■ International

Multiple year periods are calculated as the average annual return.

(Continued on next page)



Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating Less Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Agrotek Holdings, Inc.	-66.7%	-7.7%	-88.2%	(\$0.73)	\$0.00	(\$0.24)	(\$5.95)	N/A	N/A	N/A	-19.58x
American Green, Inc.	-16.4%	25.4%	-68.7%	0.66	0.05	0.05	(0.77)	100.0%	N/A	13.51x	13.51x
AmeriCann, Inc.	-55.4%	-22.1%	-68.8%	22.10	N/A	N/A	(2.50)	N/A	N/A	N/A	N/A
Bespoke Capital Acquisition Corp.	N/A	N/A	N/A	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
BLOK Technologies Inc.	-50.0%	-50.0%	-75.0%	0.62	N/A	N/A	(0.88)	N/A	N/A	N/A	N/A
Braingrid Limited	-97.4%	-92.9%	N/A	0.25	0.12	0.09	(3.09)	73.8%	N/A	2.00x	2.72x
Café Serendipity Holdings, Inc.	-39.0%	0.0%	23.5%	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Canna Consumer Goods, Inc.	-42.9%	-26.3%	-56.9%	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cannabix Technologies Inc.	-49.5%	-41.5%	-63.9%	53.01	N/A	N/A	(4.11)	N/A	N/A	N/A	N/A
CannaOne Technologies Inc.	-30.8%	-22.1%	N/A	15.26	0.10	0.10	(1.11)	100.0%	N/A	157.89x	157.89x
CannaSys, Inc.	-66.7%	-50.0%	-80.0%	0.19	0.00	0.00	(6.12)	100.0%	N/A	N/A	N/A
Captiva Verde Land Corp.	140.0%	6.7%	N/A	22.82	N/A	N/A	(1.20)	N/A	N/A	N/A	N/A
CB Scientific, Inc.	-47.6%	-52.5%	0.7%	8.91	0.05	0.03	(0.64)	54.3%	N/A	176.82x	325.40x
Crop Infrastructure Corp.	-85.0%	-80.4%	-90.8%	7.68	(0.05)	(0.05)	(11.60)	100.0%	N/A	-154.25x	-154.25x
Eurolife Brands Inc.	11.5%	51.1%	-13.9%	17.30	0.02	0.02	(6.34)	100.0%	N/A	841.85x	841.85x
FutureWorld Corp.	-100.0%	-100.0%	-100.0%	0.00	0.25	0.25	(0.87)	100.5%	-344.3%	0.00x	0.00x
Green Energy Enterprises, Inc.	0.0%	0.0%	50.0%	0.01	0.36	0.30	0.02	83.4%	5.7%	0.03x	0.03x
Green Technology Solutions, Inc.	-58.3%	-37.5%	-52.4%	0.14	N/A	N/A	(6.60)	N/A	N/A	N/A	N/A
GreenPlex Services, Inc.	168.3%	22.2%	168.3%	4.11	0.04	0.04	(0.40)	100.0%	N/A	107.85x	107.85x

 International

Multiple year periods are calculated as the average annual return.

(Continued on next page)



Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating Less Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Grow Solutions Holdings, Inc.	9.5%	-43.2%	-8.0%	0.39	N/A	N/A	(0.42)	N/A	N/A	N/A	N/A
International Consolidated Companies, Inc.	0.0%	N/A	0.0%	0.41	0.06	0.06	(0.20)	100.0%	-357.1%	7.29x	7.29x
Leviathan Cannabis Group Inc.	18.8%	2.2%	-67.2%	45.00	0.14	0.11	(6.24)	83.8%	N/A	328.11x	391.43x
MassRoots, Inc.	-93.9%	-78.0%	-97.2%	0.73	0.04	0.61	(10.45)	N/A	N/A	18.96x	1.19x
Medical Cannabis Payment Solutions, Inc.	-36.3%	-45.0%	-65.9%	4.99	N/A	N/A	(4.25)	N/A	N/A	N/A	N/A
MediGreen Holdings Corporation	N/A	-100.0%	-100.0%	0.00	0.00	(0.11)	(2.42)	N/A	N/A	0.00x	0.00x
MyDx, Inc.	-72.7%	-45.5%	-75.0%	2.66	0.10	0.00	(6.16)	4.0%	N/A	26.33x	665.31x
Nhale, Inc.	-23.8%	-37.1%	-82.0%	0.18	N/A	N/A	(0.07)	N/A	N/A	N/A	N/A
North American Cannabis Holdings, Inc.	-68.0%	0.0%	0.0%	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Northsight Capital, Inc.	-64.3%	13.6%	-70.1%	0.37	0.05	0.05	(1.99)	100.0%	N/A	7.27x	7.27x
Novus Acquisition & Development Corp.	-62.7%	-52.7%	-86.2%	0.13	0.10	0.09	0.02	96.0%	24.5%	1.37x	1.43x
Ovation Science Inc.	-1.7%	-33.7%	N/A	6.85	0.19	0.18	(0.68)	92.7%	-350.7%	35.44x	38.25x
Peak Pharmaceuticals, Inc.	-90.0%	-67.3%	-90.4%	0.94	N/A	N/A	(0.05)	N/A	N/A	N/A	N/A
Pineapple Express, Inc.	-55.7%	-43.6%	-68.0%	19.91	0.61	0.61	(3.37)	100.0%	-555.4%	32.82x	32.82x
SOL Global Investments Corp.	-46.2%	-46.0%	-71.5%	66.10	(85.26)	(85.26)	54.44	100.0%	-63.8%	-0.78x	-0.78x
STWC Holdings, Inc.	-86.9%	-73.7%	-74.0%	8.96	0.09	(0.03)	(2.98)	-35.9%	N/A	99.02x	-275.73x
TruTrace Technologies Inc.	53.8%	0.0%	-39.4%	16.04	0.06	(1.13)	(7.52)	N/A	N/A	276.57x	-14.14x

 International

Multiple year periods are calculated as the average annual return.

(Continued on next page)



Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Two Rivers Water & Farming Company	2.9%	-69.3%	-23.9%	8.95	0.09	0.09	(7.29)	100.0%	N/A	104.09x	104.09x
U.S. Lithium, Corp.	-13.7%	-15.4%	-71.1%	1.04	N/A	(0.00)	(0.50)	N/A	N/A	N/A	N/A
WEED, Inc.	-59.1%	-27.1%	-85.4%	46.57	N/A	N/A	(31.76)	N/A	N/A	N/A	N/A
World Class Extractions Inc.	N/A	-46.2%	N/A	42.01	0.17	0.10	(28.64)	58.8%	N/A	250.38x	425.54x
Median	-47.6%	-39.5%	-68.7%	\$0.99	\$0.06	\$0.05	(\$2.46)	N/A	N/A	26.33x	7.28x

 International

Multiple year periods are calculated as the average annual return.

Median Public Companies*

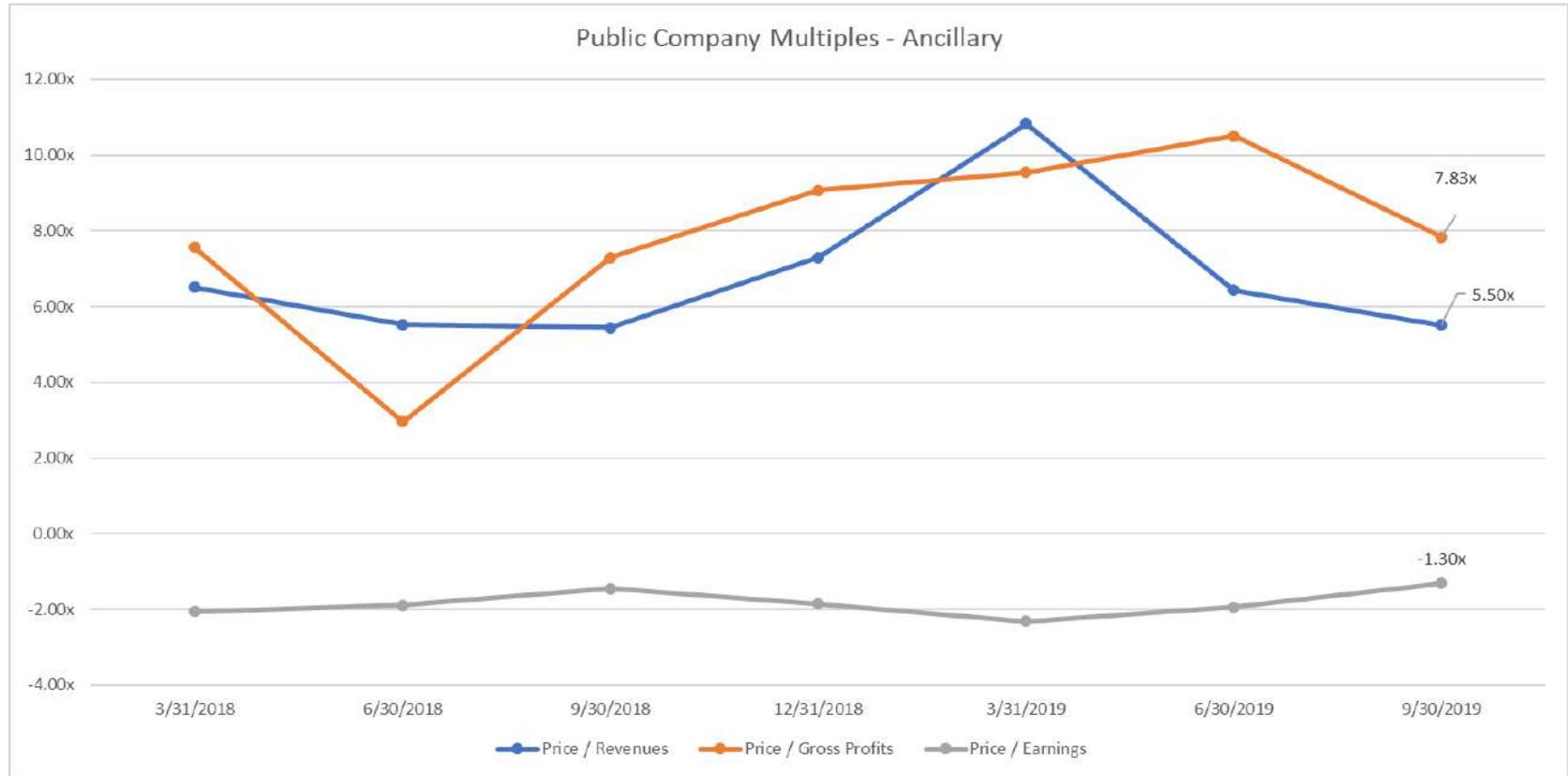
The chart and graph (next page) illustrates public company multiples for the past 18 months

	9/30/19	6/30/2019	3/31/19	12/31/18	9/30/18	6/30/18	3/31/18	Average
Price / Revenues	5.50x	6.43x	10.83x	7.29x	5.45x	5.52x	6.51x	6.79x
Price / Gross Profits	7.83x	10.52x	9.54x	9.07x	7.29x	2.96x	7.56x	7.82x
Price / Earnings	-1.30x	-1.94x	-2.31x	-1.85x	-1.45x	-1.89x	-2.05x	-1.83x
MVIC / Revenues	6.64x	11.85x	16.16x	11.89x	9.84x	8.24x	10.52x	10.73x
MVIC / Gross Profits	9.56x	14.82x	11.85x	15.68x	12.27x	12.51x	18.05x	13.54x
MVIC / Earnings	-2.02x	-2.43x	-3.28x	-2.72x	-2.16x	-3.40x	-2.78x	-2.68x

■ Highest Multiple
 ■ Lowest Multiple
 ■ Median Multiple

* Median numbers comprise of ALL public companies listed

Public Company Multiples



Industry Initial Public Offerings: Ancillary Cannabis

(dollars in millions, except share prices)

Offer Date	Company Name	Offer Price	Shares Offered	Amount Raised	Total Assets*	Debt*	LTM * Revenues	LTM * EBITDA	Shares Offered/Shares Outstanding Post-Offering
12/13/2018	The Yield Growth Corp.	\$0.50	4.48	\$2.24	\$2.61	\$0.06	\$3.06	(\$5.86)	6%
11/20/2018	CannaOne Technologies Inc.	0.40	1.25	0.50	0.54	0.16	0.01	(0.42)	6%
11/15/2018	Ovation Science Inc.	0.30	7.00	2.10	0.90	0.30	0.03	0.00	30%
1/29/2018	MTech Acquisition Corp.	10.00	5.00	50.00	0.16	0.13	0.00	0.00	100%
1/26/2018	Cannabis Growth Opportunity Corporation	2.50	15.51	38.78	0.00	0.00	0.00	0.00	100%
12/21/2017	Cannabis Strategies Acquisition Corp.	10.00	12.50	125.00	0.00	0.00	0.00	0.00	100%
5/3/2017	THC Global Group Limited	0.20	40.00	8.00	1.00	0.00	0.00	0.00	53%
7/7/2014	Searchtech Ventures Inc.	0.10	6.85	0.68	0.24	0.00	0.00	0.00	58%
12/16/2013	Cannabix Technologies Inc.	0.10	6.63	0.79	0.09	0.00	0.00	0.00	60%
5/30/2013	Nhale, Inc.	0.01	10.00	0.10	0.04	0.05	0.04	0.00	33%
2/21/2012	MJ Holdings, Inc.	0.05	0.03	0.00	0.01	0.05	0.00	(0.02)	<1%
2/15/2012	Aja Cannafacturing, Inc.	0.01	2.00	0.02	0.02	0.00	0.00	0.00	17%
10/31/2011	IPOWorld	0.01	1.00	0.01	0.01	0.00	0.00	0.00	4%
10/23/2009	Peak Pharmaceuticals, Inc.	0.10	0.41	0.04	0.01	0.00	0.00	0.00	9%
	Median of all IPOs	\$0.10	4.74	\$0.59	\$0.06	0.01	0.00	0.00	33%

* LTM as of the closing date



Reverse Merger/Backdoor IPO

Cannabis Co. LTM Information*

Transaction Date	Acquirer	Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
6/17/2019	MTech Acquisition Corp.	MJ Freeway LLC (nka:Akerna Corp.)	\$9.93	\$0.00	(\$6.43)
4/3/2019	Foreshore Exploration Partners Corp.	POSaBIT, Inc. (nka:POSaBIT Systems Corporation)	3.25	(3.58)	(3.76)
3/11/2019	CBD MED Research Corp.	World Class Extractions Inc.	0.00	(1.86)	(4.51)
9/17/2018	Aim2 Ventures Inc.	Canopy Rivers Corporation (nka:Canopy Rivers Inc.)	55.52	0.00	33.62
9/13/2018	MJ Opportunity Corp.	Lift Co. Ltd. (nka:Lift & Co. Corp.)	3.56	(3.92)	(6.91)
5/30/2018	Transform Capital Corp.	CannAmerica Brands Corp.	0.34	0.00	(0.09)
3/12/2018	Arco Resources Corp.	4Front Ventures Corp.	5.72	3.65	(2.09)
3/2/2018	Fortify Resources Inc.	Dope Ventures Infrastructure Corp. (nka:Crop Infrastructure Corp.)	0.00	0.00	(0.65)
12/22/2017	Astar Minerals Ltd.	FinCanna Capital Corp.	(0.01)	NA	(1.26)
12/22/2016	Alternate Health Corp.	Alternate Health Inc. (nka:Alternate Health Corp.)	0.18	(0.35)	(0.50)
12/4/2015	Net X America Inc.	CB Scientific, Inc.	0.00	0.00	0.00
8/24/2015	Globestar Industries Inc.	Pineapple Express, Inc.	0.00	0.00	0.00
8/7/2015	Asta Holdings, Corp.	CSA LLC (nka:CSA Holdings, Inc.)	0.98	(0.57)	(0.59)
4/30/2015	Brista Corp.	CDx, Inc. (nka:MyDx, Inc.)	0.00	(4.77)	(5.32)
4/28/2015	LightTouch Vein & Laser, Inc.	Grow Solutions Holdings, Inc.	0.00	0.00	(0.20)
1/14/2015	Cannabis Kinetics Corp.	The Big Tomato (nka:Monarch America, Inc.)	3.02	0.20	0.19

 International

* LTM as of the closing date



Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
9/17/2018	Searchtech Ventures Inc.	PharmaCan Capital (nka:Cronos Group Inc.)	(0.49)	0.00	(1.99)
9/13/2018	Brazil Interactive Media, Inc.	Hollister & Blacksmith, Inc. (nka:American Cannabis Company, Inc.)	0.22	(0.07)	(0.07)
5/30/2018	4th Grade Films, Inc.	Strainwise, Inc. (nka:STWC Holdings, Inc.)	0.10	(0.05)	(0.07)
12/22/2017	Thermal Tennis, Inc.	CannaSys, Inc.	0.00	0.00	(0.13)
12/22/2016	Crownbutte Wind Power, Inc.	Canna Brands, Inc. (nka:Canna Consumer Goods, Inc.)	0.00	0.00	0.00
4/30/2015	Force Fuels, Inc.	Café Serendipity Holdings, Inc.	0.00	0.00	0.00
4/28/2015	Gideon Capital Corp.	Bathurst Resources Corp. (nka:Leviathan Cannabis Group Inc.)	0.00	0.00	(0.24)
1/14/2015	Refill Energy, Inc.	Medical Cannabis Financial Group, Inc. (nka:Medical Cannabis Payment Solutions, Inc.)	0.00	0.00	0.00
12/10/2014	Savanna East Africa Inc.	Algae International Group Inc. (nka:North American Cannabis Holdings, Inc.)	0.00	0.00	0.00
9/29/2014	Diversified Opportunities, Inc.	Sugarmade, Inc.	0.03	(0.60)	(0.70)
8/19/2014	Estate Coffee Holdings Corp.	Fresh Traffic Group Corp. (nka:Synergetics, Inc.)	0.38	(0.02)	(0.04)
1/6/2014	Seraph Security, Inc.	Commerce Online Technologies, Inc. (nka:Agritek Holdings, Inc.)	0.05	0.00	(0.01)
5/9/2011	Equus Resources, Inc.	Quasar Aerospace Industries, Inc. (nka:Green Energy Enterprises, Inc.)	0.00	0.00	0.00
3/18/2009	Famous Food Group, Inc. (nka:Kootenai Corp.)	BizAuctions, Inc. (nka:CannaGrow Holdings, Inc.)	0.00	0.00	(0.22)

 International

* LTM as of the closing date



Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
4/26/2006	Quantech Electronics Corp.	Quantech Electronics Corp. (nka:EVIO, Inc.)	0.00	0.00	0.00
6/28/2005	Sunrise Energy Resources, Inc.	Esko Pivnich CJSC (nka:Green Technology Solutions, Inc.)	0.55	(0.05)	(0.26)
12/19/2000	Ponder Industries, Inc.	N-Vision Technology, Inc. (nka:MediGreen Holdings Corporation)	0.70	(0.84)	(1.20)
7/25/2000	Desert Winds Entertainment Corporation	SunnComm International Inc. (nka:American Green, Inc.)	0.00	0.00	(0.55)

 International

* LTM as of the closing date



2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
9/18/2019	Harvest 360 Technologies LLC	Blue Diamond Ventures, Inc.	\$0.00	100.0%	\$0.00	N/A	N/A	N/A
9/10/2019	Green Tree International, Inc.	Helix TCS, Inc.	15.00	100.0%	7.50	N/A	2.00x	N/A
8/29/2019	Blox Labs Inc.	Best Cannabis Products Inc. (nka:Sire Bioscience Inc.)	0.00	100.0%	0.00	N/A	N/A	N/A
8/20/2019	CannaMed Clinic Inc.	Natural Care Group	0.00	100.0%	0.00	N/A	N/A	N/A
N/A	Goodfellas Group, LLC	TransCanna Holdings Inc.	0.52	100.0%	0.26	N/A	2.00x	N/A
7/2/2019	Verity Corp.	Healthcare Solutions Holdings Inc	0.00	100.0%	0.00	N/A	N/A	N/A
6/17/2019	Quadron Cannatech Corporation	World Class Extractions Inc.	18.63	100.0%	3.58	(5.22)	4.95x	-3.39x
6/12/2019	Potnt Agency	MediaJel, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
5/9/2019	Green Grow Farms LLC	Iconic Brands, Inc.	11.08	51.0%	N/A	N/A	N/A	N/A
5/1/2019	Complia, LLC	NIC Inc.	15.00	100.0%	N/A	N/A	N/A	N/A
2/11/2019	EFX Laboratories Inc.	Viridium Pacific Group Ltd. (nka:Experion Holdings Ltd.)	25.05	100.0%	N/A	N/A	N/A	N/A
1/31/2019	Delta West Limited Partnership	Westleaf Inc.	14.95	50.0%	N/A	N/A	N/A	N/A
1/21/2019	Bodhi Research & Development Inc.	Green Relief Inc.	20.00	51.0%	N/A	N/A	N/A	N/A
1/16/2019	Blackbird Logistics Corporation	Santé Veritas Holdings Inc.	50.00	100.0%	N/A	N/A	N/A	N/A
1/15/2019	Silver State Relief LLC/Silver State Cultivation LLC	320204 Nevada Holdings Corp.	46.69	100.0%	17.35	N/A	2.69x	N/A
1/11/2019	Merritt Valley Cannabis Company	EPHS Holdings, Inc.	14.18	100.0%	N/A	N/A	N/A	N/A
1/7/2019	Trace Analytics Inc.	Applied Biosciences Corp.	1.25	51.0%	N/A	N/A	N/A	N/A
Median of the M&A Transaction Targets			\$14.17	100.0%	\$0.13	NMF*	2.36x	NMF

* Not Meaningful

International

M&A Transactions for Each Year

Year	Number of Acquisitions
2019	17*
2018	21
2017	12
2016	5
2015	6
2014	20
2013	3
2012	3
2011	0
2010	1

* As of September 30, 2019

Contact vspualding@singerlewak.com for a comprehensive list + description of cannabis mergers and acquisitions.

SINGERLEWAK is a nationally recognized full service accounting, advisory, tax and business valuation firm that has provided independent financial advisory and valuation services in thousands of situations for more than 50 years. These assignments include the valuation of companies and pass-through entities, their securities, and their intangible assets ranging in size from small, closely-held businesses and start-ups, to corporations with market values over a billion dollars, covering almost every industry and all types of transactions. With the collective backgrounds of our managing directors and professional staff, SingerLewak brings substantial large deal experience to bear on our middle market transaction opinions. SingerLewak utilizes proprietary research, intensive due diligence, and the experience and insights of its professionals to produce thoughtful, well-documented opinions that have consistently withstood the scrutiny of clients and their advisors, investors, regulators, and courts.

This industry research is provided at no charge to SingerLewak valuation clients and cannabis contacts. Values obtained from Capital IQ database. Research or detailed information not covered in this report can be obtained for a fee. Contact Vanita Spaulding at vspaulding@singerlewak for additional information or questions in connection with this research report.

Definitions of Financial Terms Used in this Quarterly Industry Update:

Enterprise Value (EV): Market Value of Equity + Market Value of Debt — Cash

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA): Profitability metric sometimes also referred to as operating profit or operating earnings.

Gross Cash Flows: Net Income + Depreciation and Amortization Expense

Latest Twelve Months (LTM): Financial information is as of the latest twelve months through the date of this Quarterly Industry Update.

Gross Profit (GP): Revenues — Cost of Goods Sold

Market Value of Invested Capital (MVIC) – Market Value of Equity + Market Value of Debt + Cash and Cash Equivalents; or EV+Cash

Price (P): Price is stated in US Dollars as of the report date.

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Q3: Quarterly Industry Update

As of September 30, 2019

Hemp Company Study

INDUSTRY SUMMARY

SINGERLEWAK identified Hemp publicly traded companies, IPOs, and recent M&A transactions within the Hemp industry, which provides a basis for market and transaction pricing that can be used by your firm in estimating market sentiment and its impact on your firm's value. Over the last year since September 30, 2018, the median 52-week share price return of the Hemp industry was -65.0%. As this industry is new and many companies trade through over-the-counter markets, multiples varied widely.

Median Public Company Key Statistics

	52-Week Return	YTD Return	P/Rev.	MVIC/GP	P/GP	P/Earnings	MVIC/Rev.	MVIC/Earnings
More than \$1 million in revenue	-61.3%	-55.5%	5.60x	15.72x	12.93x	-1.80x	6.10x	-2.45x
Less than \$1 million in revenue	-72.6%	-64.4%	14.90x	13.45x	5.82x	-1.87x	21.46x	-2.32x
Cumulative*	-65.0%	-58.3%	7.73x	14.52x	9.22x	-1.84x	11.06x	-2.40x

* Aggregated medians for ALL companies under Hemp

Summary of Additions from Q1-Q3 2019

Q1

- Added section for public companies with more than \$1 million in revenue.
 - 2 Public Companies added.
- Added section for Reverse Merger/Backdoor IPO.
 - 7 Reverse Mergers added.

Q2

- 3 public companies added.
- 17 Reverse Merger Acquisitions added.

Q3

- 1 IPO added
- 6 Public Companies added
 - Contact vspualding@singerlewak.com for list of public companies added.
- 2 Reverse Mergers added
- Eliminated mergers and acquisitions beyond calendar year 2019.
 - Contact vspualding@singerlewak.com for a comprehensive list of cannabis mergers and acquisitions.

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
22nd Century Group, Inc.	-9.2%	8.1%	-19.6%	\$ 284.25	\$25.71	\$0.30	(\$29.28)	1.2%	-113.9%	11.06x	933.58x
Alternate Health Corp.	-57.8%	-42.4%	-62.0%	14.80	4.43	1.64	(17.74)	37.0%	-400.9%	3.34x	9.03x
Bhang Inc.	N/A	N/A	N/A	0.05	3.84	0.97	(2.76)	25.2%	-71.9%	0.01x	0.06x
C21 Investments Inc.	-28.2%	-46.7%	-62.4%	46.05	20.09	6.00	(22.49)	29.9%	-111.9%	2.29x	7.67x
Canbiola, Inc.	-74.7%	-46.9%	-44.0%	12.33	1.60	0.72	(6.15)	45.1%	-385.8%	7.73x	17.14x
Canopy Growth Corporation	-17.1%	-42.6%	-51.6%	10538.34	344.19	192.08	(1925.26)	55.8%	-559.4%	30.62x	54.86x
EastWest Bioscience Inc.	-65.5%	-41.2%	-80.8%	4.08	1.01	0.24	(4.35)	24.0%	-431.4%	4.04x	16.86x
Ecofibre Limited	N/A	44.8%	N/A	887.53	35.61	25.35	6.00	71.2%	16.9%	24.93x	35.01x
Freedom Leaf, Inc.	-38.8%	-13.5%	-2.2%	29.91	2.54	1.07	(5.50)	42.1%	-216.6%	11.77x	27.96x
Hemp, Inc	-67.5%	-23.9%	-59.3%	61.62	2.58	2.27	(34.14)	88.0%	N/A	23.88x	27.14x
Hempco Food and Fiber Inc.	-35.2%	-21.8%	-60.7%	42.17	2.23	(1.11)	(7.68)	-49.6%	-344.2%	18.91x	-38.15x
HQ Global Education Inc.	-91.4%	-62.0%	-91.9%	0.10	56.84	21.33	16.83	37.5%	29.6%	0.00x	0.00x
Isodiol International Inc.	-79.9%	-75.9%	-93.1%	12.47	20.29	5.77	(124.91)	28.4%	-615.7%	0.61x	2.16x
Medical Marijuana, Inc.	-55.7%	-38.4%	-63.2%	120.93	74.39	54.70	(52.44)	73.5%	-70.5%	1.63x	2.21x
Naturally Splendid Enterprises Ltd.	-28.0%	-18.2%	-40.0%	10.48	2.99	0.41	(5.19)	13.7%	-173.5%	3.50x	25.55x
NutraLife BioSciences, Inc.	-29.5%	-33.3%	-29.4%	18.71	3.34	1.07	(3.08)	32.0%	-92.2%	5.60x	17.49x
Orchid Ventures, Inc.	N/A	-68.3%	N/A	7.39	5.41	1.41	(8.60)	26.1%	-159.1%	1.37x	5.24x
PotNetwork Holdings, Inc.	-55.3%	-40.1%	-82.8%	26.63	24.07	8.37	0.05	34.8%	0.2%	1.11x	3.18x

Multiple year periods are calculated as the average annual return. ■ International

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Pyxus International, Inc.	10.3%	-13.9%	-43.1%	119.89	1775.38	260.15	(93.39)	14.7%	-5.3%	0.07x	0.46x
Tree of Knowledge International Corp.	-76.2%	-60.0%	-92.3%	10.72	1.70	0.83	(10.31)	48.9%	-608.0%	6.33x	12.93x
True Leaf Brands Inc.	-56.4%	-41.4%	-69.4%	20.47	2.23	1.01	(6.62)	45.1%	-296.3%	9.16x	20.30x
Veritas Farms, Inc.	157.5%	-48.2%	83.9%	107.65	5.76	2.72	(6.31)	47.3%	-109.7%	18.70x	39.52x
Zoetic International Plc	-58.3%	-51.6%	-73.1%	6.21	1.02	1.02	(5.77)	100.0%	-567.8%	6.11x	6.11x
Median	-55.5%	-41.3%	-61.3%	\$20.47	\$4.43	\$1.41	(\$6.62)	37.0%	-166.3%	5.60x	12.93x

Multiple year periods are calculated as the average annual return. ■ International

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
420 Property Management, Inc.	-33.3%	-33.3%	-50.0%	\$0.00	\$0.05	\$0.05	(\$8.31)	100.0%	N/A	0.00x	0.00x
Acacia Diversified Holdings, Inc.	-55.9%	164.0%	-68.2%	3.11	0.68	0.33	(1.48)	48.4%	-216.6%	4.56x	9.42x
Artelo Biosciences, Inc.	-76.5%	-53.0%	-81.9%	4.54	N/A	N/A	(2.02)	N/A	N/A	N/A	N/A
Asia Cannabis Corp.	N/A	64.7%	N/A	5.07	N/A	N/A	(0.79)	N/A	N/A	N/A	N/A
Bespoke Extracts, Inc.	-79.2%	-59.6%	-94.8%	0.85	0.07	0.03	0.58	44.0%	807.8%	11.88x	27.01x
Cana Quest Medical Corp. (Formerly Algae Dynamics Corp)	0.0%	-29.4%	-50.0%	1.99	N/A	N/A	(1.10)	N/A	N/A	N/A	N/A
CBD Unlimited, Inc.	135.6%	-69.6%	170.7%	26.52	0.13	0.01	(1.17)	8.3%	-926.2%	210.07x	N/A
Corix Bioscience, Inc.	1.3%	14.3%	-59.8%	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Curative Biosciences, Inc.	16.7%	-22.2%	16.7%	6.85	N/A	N/A	(0.52)	N/A	N/A	N/A	N/A
Demand Brands, Inc.	N/A	N/A	N/A	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Earth Science Tech, Inc.	-44.3%	-39.7%	-65.0%	23.02	0.83	0.35	(2.20)	41.9%	-264.9%	27.69x	66.02x
Elev8 Brands, Inc.	-43.1%	-53.0%	-42.7%	0.02	0.30	0.23	(0.14)	77.7%	-47.7%	0.07x	0.08x
Eviana Health Corporation	-69.7%	-51.3%	-86.8%	4.42	0.09	0.15	(3.49)	164.7%	N/A	46.98x	28.53x
Exactus, Inc.	323.3%	-32.6%	100.0%	22.04	0.16	0.04	(5.03)	25.6%	N/A	141.57x	552.56x
FBEC Worldwide, Inc.	0.0%	0.0%	0.0%	0.36	0.00	0.00	(1.49)	74.5%	N/A	182.77x	245.37x
FutureWorld Corp.	-100.0%	-100.0%	-100.0%	0.00	0.25	0.25	(0.87)	100.5%	-344.3%	0.00x	0.00x
Gala Pharmaceutical, Inc.	-49.6%	-49.4%	-83.6%	1.41	N/A	(0.00)	(3.57)	N/A	N/A	N/A	-629.69x

(Continued on next page)

 International

Multiple year periods are calculated as the average annual return.

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Global Hemp Group Inc.	-66.7%	-30.8%	-73.5%	8.47	0.00	(0.32)	(4.68)	N/A	N/A	N/A	-26.63x
Greenhouse Solutions Inc.	-100.0%	-100.0%	-100.0%	0.00	N/A	N/A	(0.39)	N/A	N/A	N/A	N/A
Grey Cloak Tech Inc.	N/A	0.0%	N/A	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gridiron BioNutrients, Inc.	-84.8%	-67.5%	-86.1%	0.82	0.08	(0.04)	(0.91)	-44.2%	N/A	9.89x	-22.37x
Hemp Naturals, Inc.	-82.0%	-15.9%	-23.4%	49.86	0.00	(0.00)	(6.31)	-7.3%	N/A	N/A	N/A
HempAmericana, Inc	-64.4%	-36.8%	-55.6%	14.63	N/A	(0.03)	(2.96)	N/A	N/A	N/A	-553.22x
InnoCan Pharma Corporation	N/A	N/A	N/A	1.28	N/A	N/A	(0.33)	N/A	N/A	N/A	N/A
Kona Gold Solutions, Inc.	-9.5%	-32.3%	393.5%	0.13	0.83	0.77	0.20	92.9%	23.6%	0.15x	0.16x
Limitless Venture Group Inc.	16.7%	-10.3%	250.0%	0.00	0.00	(0.01)	(0.02)	-329.6%	-431.8%	N/A	N/A
Marijuana Company of America, Inc.	-87.3%	-74.9%	-90.1%	7.33	0.53	0.39	(12.25)	74.3%	N/A	13.89x	18.69x
MYM Nutraceuticals Inc.	-61.6%	-32.3%	-82.5%	18.22	N/A	N/A	(19.93)	N/A	N/A	N/A	N/A
Natures Hemp Corp.	N/A	1900.0%	N/A	0.06	N/A	N/A	(0.28)	N/A	N/A	N/A	N/A
NewLeaf Brands Inc.	-75.9%	-26.1%	-85.6%	8.22	0.23	0.19	(5.42)	83.5%	N/A	36.46x	43.65x
North American Cannabis Holdings, Inc.	-68.0%	0.0%	0.0%	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Novus Acquisition & Development Corp.	-62.7%	-52.7%	-86.2%	0.13	0.10	0.09	0.02	96.0%	24.5%	1.37x	1.43x
Nuvus Gro Corp.	26.3%	-34.3%	-13.2%	2.09	N/A	(0.01)	(0.87)	N/A	N/A	N/A	-142.18x
Omniscanna Health Solutions, Inc.	-51.9%	-30.6%	-71.8%	0.43	N/A	N/A	(5.43)	N/A	N/A	N/A	N/A
Ovation Science Inc.	-1.7%	-33.7%	N/A	6.85	0.19	0.18	(0.68)	92.7%	-350.7%	35.44x	38.25x

(Continued on next page)

 International

Multiple year periods are calculated as the average annual return.

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Peak Pharmaceuticals, Inc.	-90.0%	-67.3%	-90.4%	0.94	N/A	N/A	(0.05)	N/A	N/A	N/A	N/A
Phivida Holdings Inc.	-61.8%	-48.1%	-81.4%	18.61	0.12	0.09	(9.98)	72.0%	N/A	150.54x	209.18x
Premier Biomedical, Inc.	-92.2%	-58.8%	-96.5%	0.09	0.03	(0.07)	(1.02)	-277.9%	N/A	3.33x	-1.20x
Pure Harvest Cannabis Group, Inc.	N/A	11.1%	N/A	15.90	0.02	0.01	(0.78)	54.2%	N/A	818.41x	N/A
Right On Brands, Inc.	-94.8%	-45.7%	-94.5%	0.62	0.34	0.13	(6.27)	38.7%	N/A	1.85x	4.79x
Rocky Mountain High Brands, Inc.	-74.4%	-46.2%	-72.6%	5.86	0.37	0.02	(1.58)	5.3%	-427.6%	15.90x	301.14x
Spyder Cannabis Inc.	N/A	-13.3%	N/A	2.60	0.98	0.45	(1.13)	45.6%	-115.5%	2.65x	5.82x
Vinergy Cannabis Capital Inc.	-81.7%	N/A	N/A	5.43	N/A	N/A	(1.22)	N/A	N/A	N/A	N/A
Vitalibis, Inc.	-79.6%	18.0%	-88.6%	10.78	0.25	0.11	(5.29)	43.3%	N/A	43.45x	100.40x
Wanderport Corporation	-68.1%	-35.0%	30.0%	4.18	N/A	(0.02)	(0.17)	N/A	N/A	N/A	-185.61x
Western Sierra Resource Corporation	-89.1%	-49.6%	-84.3%	3.09	0.06	0.02	(0.11)	30.6%	-196.1%	55.46x	181.34x
Median	-64.4%	-33.7%	-72.6%	\$2.35	\$0.13	\$0.04	(\$1.15)	-47.0%	-216.6%	14.90x	5.82x

 International

Multiple year periods are calculated as the average annual return.

Median Public Companies*

The chart and graph (next page) illustrates public company multiples for the past 18 months

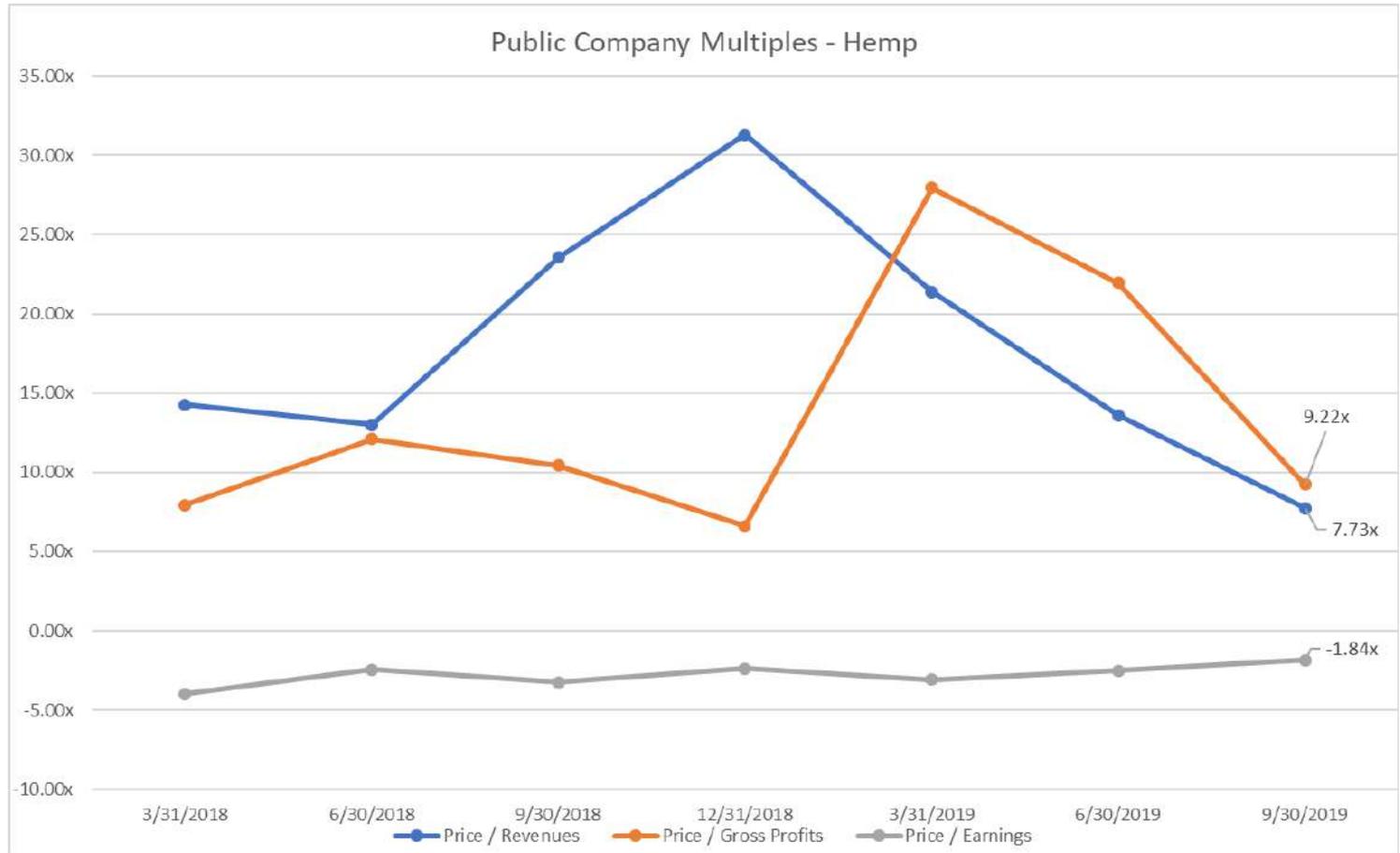
	9/30/19	6/30/2019	3/31/19	12/31/18	9/30/18	6/30/18	3/31/18	Average
Price / Revenues	7.73x	13.61x	21.38x	31.32x	23.56x	13.01x	14.26x	17.84x
Price / Gross Profits	9.22x	21.94x	27.93x	6.60x	10.45x	12.09x	7.96x	13.74x
Price / Earnings	-1.84x	-2.51x	-3.08x	-2.36x	-3.23x	-2.45x	-3.99x	-2.78x
MVIC / Revenues	11.06x	17.21x	22.76x	34.95x	26.79x	15.00x	17.14x	20.70x
MVIC / Gross Profits	14.52x	21.18x	20.82x	7.12x	11.82x	14.84x	10.13x	14.35x
MVIC / Earnings	-2.40x	-3.13x	-3.68x	-3.03x	-3.61x	-2.95x	-5.17x	-3.42x

Multiples may vary from previous QIUs due to added public companies

■ Highest Multiple
 ■ Lowest Multiple
 ■ Median Multiple

** Median numbers comprise of ALL public companies listed*

Public Company Multiples



Industry Initial Public Offerings: Ancillary Cannabis (dollars in millions, except share prices)

Offer Date	Company Name	Offer Price	Shares Offered	Amount Raised	Total Assets*	Debt*	LTM * Revenues	LTM * EBITDA	Shares Offered/Shares Outstanding Post-Offering
3/28/2019	Ecofibre Limited	\$1.00	\$20.00	\$20.00	\$47.78	\$1.34	\$35.61	\$4.05	7%
1/11/2019	Asia Cannabis Corp.	0.25	5.05	1.26	1.19	0.00	0.00	0.00	14%
11/15/2018	Ovation Science Inc.	0.30	7.00	2.10	2.30	0.28	0.19	0.00	30%
8/30/2018	Charlotte's Web Holdings, Inc.	7.00	14.30	100.10	180.98	20.26	93.22	8.41	15%
1/5/2018	Elixinol Global Limited	1.00	20.00	20.00	195.92	4.65	39.70	(12.79)	19%
12/18/2017	Phivida Holdings Inc.	0.40	12.50	5.00	26.19	0.00	0.12	0.00	32%
10/18/2016	Creso Pharma Limited	0.20	25.00	5.00	24.89	5.38	1.32	(12.73)	43%
3/24/2015	Zoetic International Plc	0.05	19.00	0.95	7.63	0.00	1.02	(3.93)	95%
2/15/2012	Aja Cannafacturing, Inc.	0.01	2.00	0.02	0.02	0.40	0.02	0.00	17%
9/16/2010	Phoenix Life Sciences International Limited	0.01	3.30	0.03	0.24	0.04	0.00	0.00	69%
10/23/2009	Peak Pharmaceuticals, Inc.	0.10	0.41	0.04	0.02	0.07	0.00	0.00	9%
11/7/2008	Northsight Capital, Inc.	0.10	0.55	0.06	0.89	3.05	0.05	(1.81)	39%
1/9/2008	Cann Global Limited	0.20	25.00	5.00	10.83	6.41	0.48	(5.40)	100%
	Median of all IPOs	\$0.20	12.50	\$2.10	\$7.63	\$0.40	\$0.19	0.00	30%

* LTM as of the closing date

Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
5/31/2019	Anchor Capital Corporation	Spyder Vapes Inc. (nka:Spyder Cannabis Inc.)	\$1.00	(\$0.55)	(\$0.84)
7/9/2019	Pele Mountain Resources Inc. (nka:Bhang Inc.)	Bhang Chocolate Company Inc. (nka:Bhang Inc.); Bhang Corporation. (nka:Bhang Inc.)	0.00	(0.60)	(0.38)
3/7/2019	Earny Resources Ltd.	CR International Inc. (nka:Orchid Ventures, Inc.)	3.61	(2.36)	(2.40)
7/16/2018	Harbour Star Capital Inc.	1011705 B.C. Ltd. (nka:EastWest Bioscience Inc.)	0.04	(1.27)	(1.60)
6/29/2018	Courtland Capital Inc.	Tree of Knowledge, Inc. (nka:Tree of Knowledge International Corp.)	0.43	(3.61)	(3.91)
10/9/2017	My Cloudz, Inc.	Gridiron BioNutrients, Inc.	0.00	0.00	(0.16)
9/27/2017	Armeau Brands Inc.	271 Lake Davis Holdings, LLC (nka:Veritas Farms, Inc.)	0.56	(1.47)	(1.86)
5/18/2017	Laguna Blends Inc.	Iso International, LLC (nka:Isodiol International Inc.)	0.36	(3.03)	(4.29)
3/31/2017	Grey Cloak Tech Inc.	ShareRails, LLC (nka:Grey Cloak Tech, Inc.)	0.17	(0.85)	(3.54)
3/13/2017	American Housing Income Trust, Inc.	American Housing Income Trust, Inc. (nka:Corix Bioscience, Inc.)	0.00	0.00	0.00
12/22/2016	Alternate Health Corp.	Alternate Health Inc. (nka:Alternate Health Corp.)	0.18	(0.35)	(0.50)
4/15/2016	Genview Capital Corp.	Dharma Distributors Ltd (nka:Hempco Food and Fiber Inc.)	4.03	0.12	0.02
7/7/2015	Global Gaming Network, Inc.	Innovativ Media Group, Inc. (nka:Demand Brands, Inc.)	0.00	0.00	0.00
2/3/2014	Frontier Beverage Company, Inc.	Frontier Beverage Company, Inc (nka:FBEC Worldwide, Inc.)	0.00	0.00	0.00

■ International

* LTM as of the closing date

Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
2/28/2013	Race Capital Corp.	Naturally Splendid Enterprises Ltd.	0.10	(0.32)	(0.13)
11/5/2012	Savanna East Africa Inc.	Algae International Group Inc. (nka:North American Cannabis Holdings, Inc.)	0.00	0.00	0.00
11/10/2011	First Quantum Ventures, Inc.	DiMi Telematics, Inc. (nka:Bespoke Extracts, Inc.)	0.00	(0.38)	(0.38)
3/23/2011	Medical Marijuana, Inc.	Hemp Deposit Distribution Corp. (nka:Medical Marijuana, Inc.)	0.00	0.00	0.00
3/21/2011	Maggie Gold Property	Arris Holdings Inc. (nka:Global Hemp Group Inc.)	0.00	0.00	(0.62)
1/25/2011	Touchstone Mining Limited (nka:22nd Century Group, Inc.)	22nd Century Limited, LLC (nka:22nd Century Group, Inc.)	0.05	(0.93)	(1.42)
9/23/2010	Time Associates, Inc.	Healthient, Inc. (nka:Curative Biosciences, Inc.)	0.00	(0.56)	(0.56)
5/21/2010	Union Equity Inc.	Union Equity Inc. (nka:Kona Gold Solutions, Inc.)	0.15	0.00	0.09
2/11/2010	Green Star Mining Corp.	HQ Global Education Inc.	37.41	13.30	10.60
12/8/2008	EnerBrite Technologies Group, Inc.	Rebel Oil Co., Inc. (nka:Limitless Venture Group Inc.)	0.00	0.00	0.00
7/14/2005	Panamed Corp.	ENDEXX Corp. (nka:CBD Unlimited, Inc.)	0.00	0.00	0.00
11/1/2000	Gibbs Construction, Inc.	Gibbs Construction, Inc. (nka:Acacia Diversified Holdings, Inc.)	5.65	0.41	0.35

International

* LTM as of the closing date

2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
9/23/2019	Dalitso LLC	Jushi Holdings Inc.	\$16.00	61.8%	N/A	N/A	N/A	N/A
9/18/2019	Aristaeus Elements Ltd	DJT Group Limited	0.05	100.0%	N/A	N/A	N/A	N/A
9/10/2019	Vivis Corporation	Neutra Corp.	0.04	100.0%	N/A	N/A	N/A	N/A
9/6/2019	Prolific Nutrition, LLC / Gratus Living, LLC	Pure Harvest Cannabis Group, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
9/5/2019	CBD247STORE.COM	Holiday Island Holdings, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
8/22/2019	Assets of HapiFoods Group Inc.	Natures Hemp Corp.	0.20	100.0%	N/A	N/A	N/A	N/A
8/7/2019	General Extract LLC	First Colombia Development Corp. (nka:Redwood Green Corp.)	0.00	100.0%	N/A	N/A	N/A	N/A
7/31/2019	Hemp Business and Assets of Green Goddess Extracts, LLC	Exactus, Inc.	0.79	100.0%	N/A	N/A	N/A	N/A
7/31/2019	Vaxa Global, LLC	Two Rivers Water & Farming Company	9.25	100.0%	N/A	N/A	N/A	N/A
7/30/2019	Ladope Inc.	Oliveda International, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/30/2019	BioHemp Naturals	MYM Nutraceuticals Inc.	4.72	50.0%	N/A	N/A	N/A	N/A
7/25/2019	Raw Chocolate Alchemy, LLC	Gabriella's Kitchen Inc. (nka:Gaby Inc.)	1.08	100.0%	N/A	N/A	N/A	N/A
7/24/2019	Substantially all Assets of SugarLeaf Labs, LLC and Forest Remedies LLC	Neptune Wellness Solutions Inc.	150.00	100.0%	N/A	N/A	N/A	N/A
7/17/2019	82.42-Acre Contiguous Parcel of Agricultural Farm Land in Kendall County	California Gold Mining Inc.	0.82	100.0%	N/A	N/A	N/A	N/A
7/5/2019	CBD Products B.V.	Medcolcanna Organics Inc.	0.90	100.0%	N/A	N/A	N/A	N/A

 International

(Continued on next page)

2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
7/1/2019	Business Development Team, LLC	Zicix Corporation	0.00	51.0%	N/A	N/A	N/A	N/A
6/12/2019	Shredibles LLC	Indus Holdings, Inc.	0.24	70.0%	N/A	N/A	N/A	N/A
6/11/2019	Pure Ratios Holdings, Inc.	Cannex Capital Holdings Inc. (nka:4Front Ventures Corp.)	8.16	100.0%	N/A	N/A	N/A	N/A
6/11/2019	Green Leaf Company SAS	Emmac Life Sciences Limited	N/A	100.0%	N/A	N/A	N/A	N/A
4/1/2019	CBD Lifestyle Corp.	River Wild Exploration Inc. (nka:CENTR Brands Corp.)	14.30	100.0%	N/A	N/A	N/A	N/A
3/25/2019	US Cannaceuticals, LLC	Strategic Management and Opportunity Corporation	\$0.20	100.0%	N/A	N/A	N/A	N/A
2/27/2019	Fresh Hemp Foods Ltd. (dba Manitoba Harvest)	Tilray, Inc.	\$414.11	100.0%	87.42	(67.19)	4.74x	-6.16x
2/15/2019	All Assets of Khrysos Global, Inc./INXL Laboratories, Inc./INXL Holdings, Inc.	Khrysos Industries Inc.	15.14	100.0%	N/A	N/A	N/A	N/A
1/15/2019	Substantially All of the Assets of Grander Distribution, LLC	TerrAscend Corp.	23.00	100.0%	N/A	N/A	N/A	N/A
Median of the M&A Transaction Targets			\$0.82	100.0%	NMF*	NMF	NMF	NMF

* Not Meaningful



M&A Transactions for Each Year

Year	Number of Acquisitions
2019	24*
2018	15
2017	8
2016	5
2015	5
2014	7
2013	3
2012	3
2011	0
2010	5

* As of September 30, 2019

Contact vspualding@singerlewak.com for a comprehensive list + description of cannabis mergers and acquisitions.

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This industry research is provided at no charge to SingerLewak valuation clients and cannabis contacts. Values obtained from Standard and Poor's Capital IQ database. Research or detailed information not covered in this report can be obtained for a fee. Contact Vanita Spaulding at vspaulding@singerlewak for additional information or questions in connection with this research report.

Definitions of Financial Terms Used in this Quarterly Industry Update:

Enterprise Value (EV): Market Value of Equity + Market Value of Debt — Cash

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA): Profitability metric sometimes also referred to as operating profit or operating earnings.

Gross Cash Flows: Net Income + Depreciation and Amortization Expense

Latest Twelve Months (LTM): Financial information is as of the latest twelve months through the date of this Quarterly Industry Update.

Gross Profit (GP): Revenues — Cost of Goods Sold

Market Value of Invested Capital (MVIC) – Market Value of Equity + Market Value of Debt + Cash and Cash Equivalents; or EV+Cash

Price (P): Price is stated in US Dollars as of the report date.

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Q3: Quarterly Industry Update

As of September 30, 2019



Plant-Touching Cannabis Company Study

INDUSTRY SUMMARY

SINGERLEWAK valuation identified Plant-Touching publicly traded companies, IPOs, and recent M&A transactions within the Plant-Touching Cannabis, which provides a basis for market and transaction pricing that can be used by your firm in estimating market sentiment and its impact on your firm's value. Over the last year since September 30, 2018, the median 52-week share price return of the Plant-Touching Cannabis industry was -61.75%. As this industry is new and many companies trade through over-the-counter markets, multiples varied widely.

Median Public Company Key Statistics

	52-Week Return	YTD Return	P/Rev.	MVIC/GP	P/GP	P/Earnings	MVIC/Rev.	MVIC/Earnings
More than \$1 million	-56.3%	-29.25%	6.35x	14.32x	11.44x	-3.00x	7.20x	-3.78x
Less than \$1 million	-75.52%	-35.16%	78.68x	9.63x	13.41x	-2.64x	72.11x	-2.79x
Cumulative*	-61.77%	-30.80%	9.10x	14.23x	11.44x	-2.83x	10.01x	-3.47x

* Aggregated medians for ALL companies under Plant-Touching

Summary of Additions from Q1-Q3 2019

Q1

- Added section for public companies with more than \$1 million in revenue.
 - 33 Public Companies added.
- Added section for Reverse Merger/Backdoor IPO.
 - 40 Reverse Mergers added.

Q2

- 32 public companies added.
- **Delisted** - Bliss Co. Cannabis Corp
- 23 reverse mergers added.

Q3

- 19 public companies added.
 - Contact vspualding@singerlewak.com for list of public companies added.
- **Delisted** - Cannabis Science, Inc. & Mojave Jane Brands, Inc.
- 4 reverse mergers added.
- Eliminated mergers and acquisitions beyond calendar year 2019.
 - Contact vspualding@singerlewak.com for a comprehensive list + description of cannabis mergers and acquisitions.

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
1933 Industries Inc.	-11.8%	-34.8%	-38.8%	84.45	18.06	5.30	(18.79)	29.3%	-104.0%	4.68x	15.94x
48North Cannabis Corp.	0.0%	-23.5%	-8.8%	105.95	5.00	14.69	(4.87)	293.9%	-97.5%	21.19x	7.21x
Acreage Holdings, Inc.	-61.2%	-55.0%	N/A	661.72	63.52	64.17	(300.69)	101.0%	-473.4%	10.42x	10.31x
Aleafia Health Inc.	-33.6%	-28.0%	-69.5%	263.00	10.97	15.16	(41.81)	138.2%	-381.2%	23.98x	17.35x
Aphria Inc.	-12.4%	-25.3%	-61.8%	1733.85	349.93	107.08	(21.23)	30.6%	-6.1%	4.95x	16.19x
Auxly Cannabis Group Inc.	-14.3%	-3.7%	-32.2%	464.88	11.78	4.90	(80.14)	41.6%	-680.4%	39.47x	94.91x
Bhang Inc.	N/A	N/A	N/A	43.83	4.96	0.65	(11.37)	13.0%	-229.0%	8.83x	67.75x
Canada House Wellness Group Inc.	-67.6%	-50.0%	-85.7%	13.76	4.93	3.14	(11.11)	63.7%	-225.2%	2.79x	4.38x
Cann Group Limited	-23.2%	-19.6%	-42.3%	223.34	2.61	2.14	(10.93)	82.1%	-419.0%	85.64x	104.27x
Cannabis One Holdings Inc.	N/A	-74.4%	N/A	11.82	2.71	0.81	(1.73)	29.8%	-64.0%	4.37x	14.63x
Canopy Growth Corporation	-17.1%	-42.6%	-51.6%	10571.75	344.19	192.08	(1925.26)	55.8%	-559.4%	30.71x	55.04x
Cansortium Inc.	N/A	-60.6%	N/A	121.90	23.90	9.94	(46.71)	41.6%	-195.4%	5.10x	12.27x
Charlotte's Web Holdings, Inc.	21.0%	-4.0%	22.3%	1796.49	93.22	68.93	6.36	73.9%	6.8%	19.27x	26.06x
Chemosis International Inc.	-14.3%	-57.4%	-56.0%	92.13	12.77	4.30	(29.40)	33.7%	-230.2%	7.21x	21.41x
Columbia Care Inc.	N/A	-33.3%	N/A	756.70	65.27	18.12	(97.16)	27.8%	-148.9%	11.59x	41.76x
Core One Labs Inc.	-61.5%	-69.8%	-76.5%	15.57	7.54	(2.40)	(12.08)	-31.9%	-160.1%	2.06x	-6.48x
Creso Pharma Limited	-21.9%	-27.1%	-31.7%	52.73	1.32	1.03	(15.30)	78.4%	N/A	39.99x	51.01x
Cronos Group Inc.	-16.8%	-43.0%	-16.6%	4114.86	35.01	0.80	1455.88	2.3%	N/A	117.53x	N/A

Multiple year periods are calculated as the average annual return.

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■ International



Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Delta 9 Cannabis Inc.	-41.8%	-33.0%	-60.1%	62.45	26.45	14.52	11.88	54.9%	44.9%	2.36x	4.30x
Diego Pellicer Worldwide, Inc.	-88.4%	-35.4%	-86.0%	1.18	1.65	0.50	(3.76)	30.4%	-228.2%	0.72x	2.35x
Dionymed Brands Inc.	-96.8%	-89.6%	N/A	3.90	33.12	9.50	(73.04)	28.7%	-220.6%	0.12x	0.41x
Driven Deliveries, Inc.	610.1%	-27.0%	487.7%	30.47	1.24	0.64	(11.21)	51.3%	-903.3%	24.55x	47.86x
Elixinol Global Limited	-18.8%	-45.9%	5.7%	278.32	39.70	19.89	(10.84)	50.1%	-27.3%	7.01x	13.99x
Emerald Health Therapeutics, Inc.	-54.1%	-45.6%	-71.7%	196.83	17.02	(6.22)	(34.87)	-36.5%	-204.9%	11.57x	-31.66x
Gaby Inc.	-18.5%	-43.6%	-31.3%	38.72	9.46	(0.57)	(12.46)	-6.0%	-131.8%	4.09x	-67.89x
GB Sciences, Inc.	-39.1%	-23.3%	-69.9%	24.70	3.50	(1.34)	(13.84)	-38.2%	-394.8%	7.05x	-18.44x
Golden Leaf Holdings Ltd.	-64.0%	66.7%	-69.7%	40.81	17.53	5.54	(20.03)	31.6%	-114.2%	2.33x	7.36x
Green Cures & Botanical Distribution Inc.	0.0%	15.8%	-77.8%	0.00	1.24	0.99	6.14	80.0%	496.4%	0.00x	0.00x
Green Growth Brands Inc.	-71.8%	-53.7%	N/A	312.12	28.43	1.07	(91.61)	3.8%	-322.2%	10.98x	292.43x
Greenlane Holdings, Inc.	N/A	-64.7%	N/A	33.89	199.33	33.98	(34.11)	17.0%	-17.1%	0.17x	1.00x
Grown Rogue International Inc.	-42.9%	2.6%	N/A	14.49	4.28	0.66	(9.72)	15.4%	-227.0%	3.38x	21.90x
GSRX Industries Inc.	-87.5%	-78.9%	-87.7%	16.17	10.72	4.89	(31.89)	45.6%	-297.4%	1.51x	3.31x
GTEC Holdings Ltd.	-52.0%	-48.4%	-81.0%	29.48	1.29	1.68	(10.70)	130.2%	-829.3%	22.84x	17.55x
Harborside Inc.	N/A	-56.7%	N/A	82.99	28.25	18.23	(19.60)	64.5%	-69.4%	2.94x	4.55x
Harvest Health & Recreation Inc.	-41.9%	-48.3%	N/A	1207.54	95.93	39.28	(155.73)	41.0%	-162.3%	12.59x	30.74x
Harvest One Cannabis Inc.	5.1%	-43.1%	-49.4%	88.02	13.85	8.40	(27.32)	60.6%	-197.2%	6.35x	10.48x

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Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
HEXO Corp.	11.0%	-25.2%	-40.2%	1344.01	47.54	24.51	(69.61)	51.6%	-146.4%	28.27x	54.84x
High Tide Inc.	-31.6%	-23.9%	N/A	55.85	21.48	6.16	(14.62)	28.7%	-68.0%	2.60x	9.06x
Ignite International Brands, Ltd.	N/A	217.3%	N/A	251.32	8.98	2.70	(43.37)	30.0%	-482.7%	27.97x	93.16x
Indus Holdings, Inc.	N/A	-57.9%	N/A	107.96	32.50	(3.74)	(35.96)	-11.5%	-110.6%	3.32x	-28.86x
Innovative Industrial Properties, Inc.	103.5%	-25.2%	91.5%	1050.05	31.78	30.76	16.24	96.8%	51.1%	33.04x	34.14x
Invictus MD Strategies Corp.	-71.5%	-51.1%	-87.5%	28.03	7.24	2.48	(42.00)	34.3%	-580.4%	3.87x	11.31x
Ionic Brands Corp.	N/A	-86.2%	N/A	0.01	3.67	1.94	(1.51)	52.8%	-41.1%	0.00x	0.01x
James E. Wagner Cultivation Corporation	-35.0%	-35.0%	-56.3%	43.81	2.82	1.12	(9.25)	39.8%	-327.9%	15.53x	39.06x
Jushi Holdings Inc.	N/A	-29.3%	N/A	144.37	4.52	2.46	(18.72)	54.6%	-414.6%	31.97x	58.60x
Kali, Inc.	-62.2%	-21.2%	2633.3%	0.02	105.99	45.82	21.05	43.2%	19.9%	0.00x	0.00x
Kaya Holdings, Inc.	-51.4%	-12.6%	-49.1%	9.87	1.01	0.53	1.85	52.9%	183.1%	9.80x	18.50x
Khiron Life Sciences Corp.	-21.6%	-47.4%	-35.1%	136.96	7.96	1.69	(35.77)	21.2%	-449.2%	17.20x	81.27x
Lineage Grow Company Ltd.	N/A	N/A	N/A	0.00	1.21	0.35	(5.11)	28.8%	-422.7%	0.00x	0.00x
MariMed Inc.	-69.2%	-50.5%	-73.3%	218.21	43.85	18.86	(10.49)	43.0%	-23.9%	4.98x	11.57x
Medical Marijuana, Inc.	-55.7%	-38.4%	-63.2%	120.93	74.39	54.70	(52.44)	73.5%	-70.5%	1.63x	2.21x
Medicine Man Technologies, Inc.	187.3%	11.7%	122.1%	142.52	8.90	2.06	(17.77)	23.2%	-199.8%	16.02x	69.17x
MediPharm Labs Corp.	118.4%	-26.6%	N/A	496.92	107.01	36.88	1.35	34.5%	1.3%	4.64x	13.48x
MedMen Enterprises Inc.	-49.6%	-43.1%	-61.0%	405.15	152.48	68.39	(98.12)	44.9%	-64.3%	2.66x	5.92x

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Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
MJardin Group, Inc.	-86.1%	-57.8%	N/A	58.01	31.04	12.12	(110.89)	39.1%	-357.3%	1.87x	4.78x
MMJ Group Holdings Limited	4.3%	0.0%	-15.5%	56.39	29.75	29.75	21.62	100.0%	72.7%	1.90x	1.90x
National Access Cannabis Corp.	-29.2%	-37.5%	-61.7%	70.91	54.10	17.57	(26.76)	32.5%	-49.5%	1.31x	4.04x
Neptune Wellness Solutions Inc.	36.4%	-17.2%	-5.4%	437.85	23.08	3.06	(43.27)	13.3%	-187.5%	18.97x	143.07x
Nutritional High International Inc.	-53.5%	-32.3%	-62.3%	32.32	23.66	2.44	(27.70)	10.3%	-117.1%	1.37x	13.24x
Orchid Ventures, Inc.	N/A	-68.3%	N/A	7.39	5.41	1.41	(8.60)	26.1%	-159.1%	1.37x	5.24x
Origin House	-14.6%	-40.0%	-22.2%	410.95	63.23	11.76	(82.78)	18.6%	-130.9%	6.50x	34.96x
Planet 13 Holdings Inc.	57.0%	-10.0%	-7.5%	319.63	55.33	31.17	(7.35)	56.3%	-13.3%	5.78x	10.25x
Plus Products Inc.	-22.2%	-4.6%	N/A	151.81	13.70	2.29	(23.14)	16.7%	-168.8%	11.08x	66.38x
Pure Global Cannabis Inc.	-37.2%	17.4%	-61.4%	21.44	1.28	(0.36)	(11.26)	-28.4%	-880.4%	16.75x	-58.98x
RavenQuest BioMed Inc.	-32.2%	-43.5%	-68.9%	37.70	1.52	0.89	(32.35)	58.6%	N/A	24.77x	42.25x
Stem Holdings, Inc.	-60.0%	-33.9%	-64.1%	33.32	1.20	0.94	(11.76)	78.5%	-981.2%	27.81x	35.44x
Stenocare A/S	161.2%	4.1%	N/A	344.30	7.37	(0.90)	(4.46)	-12.3%	-60.5%	46.72x	-381.21x
Sundial Growers Inc.	N/A	N/A	N/A	494.40	54.31	29.07	(168.18)	53.5%	-309.7%	9.10x	17.01x
Sunniva Inc.	-61.8%	-53.8%	-77.5%	49.40	35.04	12.28	(49.98)	35.0%	-142.6%	1.41x	4.02x
Terra Tech Corp.	-36.6%	-37.8%	-82.8%	40.42	35.64	16.76	(35.53)	47.0%	-99.7%	1.13x	2.41x
TerrAscend Corp.	-13.7%	-28.3%	-22.8%	646.50	64.02	11.54	(58.01)	18.0%	-90.6%	10.10x	56.04x
THC Biomed Intl Ltd.	-51.6%	-22.5%	-81.3%	23.69	1.49	1.50	(12.70)	100.5%	-852.5%	15.91x	15.83x

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Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **More** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
The Flowr Corporation	-37.6%	-55.3%	-60.9%	284.18	7.62	6.01	(14.01)	78.8%	-183.8%	37.27x	47.30x
The Green Organic Dutchman Holdings Ltd.	-17.5%	-37.2%	-71.8%	560.03	9.71	6.70	(68.70)	69.0%	-707.9%	57.71x	83.61x
The Supreme Cannabis Company, Inc.	-12.1%	-25.6%	-48.0%	410.69	48.13	39.12	(25.64)	81.3%	-53.3%	8.53x	10.50x
Tianjin Guifaxiang 18th Street Mahua Food Co.,Ltd.	-0.3%	-5.9%	-1.0%	2430.51	494.35	236.97	82.64	47.9%	16.7%	4.92x	10.26x
Tilray, Inc.	-64.9%	-46.9%	-82.8%	2480.72	126.87	38.69	(132.04)	30.5%	-104.1%	19.55x	64.12x
Trulieve Cannabis Corp.	-0.9%	-24.4%	-28.7%	1202.78	209.07	287.78	143.22	137.6%	68.5%	5.75x	4.18x
United Cannabis Corporation	22.5%	3.5%	-36.7%	32.41	16.08	0.71	(20.58)	4.4%	-128.0%	2.02x	45.63x
Ventura Cannabis and Wellness Corp.	-24.3%	-42.5%	-43.2%	8.92	27.21	6.06	(4.66)	22.3%	-17.1%	0.33x	1.47x
Vireo Health International Inc.	N/A	-49.3%	N/A	145.78	26.59	10.68	(21.07)	40.2%	-79.2%	5.48x	13.64x
VIVO Cannabis Inc.	-47.9%	-35.1%	-76.3%	109.46	22.48	14.28	(26.56)	63.5%	-118.1%	4.87x	7.67x
Wayland Group Corp.	-19.6%	0.0%	-61.9%	103.51	2.68	(2.12)	(42.96)	-79.2%	N/A	38.62x	-48.76x
WeedMD Inc.	3.1%	-14.0%	-35.7%	154.48	20.69	13.87	(10.90)	67.0%	-52.7%	7.47x	11.14x
Westleaf Inc.	N/A	N/A	N/A	0.00	4.59	2.05	(0.65)	44.7%	-14.1%	0.00x	0.00x
Wildflower Brands Inc.	-30.8%	-43.5%	-69.9%	33.07	12.44	5.47	(7.28)	43.9%	-58.5%	2.66x	6.05x
Zenabis Global Inc.	N/A	-49.5%	N/A	198.20	52.01	41.62	(53.27)	80.0%	-102.4%	3.81x	4.76x
Median	-29.2%	-35.1%	-56.3%	\$103.51	\$18.06	\$5.54	(\$18.79)	41.6%	-131.8%	6.35x	11.44x

Multiple year periods are calculated as the average annual return.

International

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Abattis Bioceuticals Corp.	-66.5%	-34.9%	-86.8%	\$8.62	\$0.13	\$0.08	(\$56.33)	61.4%	N/A	64.75x	105.50x
Advantis Corp.	-90.9%	-66.2%	-88.7%	1.16	N/A	N/A	(0.29)	N/A	N/A	N/A	N/A
AgraFlora Organics International Inc.	-21.7%	-55.0%	-86.2%	157.30	N/A	(4.84)	(57.06)	N/A	N/A	N/A	-32.49x
Alliance Growers Corp.	-50.0%	-20.0%	-78.9%	3.42	N/A	N/A	(2.79)	N/A	N/A	N/A	N/A
Althea Group Holdings Limited	200.0%	-27.2%	23.5%	149.43	0.77	0.46	(8.68)	59.3%	N/A	194.83x	328.42x
Ayr Strategies Inc.	N/A	-29.3%	N/A	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Blueberries Medical Corp.	N/A	-55.1%	N/A	9.92	N/A	N/A	(1.61)	N/A	N/A	N/A	N/A
Bud Genius, Inc.	-100.0%	-100.0%	-100.0%	0.00	0.13	0.09	(0.12)	72.6%	-92.2%	0.00x	0.00x
CanadaBis Capital Inc.	N/A	-29.2%	N/A	25.65	N/A	(0.05)	(9.00)	N/A	N/A	N/A	-548.22x
Canadian Cannabis Corp.	-6.5%	-1.1%	-66.8%	3.08	0.32	0.32	(16.48)	100.0%	N/A	9.63x	9.63x
Cann Global Limited	-18.9%	-18.9%	-18.9%	48.37	0.48	(0.08)	(6.43)	-17.0%	N/A	100.64x	-593.03x
Cannabics Pharmaceuticals Inc.	-20.7%	-17.8%	-69.0%	30.92	0.01	0.01	1.13	100.0%	N/A	N/A	N/A
Cannabis Sativa, Inc.	-65.6%	-30.4%	-79.2%	20.41	0.80	0.47	(3.14)	58.4%	-391.4%	25.45x	43.59x
CannaPharmaRX, Inc.	24.7%	48.3%	26.2%	76.33	N/A	N/A	(13.07)	N/A	N/A	N/A	N/A
Choom Holdings Inc.	-22.4%	-25.8%	-72.0%	64.22	0.46	0.23	(101.56)	51.4%	N/A	140.56x	273.28x
Citation Growth Corp.	-59.7%	-54.5%	-69.5%	25.63	0.67	0.24	(26.79)	36.1%	N/A	38.55x	106.81x
CTT Pharmaceutical Holdings, Inc.	-23.0%	42.9%	-79.3%	6.40	N/A	N/A	(1.67)	N/A	N/A	N/A	N/A
Easton Pharmaceuticals Inc.	-67.4%	-33.3%	-76.5%	2.61	N/A	N/A	(0.53)	N/A	N/A	N/A	N/A

Multiple year periods are calculated as the average annual return.

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Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Eve & Co Incorporated	-10.4%	-42.7%	-52.2%	50.25	0.41	2.06	(6.56)	499.0%	N/A	121.46x	24.34x
Redwood Green Corp.	14900.0%	13.6%	14900.0%	61.38	N/A	N/A	(0.58)	N/A	N/A	N/A	N/A
FSD Pharma Inc.	-71.9%	-50.0%	-88.7%	125.68	0.06	(1.32)	(54.09)	N/A	N/A	N/A	-95.32x
Geyser Brands Inc.	N/A	-12.5%	N/A	14.94	0.25	0.04	(33.23)	14.7%	N/A	60.12x	408.28x
Green Energy Enterprises, Inc.	0.0%	0.0%	50.0%	0.01	0.36	0.30	0.02	83.4%	5.7%	0.03x	0.03x
Grow Solutions Holdings, Inc.	9.5%	-43.2%	-8.0%	0.39	N/A	N/A	(0.42)	N/A	N/A	N/A	N/A
ICC International Cannabis Corp.	-84.2%	-73.7%	-93.4%	28.95	N/A	(37.62)	(124.02)	N/A	N/A	N/A	-0.77x
Indiva Limited	-34.6%	-46.9%	-69.6%	21.17	0.66	(0.58)	(11.10)	-87.7%	N/A	32.14x	-36.64x
InMed Pharmaceuticals Inc.	0.6%	-10.0%	-59.0%	34.13	N/A	N/A	(14.30)	N/A	N/A	N/A	N/A
Integrated Cannabis Company, Inc.	35.3%	39.4%	N/A	61.74	0.11	0.01	(4.58)	7.9%	N/A	569.79x	N/A
Kalytera Therapeutics, Inc.	-41.7%	-30.0%	-76.7%	17.86	N/A	N/A	(11.55)	N/A	N/A	N/A	N/A
Lotus Ventures Inc.	-14.0%	-2.6%	-35.1%	15.55	N/A	0.25	(2.91)	N/A	N/A	N/A	62.08x
Maple Leaf Green World Inc.	-43.4%	-26.3%	-82.7%	9.21	N/A	(0.44)	(3.35)	N/A	N/A	N/A	-20.74x
Marijuana Company of America, Inc.	-87.3%	-74.9%	-90.1%	8.06	0.67	0.47	(20.62)	70.3%	N/A	12.09x	17.19x
Medcolcanna Organics Inc.	N/A	-28.9%	N/A	5.58	0.07	0.01	(1.08)	15.5%	N/A	85.25x	549.06x
Eve & Co Incorporated	-10.4%	-42.7%	-52.2%	50.25	0.41	2.06	(6.56)	499.0%	N/A	121.46x	24.34x
Redwood Green Corp.	14900.0%	13.6%	14900.0%	61.38	N/A	N/A	(0.58)	N/A	N/A	N/A	N/A
FSD Pharma Inc.	-71.9%	-50.0%	-88.7%	125.68	0.06	(1.32)	(54.09)	N/A	N/A	N/A	-95.32x

Multiple year periods are calculated as the average annual return.

(Continued on next page)

■ International

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Geyser Brands Inc.	N/A	-12.5%	N/A	14.94	0.25	0.04	(33.23)	14.7%	N/A	60.12x	408.28x
Green Energy Enterprises, Inc.	0.0%	0.0%	50.0%	0.01	0.36	0.30	0.02	83.4%	5.7%	0.03x	0.03x
Grow Solutions Holdings, Inc.	9.5%	-43.2%	-8.0%	0.39	N/A	N/A	(0.42)	N/A	N/A	N/A	N/A
ICC International Cannabis Corp.	-84.2%	-73.7%	-93.4%	28.95	N/A	(37.62)	(124.02)	N/A	N/A	N/A	-0.77x
Indiva Limited	-34.6%	-46.9%	-69.6%	21.17	0.66	(0.58)	(11.10)	-87.7%	N/A	32.14x	-36.64x
InMed Pharmaceuticals Inc.	0.6%	-10.0%	-59.0%	34.13	N/A	N/A	(14.30)	N/A	N/A	N/A	N/A
Integrated Cannabis Company, Inc.	35.3%	39.4%	N/A	61.74	0.11	0.01	(4.58)	7.9%	N/A	569.79x	N/A
Kalytera Therapeutics, Inc.	-41.7%	-30.0%	-76.7%	17.86	N/A	N/A	(11.55)	N/A	N/A	N/A	N/A
Lotus Ventures Inc.	-14.0%	-2.6%	-35.1%	15.55	N/A	0.25	(2.91)	N/A	N/A	N/A	62.08x
Maple Leaf Green World Inc.	-43.4%	-26.3%	-82.7%	9.21	N/A	(0.44)	(3.35)	N/A	N/A	N/A	-20.74x
Marijuana Company of America, Inc.	-87.3%	-74.9%	-90.1%	8.06	0.67	0.47	(20.62)	70.3%	N/A	12.09x	17.19x
Medcolcanna Organics Inc.	N/A	-28.9%	N/A	5.58	0.07	0.01	(1.08)	15.5%	N/A	85.25x	549.06x
MGC Pharmaceuticals Limited	-2.5%	-25.0%	-18.8%	47.32	0.66	0.30	(2.31)	45.7%	-351.9%	72.11x	157.95x
Modern Mobility Aids, Inc.	-66.7%	-7.7%	-84.0%	0.68	N/A	N/A	(1.59)	N/A	N/A	N/A	N/A
MPX International Corporation	N/A	-10.8%	N/A	0.00	0.07	0.05	(1.93)	80.9%	N/A	N/A	N/A
MYM Nutraceuticals Inc.	-68.9%	-36.5%	-85.3%	24.48	N/A	N/A	(19.93)	N/A	N/A	N/A	N/A
Nabis Holdings Inc.	-84.5%	-83.8%	-61.8%	7.11	N/A	N/A	(17.09)	N/A	N/A	N/A	N/A
Neutra Corp.	-97.5%	-54.5%	-98.6%	0.18	N/A	N/A	(2.43)	N/A	N/A	N/A	N/A

Multiple year periods are calculated as the average annual return.

(Continued on next page)

International

Comparable Public Company Market Metrics as of September 30, 2019

Public Companies Generating **Less** Than a Million in Revenue

Public Company	YTD	3 Month	1 Year	Market Cap. (In millions)	Revenues	Gross Profit	Net Income	GP Margin	NI Margin	P/Rev.	P/GP
Next Generation Management Corp.	-35.7%	-41.9%	-43.8%	0.23	0.05	0.05	(5.38)	100.0%	N/A	4.40x	4.40x
Next Green Wave Holdings Inc.	-43.9%	-42.2%	N/A	29.23	0.14	0.63	(6.70)	445.4%	N/A	205.97x	46.24x
Nextleaf Solutions Ltd.	N/A	-8.5%	N/A	46.34	0.18	(0.07)	(7.53)	-38.5%	N/A	254.63x	-660.73x
North Bud Farms Inc.	-6.1%	-11.5%	-54.0%	14.59	N/A	N/A	(2.44)	N/A	N/A	N/A	N/A
One World Pharma, Inc.	N/A	8.6%	N/A	169.04	N/A	N/A	(6.39)	N/A	N/A	N/A	N/A
Pasha Brands Ltd.	N/A	-66.9%	N/A	8.50	N/A	(0.13)	(1.90)	N/A	N/A	N/A	-65.39x
PharmaCielo Ltd.	N/A	-24.1%	N/A	500.12	0.13	2.08	(31.22)	N/A	N/A	N/A	239.93x
Phivida Holdings Inc.	-61.8%	-48.1%	-81.4%	18.61	0.12	0.09	(9.98)	72.0%	N/A	150.54x	209.18x
RMMI Corp.	-75.8%	-57.4%	-84.1%	5.43	N/A	N/A	(1.52)	N/A	N/A	N/A	N/A
Rubicon Organics Inc.	10.1%	-30.7%	N/A	83.13	0.67	(0.15)	(15.34)	-22.5%	N/A	123.67x	-550.79x
Sunset Island Group, Inc.	-41.9%	28.6%	-57.6%	0.97	N/A	(0.83)	(1.75)	N/A	N/A	N/A	-1.17x
Tetra Bio-Pharma Inc.	-62.1%	-0.1%	-75.5%	38.72	0.11	0.04	(15.29)	39.8%	N/A	344.69x	865.54x
Upper Street Marketing Inc.	61.8%	-63.3%	N/A	0.00	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Weekend Unlimited Inc.	-23.5%	-13.3%	N/A	26.98	N/A	N/A	(47.17)	N/A	N/A	N/A	N/A
XPhyto Therapeutics Corp.	N/A	N/A	N/A	63.26	0.05	0.05	(5.98)	100.0%	N/A	N/A	N/A
YSS Corp.	-6.7%	-12.5%	-83.9%	31.27	N/A	N/A	(17.55)	N/A	N/A	N/A	N/A
Median	-35.2%	-29.1%	-75.5%	\$18.61	\$0.18	\$0.05	(\$6.43)	59.3%	-222.1%	78.68x	13.41x

Multiple year periods are calculated as the average annual return.

International

Median Public Companies*

The chart and graph (next page) illustrates public company multiples for the past 18 months

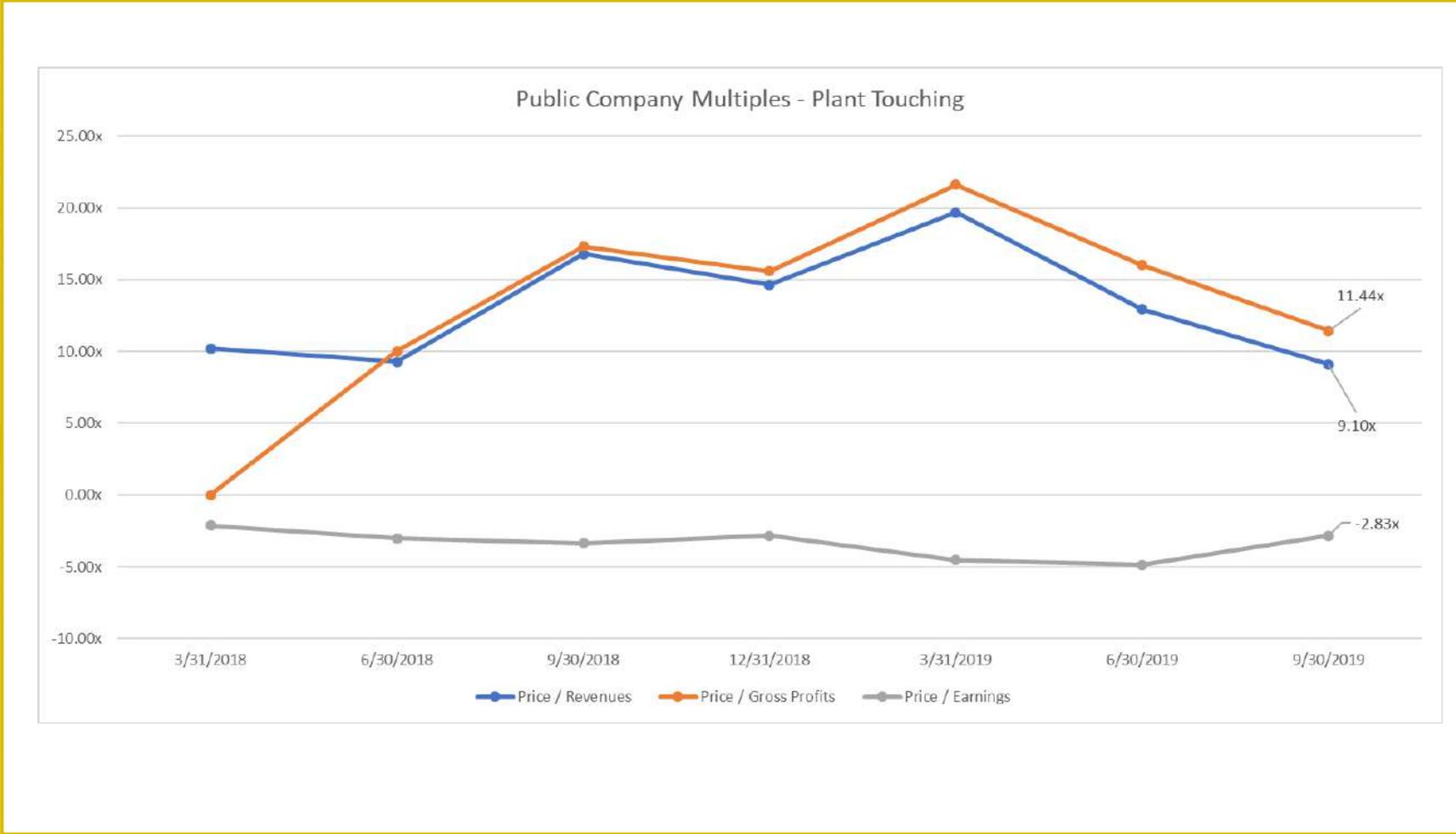
	9/30/19	6/30/19	3/31/18	12/31/18	9/30/18	6/30/18	3/31/18	Average
Price / Revenues	9.10x	12.95x	19.67x	14.63x	16.80x	9.29x	10.21x	13.24x
Price / Gross Profits	11.44x	16.02x	21.64x	15.60x	17.32x	10.03x	0.05x	13.15x
Price / Earnings	-2.83x	-4.85x	-4.51x	-2.83x	-3.37x	-3.01x	-2.12x	-3.36x
MVIC / Revenues	10.01x	14.56x	19.72x	14.51x	18.64x	11.47x	10.09x	14.14x
MVIC / Gross Profits	14.23x	18.84x	24.46x	16.66x	20.15x	11.83x	3.52x	15.67x
MVIC / Earnings	-3.47x	-5.43x	-5.10x	-3.44x	-3.93x	-3.66x	-3.20x	-4.03x

*Multiples may vary from previous QIUs due to added public companies

■ Highest Multiple
 ■ Lowest Multiple
 ■ Median Multiple

* Median numbers comprise of ALL public companies listed

Public Company Multiples



Industry Initial Public Offerings: Plant-Touching Cannabis (dollars in millions, except share prices)

Offer Date	Company Name	Offer Price	Shares Offered	Amount Raised	Total Assets*	Debt*	LTM * Revenues	LTM * EBITDA	Shares Offered/Shares Outstanding Post-Offering
7/31/2019	Sundial Growers Inc.	\$13.00	11.00	\$143.00	\$369.22	\$217.64	\$20.80	(\$40.31)	13%
3/21/2019	Cansortium Inc.	2.00	N/A	52.00	147.87	53.37	8.06	(16.67)	N/A
10/25/2018	Plus Products Inc.	\$3.25	6.15	\$20.00	\$15.25	\$0.00	\$5.40	(\$4.67)	20%
10/12/2018	Stenocare A/S	8.80	2.11	18.59	0.00	0.00	0.00	0.00	24%
9/24/2018	RMMI Corp.	2.50	1.70	4.41	4.92	0.00	0.00	0.00	13%
9/20/2018	Canaccord Genuity Growth Corp.	3.00	13.35	40.05	0.00	0.00	0.00	0.00	100%
9/19/2018	Althea Group Holdings Limited	0.20	70.63	19.65	3.30	0.00	0.01	0.00	35%
8/30/2018	Charlotte's Web Holdings, Inc.	7.00	14.30	100.10	27.56	0.57	54.14	18.44	15%
7/18/2018	Tilray, Inc.	17.00	9.00	153.00	106.48	54.74	28.07	(17.00)	12%
5/2/2018	The Green Organic Dutchman Holdings Ltd.	3.65	31.50	132.26	153.77	0.00	0.00	(18.74)	17%
1/5/2018	Elixinol Global Limited	1.00	20.00	20.00	105.00	0.29	0.00	(8.15)	19%
12/18/2017	Phivida Holdings Inc.	0.40	12.50	5.00	0.85	0.00	0.01	0.00	32%
5/30/2017	MedReleaf Corp.	9.50	7.97	100.70	74.89	9.60	40.34	17.39	9%
5/3/2017	Cann Group Limited	0.30	45.00	13.50	1.87	0.00	0.01	(1.42)	42%
2/10/2017	eSense-Lab Limited	0.20	17.50	3.50	0.67	1.40	0.00	0.00	28%
12/28/2016	CanniMed Therapeutics Inc.	12.00	5.00	60.00	52.77	30.01	9.80	(0.46)	18%
11/30/2016	Innovative Industrial Properties, Inc.	20.00	3.35	67.00	0.00	0.00	5.63	5.63	87%
11/17/2016	Tianjin Guifaxiang 18th Street Mahua Food Co.,Ltd.	16.60	32.00	531.20	650.58	100.00	457.61	127.79	14%

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Industry Initial Public Offerings: Plant-Touching Cannabis (dollars in millions, except share prices)

Offer Date	Company Name	Offer Price	Shares Offered	Amount Raised	Total Assets*	Debt*	LTM * Revenues	LTM * EBITDA	Shares Offered/Shares Outstanding Post-Offering
10/18/2016	Creso Pharma Limited	0.20	25.00	5.00	0.00	0.00	0.00	0.00	43%
10/4/2016	Origin House	2.00	2.50	5.00	12.29	1.32	0.14	0.00	N/A
3/13/2015	Nutritional High International Inc.	0.05	32.90	1.65	0.70	0.00	0.00	0.00	25%
1/20/2015	MMJ Group Holdings Limited	0.20	29.66	5.93	0.00	0.00	0.00	0.00	66%
7/7/2014	Searchtech Ventures Inc.	0.10	6.85	0.68	0.24	0.00	0.00	0.00	47%
11/26/2013	Redwood Green Corp.	0.02	15.00	0.30	0.10	0.00	0.00	0.00	30%
	Median of all IPOs	\$0.70	11.0	\$9.72	\$0.91	0.00	0.00	0.00	30%

Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
8/2/2019	ACC C Corp.	Liht Cannabis Corp. (nka:Citation Growth Corp.)	\$0.21	(\$19.48)	(\$24.81)
7/9/2019	Pele Mountain Resources Inc. (nka:Bhang Inc.)	Bhang Chocolate Company Inc. (nka:Bhang Inc.); Bhang Corporation. (nka:Bhang Inc.)	0.00	(0.60)	(0.38)
6/6/2019	Tanzania Minerals Corp.	Jushi Inc. (nka:Jushi Holdings Inc.)	0.94	(14.19)	(14.73)
2/25/2019	Metropolitan Energy Corp.	Bertram Capital Finance Inc. (nka:Cannabis One Holdings Inc.)	2.71	(0.80)	(1.73)
1/8/2019	Bevo Agro Inc.	Sun Pharm Investments Ltd. (nka:Zenabis Global Inc.)	6.99	(14.97)	(32.52)
5/30/2019	Lineage Grow Company Ltd.	FLRish, Inc. (nka:Harborside Inc.)	23.51	(8.85)	(17.08)
5/30/2019	Ignite International Brands, Ltd.	Ignite International, Ltd. (nka:Ignite International Brands, Ltd.)	4.05	0.00	(27.02)
5/29/2019	Broome Capital Inc.	Pasha Brands Ltd.	0.00	0.00	(1.90)
4/26/2019	Mezzotin Minerals Inc.	Indus Holding Company (nka:Indus Holdings, Inc.)	21.33	(8.84)	(11.44)
4/26/2019	CanadaBis Capital Inc.	CanadaBis Capital Inc.	0.00	(0.44)	(0.44)
3/22/2019	Zara Resources Inc.	Blacklist Holdings Inc. (nka:Ionic Brands Corp.)	2.37	(1.16)	(1.93)
3/14/2019	Legion Metals Corp.	Nextleaf Solutions Ltd.	0.49	(2.24)	(2.54)
3/7/2019	Earny Resources Ltd.	CR International Inc. (nka:Orchid Ventures, Inc.)	3.61	(2.36)	(2.40)
2/21/2019	One World Pharma, Inc.	One World Pharma, Inc.	0.00	(2.49)	(2.61)
1/15/2019	AAJ Capital 1 Corp.	PharmaCielo Ltd.	0.00	(23.24)	(24.43)

* LTM as of the closing date

(Continued on next page)

 International

Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
12/28/2018	IGC Resources Inc.	Westleaf Cannabis Inc. (nka:Westleaf Inc.)	0.00	0.00	(0.65)
12/20/2018	Kanzen Capital Corp.	Geyser Management Inc. (nka:Geyser Brands Inc.)	(0.07)	(1.70)	(1.92)
11/27/2018	Sixonine Ventures Corp.	DionyMed Holdings Inc (nka:DionyMed Brands Inc.)	0.05	(6.31)	(6.27)
11/15/2018	Novicius Corp.	Grown Rogue Unlimited, LLC (nka:Grown Rogue International Inc.)	1.93	(4.19)	(7.51)
11/13/2018	Sumtra Diversified Inc.	MJAR Holdings, LLC (nka:MJardin Group, Inc.)	19.77	1.43	(5.83)
11/9/2018	Xanthic Biopharma Inc.	Green Growth Brands Ltd. (nka:Green Growth Brands Inc.)	0.00	0.00	(6.30)
10/1/2018	POCML 4 Inc.	MediPharm Labs Inc. (nka:MediPharm Labs Corp.)	0.00	0.00	(5.61)
9/20/2018	The Needle Capital Corp.	The Flowr Cannabis ULC (nka:The Flowr Corporation)	0.00	(8.20)	(6.16)
6/28/2018	Carlaw Capital V Corp.	1600978 Ontario Inc. (nka:Eve & Co Incorporated)	0.00	(2.21)	(2.56)
6/12/2018	Black Birch Capital Acquisition III Corp.	GTEC Holdings Ltd.	0.00	0.00	(1.85)
6/11/2018	Carpincho Capital Corp.	Planet 13 Holdings Inc.	11.43	1.13	(1.28)
6/7/2018	AIM1 Ventures Inc.	James E. Wagner Cultivation Ltd. (nka:James E. Wagner Cultivation Corporation)	0.00	(4.80)	(5.00)
6/1/2018	Kramer Capital Corp.	48North Cannabis Corp.	0.00	0.00	(9.71)
5/28/2018	Ladera Ventures Corp.	MM Enterprises USA, LLC (nka:MedMen Enterprises Inc.)	20.68	(30.26)	(42.12)
5/24/2018	Century Financial Capital Group Inc.	FSD Pharma Inc.	0.07	0.00	(5.36)
5/16/2018	Adent Capital Corp.	Khiron Life Sciences Corp.	0.00	0.00	(6.50)

* LTM as of the closing date

(Continued on next page)

International

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Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
3/26/2018	Canabo Medical Inc.	Aleafia Inc. (nka:Aleafia Health Inc.)	0.02	(10.51)	(10.57)
2/23/2018	Trigen Resources Inc.	Bliss Co Holdings Ltd. (nka:BlissCo Cannabis Corp.)	0.00	0.00	(0.45)
12/29/2017	Mira IX Acquisition Corp.	Nuuvera Corp. (nka:Aphria International Inc.)	0.00	0.00	0.00
12/13/2017	Rainmaker Resources Ltd.	INDIVA Corporation (nka:Indiva Limited)	0.00	(1.86)	(2.29)
10/31/2017	SVT Capital Corp.	Delta 9 Bio-Tech LP (nka:Delta 9 Cannabis Inc.)	0.77	(1.85)	(2.46)
9/27/2017	Morro Bay Resources Ltd.	Experion Biotechnologies Inc. (nka:Experion Holdings Ltd.)	0.00	0.00	(0.79)
8/30/2017	Brassneck Capital Corp.	National Access Cannabis Corp.	0.92	(3.20)	(3.57)
5/11/2017	Cyberspace Vita, Inc.	Green Spirit Industries Inc. (nka:GSRX Industries Inc.)	0.00	0.00	(0.09)
4/28/2017	Panda Capital Inc.	ABcann Medicinals Inc. (nka:VIVO Cannabis Inc.)	0.59	(6.09)	(8.86)
4/26/2017	Harvest One Capital Inc.	Harvest One Cannabis Inc.	(0.01)	(3.53)	(4.35)
4/20/2017	Danbel Ventures Inc.	MariCann Inc. (nka:Wayland Group Corp.)	4.25	(9.90)	(74.30)
4/13/2017	Aumento Capital V Corporation	WeedMD Inc.	0.00	(1.25)	(2.75)
3/15/2017	BFK Capital Corp.	The Hydrothecary Corporation (nka:HEXO Corp.)	3.72	(2.27)	(3.32)
10/20/2016	Sunset Island Group, Inc.	Sunset Island Group, Inc.	0.00	0.00	0.00
11/23/2015	Viper Gold Ltd.	Quikflo Health Inc. (nka:1933 Industries Inc.)	0.00	0.00	(0.16)
10/6/2015	Longacre Resources Inc.	Golden Leaf Holdings Ltd.	8.51	(10.60)	(20.42)

* LTM as of the closing date

(Continued on next page)

 International



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Reverse Merger/Backdoor IPO

Transaction Date	Acquirer	Cannabis Co. LTM Information*			
		Cannabis Company Being Acquired	LTM Revenues	LTM EBITDA	LTM NET INCOME
6/29/2015	Golden Dragon Holding Co.	CannaPharmaRX, Inc.	0.00	0.00	(5.55)
12/10/2014	Searchtech Ventures Inc.	PharmaCan Capital (nka:Cronos Group Inc.)	(0.49)	0.00	(1.99)
12/1/2014	Black Sparrow Capital Corp.	Pure Natures Wellness Inc. (nka:Aphria Inc.)	0.00	(3.22)	(3.92)
9/9/2014	Mindesta Inc.	Mindesta Inc. (nka:CTT Pharmaceutical Holdings, Inc.)	0.00	0.00	(0.02)
9/4/2014	Firebird Energy Inc.	Thunderbird Biomedical Inc. (nka:Emerald Health Therapeutics, Inc.)	0.00	0.00	(0.50)
5/20/2014	Gold Party Payday Inc.	Canadian Cannabis Corp.	0.00	0.00	0.00
3/26/2014	LW Capital Pool Inc.	Tweed Inc. (nka:Canopy Growth Corporation)	0.00	(0.93)	(0.93)
3/13/2014	Signature Exploration and Production Corp.	GrowBlox Sciences, Inc. (nka:GB Sciences, Inc.)	0.00	(0.08)	0.04
7/12/2013	Ultra Sun Corp.	Cannabis Sativa, Inc.	0.00	0.00	0.00
9/14/2012	Health Corporation Limited	Erin Mineral Resources Limited (nka:MGC Pharmaceuticals Limited)	0.05	0.00	(0.29)
2/2/2012	Private Secretary, Inc.	Terra Tech Corp.	0.82	(2.22)	(2.27)
12/20/2011	Grasslands Entertainment, Inc.	Lakeside Minerals Corp. (nka:Lineage Grow Company Ltd.)	0.00	0.00	(0.40)
3/23/2011	Medical Marijuana, Inc.	Hemp Deposit Distribution Corp. (nka:Medical Marijuana, Inc.)	0.00	0.00	0.00
1/6/2010	NetSpace International Holdings, Inc.	Alternative Fuels America, Inc. (nka:Kaya Holdings, Inc.)	0.00	0.00	(0.31)
8/5/2009	Potential Holdings, Inc.	RightSmile, Inc. (nka:Bud Genius, Inc.)	0.00	0.00	(0.02)
3/30/2009	Gulf Onshore, Inc.	Cannabis Science, Inc.	0.00	(0.23)	3.56

* LTM as of the closing date

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 International



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M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
9/30/2019	Conscious B.V.	Greenlane Holdings, Inc.	\$7.50	100.0%	\$10.40	N/A	0.72x	N/A
9/23/2019	0989561 B.C. Ltd.	N/A	0.00	100.0%	N/A	N/A	N/A	N/A
9/19/2019	Tres Ojos Naturals, LLC	TransCanna Holdings Inc.	1.04	100.0%	N/A	N/A	N/A	N/A
9/17/2019	Ilera Real Estate GP	TerrAscend Corp.	223.91	100.0%	N/A	N/A	N/A	N/A
9/11/2019	Three Cannabis Dispensary Operations in Puerto Rico of Caribbean Green LLC	Natural Ventures PR, LLC	1.30	100.0%	N/A	N/A	N/A	N/A
9/10/2019	Facility Located in Camp Verde, Arizona	Nabis Holdings Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
9/6/2019	10 Dispensaries	Cannabinoid Biosciences, Inc.	49.00	100.0%	54.00	N/A	0.91x	N/A
9/4/2019	MattnJeremy, Inc. LLC	MedMen Enterprises Inc.	13.00	100.0%	6.00	N/A	2.17x	N/A
8/29/2019	Rare Industries, Inc.	48North Cannabis Corp.	5.12	100.0%	N/A	N/A	N/A	N/A
8/29/2019	GSRX Industries Inc.	Chemesis International Inc.	12.05	72.7%	8.63	(8.72)	1.40x	-1.38x
8/28/2019	White & Fluffy Vertriebs GmbH	Cannabis Health AG	0.00	100.0%	N/A	N/A	N/A	N/A
8/28/2019	Henderson Organic Remedies, LLC	Green Growth Brands Inc.	24.46	100.0%	N/A	N/A	N/A	N/A
8/23/2019	Fiorello Pharmaceuticals, Inc.	Green Thumb Industries Inc.	59.51	100.0%	N/A	N/A	N/A	N/A
8/21/2019	Haven	ManifestSeven	0.00	100.0%	N/A	N/A	N/A	N/A
8/20/2019	Holigen Limited	The Flowr Corporation	162.09	80.2%	N/A	N/A	N/A	N/A
8/19/2019	Certain Assets In Florida And Substantially All Of The Assets In Ohio of Liberty Health Science Inc.	N/A	14.75	0.0%	N/A	N/A	N/A	N/A
8/19/2019	Glendale Green House	Curaleaf Holdings, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
8/16/2019	Alphafarma Operations Ltd.	MPXI Malta Property Ltd.	2.95	100.0%	N/A	N/A	N/A	N/A
8/14/2019	805 Beach Breaks, Inc.	Harvest Health & Recreation Inc.	0.00	100.0%	N/A	N/A	N/A	N/A

International

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2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
8/14/2019	Iuvo Therapeutics GmbH	Wundr Co. Limited	0.00	100.0%	N/A	N/A	N/A	N/A
8/13/2019	Ametrine Wellness Inc.	Kiva Sales & Service, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
8/13/2019	Truverra Inc.	The Supreme Cannabis Company, Inc.	20.29	100.0%	N/A	N/A	N/A	N/A
8/6/2019	Crockett Family Farms Inc.	OG DNA Genetics, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
8/6/2019	Elements Bioscience and Sativa	Xebra Brands Ltd.	0.00	100.0%	N/A	N/A	N/A	N/A
8/6/2019	Certain Assets of Critical Mass Industries LLC	First Colombia Development Corp. (nka:Redwood Green Corp.)	0.00	100.0%	N/A	N/A	N/A	N/A
8/2/2019	ACC C Corp.	Liht Cannabis Corp. (nka:Citation Growth Corp.)	30.81	100.0%	7.90	1.00	3.90x	30.81x
8/1/2019	Patients Mutual Assistance Collective Corporation	Harborside Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
8/1/2019	Spring Oaks Greenhouses, Inc.	Green Growth Brands Inc.	49.92	100.0%	N/A	N/A	N/A	N/A
7/31/2019	Sannabis S.A.S.	View Systems, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/31/2019	Ganja Gold Inc.	Integrated Cannabis Company, Inc.	30.40	100.0%	N/A	N/A	N/A	N/A
7/31/2019	4Front Holdings, LLC	Cannex Capital Holdings Inc. (nka:4Front Ventures Corp.)	272.22	100.0%	N/A	N/A	N/A	N/A
7/29/2019	150,000 square feet property in Holyoke, Massachusetts	Innovative Industrial Properties, Inc.	3.50	100.0%	N/A	N/A	N/A	N/A
7/25/2019	Dispensary Located at 2057 S. Broadway	Diego Pellicer Worldwide, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/25/2019	KJM Data and Research, LLC	Gabriella's Kitchen Inc. (nka:Gaby Inc.)	0.40	80.0%	N/A	N/A	N/A	N/A
7/24/2019	Full Spectrum Labs Ltd.	CanadaBis Capital Inc.	2.00	100.0%	N/A	N/A	N/A	N/A
7/24/2019	Urban Greenhouse Dispensary	Harvest Health & Recreation Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/24/2019	Assets of MM Esperanza 2 LLC	DionyMed Brands Inc.	19.07	100.0%	N/A	N/A	N/A	N/A
7/23/2019	Top Leaf, BC Weed Co. and Certain Brands of Sun 8 Holdings Inc.	Sundial Growers Inc.	0.00	100.0%	N/A	N/A	N/A	N/A

 International

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2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
7/23/2019	Green Farma Brasil	Brazil Investments, Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/17/2019	Phyto Pharma Inc	Vinergy Resources Ltd. (nka:Vinergy Cannabis Capital Inc.)	0.00	100.0%	N/A	N/A	N/A	N/A
7/16/2019	Terra Verde, LDA	Emmac Life Sciences Limited	0.00	100.0%	N/A	N/A	N/A	N/A
7/12/2019	Cheyenne Avenue in Las Vegas	Innovative Industrial Properties, Inc.	9.60	100.0%	N/A	N/A	N/A	N/A
7/11/2019	BlissCo Cannabis Corp.	The Supreme Cannabis Company, Inc.	48.87	90.7%	0.71	(2.82)	68.46x	-17.30x
7/10/2019	Mountain High Recreation, Inc.	Driven Deliveries, Inc.	2.30	100.0%	N/A	N/A	N/A	N/A
7/8/2019	LeafLife AZ	Harvest Health & Recreation Inc.	0.00	100.0%	N/A	N/A	N/A	N/A
7/3/2019	Delivra Corp.	Harvest One Cannabis Inc.	20.42	100.0%	5.05	(2.36)	4.04x	-8.63x
7/2/2019	Kanna, Inc.	Acreage Holdings, Inc.	5.52	100.0%	N/A	N/A	N/A	N/A
6/28/2019	City Cannabis Co.	Wildflower Brands Inc.	51.00	100.0%	7.70	N/A	6.62x	N/A
6/13/2019	Sweet Tree Modern Apothecary Ltd.	YSS Corp.	10.94	100.0%	N/A	N/A	N/A	N/A
6/12/2019	Blum Reno dispensary	Terra Tech Corp.	N/A	50.0%	N/A	N/A	N/A	N/A
6/12/2019	Vegas Valley Growers North LLC	Ionic Brands Corp.	11.34	100.0%	N/A	N/A	N/A	N/A
6/5/2019	Medcann Health Products Ltd.	Pasha Brands Ltd.	16.00	100.0%	N/A	N/A	N/A	N/A
5/29/2019	Emerald Dispensary in Gilbert, Arizona	Curaleaf Holdings, Inc.	18.00	100.0%	N/A	N/A	N/A	N/A
5/29/2019	2103430 Alberta Ltd.	Fire & Flower Inc.	4.41	100.0%	N/A	N/A	N/A	N/A
5/28/2019	Wikala.com Inc.	Phivida Holdings Inc.	23.43	100.0%	N/A	N/A	N/A	N/A

International

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2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
5/24/2019	Newstrike Brands Ltd.	HEXO Corp.	263.69	100.0%	8.07	(29.96)	32.66x	-8.80x
5/24/2019	Nevada cultivation Manufacturing Dreamweavers Cannabis Products Inc.	Integrated Cannabis Company, Inc.	22.77	100.0%	N/A	N/A	N/A	N/A
5/24/2019	High Tide Inc.	High Tide Inc.	2.68	100.0%	N/A	N/A	N/A	N/A
5/21/2019	Holyworld SA	MPX International Corporation	12.92	100.0%	N/A	N/A	N/A	N/A
5/16/2019	Pahrump	Green Growth Brands Inc.	13.37	100.0%	N/A	N/A	N/A	N/A
5/6/2019	Amberlight LLC	Ventura Cannabis and Wellness Corp.	0.60	100.0%	N/A	N/A	N/A	N/A
5/1/2019	Panag Pharma Inc.	Tetra Bio-Pharma Inc.	27.36	100.0%	N/A	N/A	N/A	N/A
4/24/2019	Cannabis Extraction and Manufacturing Facility	Chemesis International Inc.	8.00	80.0%	N/A	N/A	N/A	N/A
4/18/2019	New Leaf Emporium Inc.	NAC Prairies Ltd.	1.62	100.0%	N/A	N/A	N/A	N/A
4/16/2019	Form Factory, Inc.	Acreage Holdings, Inc.	100.35	100.0%	N/A	N/A	N/A	N/A
4/16/2019	196,000 Square Foot Vertically Integrated Cannabis Facility in Modesto, California	TransCanna Holdings Inc.	15.00	100.0%	N/A	N/A	N/A	N/A
4/11/2019	MedMar, Inc.	Cresco Labs, LLC (nka:Cresco Labs Inc.)	27.50	100.0%	N/A	N/A	N/A	N/A
4/3/2019	Lucrum Enterprises Inc.	Altai Partners LLC	1.20	55.0%	N/A	N/A	N/A	N/A
4/2/2019	Mayflower Botanicals Inc.	Vireo Health of Massachusetts, LLC	10.05	100.0%	N/A	N/A	N/A	N/A
4/1/2019	Sonoma Pacific Distribution Inc.	Gabriella's Kitchen Inc. (nka:Gaby Inc.)	5.93	100.0%	N/A	N/A	N/A	N/A
4/1/2019	Eureka Investment Partners, LLC	Curaleaf Holdings, Inc.	30.50	100.0%	N/A	N/A	N/A	N/A
3/28/2019	Silver Fox Management, Inc.	Vireo Health of New Mexico LLC	0.00	100.0%	N/A	N/A	N/A	N/A
3/25/2019	LLC/Sacred Plant, Inc/Live Fire, Inc./Elephant Head Farm, LLC	Vireo Health International Inc.	15.50	100.0%	N/A	N/A	N/A	N/A

International

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2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
3/18/2019	Delta Organic Cannabis Corp.	Organic Flower Investments Group Inc.	17.50	73.0%	N/A	N/A	N/A	N/A
3/14/2019	Emblem Corp.	Aleafia Health Inc.	182.06	100.0%	5.71	-13.06	31.91x	-13.94x
3/1/2019	Whistler Medical Marijuana Corporation	Aurora Cannabis Inc.	155.77	100.0%	N/A	N/A	N/A	N/A
2/27/2019	Certain Assets of Canna Gold Inc.	AREV Brands International Ltd.	1.28	100.0%	N/A	N/A	N/A	N/A
2/27/2019	A Dispensary in Santa Ana, California of Captor Capital Corp.	MedMen Enterprises Inc.	16.26	100.0%	N/A	N/A	N/A	N/A
2/26/2019	Mr. Natural Productions, Inc.	Australis Capital Inc.	1.30	100.0%	N/A	N/A	N/A	N/A
2/19/2019	R&D Pharma Corp.	Weekend Unlimited Inc.	12.40	100.0%	N/A	N/A	N/A	N/A
2/15/2019	Natura Naturals Holdings Inc.	Tilray, Inc.	70.00	100.0%	N/A	N/A	N/A	N/A
2/12/2019	Kannaboost Technology Inc./ CSI Solutions LLC	MedMen Enterprises Inc.	33.50	100.0%	N/A	N/A	N/A	N/A
2/5/2019	MPX Bioceutical Corporation	iAnthus Capital Holdings, Inc.	652.99	100.0%	41.60	(16.85)	15.70x	-38.75x
2/4/2019	Seven Point	MedMen Enterprises Inc.	13.55	100.0%	N/A	N/A	N/A	N/A
1/31/2019	HMS Health LLC	Curaleaf, Inc. (nka:Curaleaf Holdings, Inc.)	0.03	100.0%	N/A	N/A	N/A	N/A
1/31/2019	Canndara Canada Inc.	Westleaf Inc.	49.71	78.6%	N/A	N/A	N/A	N/A
1/30/2019	Just Healthy LLC	Green Growth Brands Inc.	4.20	100.0%	N/A	N/A	N/A	N/A
1/29/2019	SPRQ Health Group Corp.	PureSinsc Inc.	0.48	100.0%	N/A	N/A	N/A	N/A
1/28/2019	Standard Farms, LLC	Santé Veritas Holdings Inc.	39.19	100.0%	N/A	N/A	N/A	N/A
1/25/2019	ICH California Holdings, Ltd.	MedMen Enterprises Inc.	31.97	100.0%	N/A	N/A	N/A	N/A

 International

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2019 M&A Transactions for a Majority Stake (\$ in 000,000s)

Transaction Date	Target	Acquirer	Transaction Size	% Bought	LTM Revenues	LTM EBITDA	EV/ Revenues	EV/ EBITDA
1/22/2019	National Concessions Group, Inc.	SLANG Worldwide Inc.	81.88	92.5%	N/A	N/A	N/A	N/A
1/15/2019	Silver State Relief LLC/Silver State Cultivation LLC	320204 Nevada Holdings Corp.	46.69	100.0%	17.35	N/A	2.69x	N/A
1/14/2019	High Gardens, Inc.	Vireo Health International Inc.	1.00	100.0%	N/A	N/A	N/A	N/A
1/14/2019	Jupiter Research, LLC	Santé Veritas Holdings Inc.	213.89	100.0%	77.00	N/A	2.78x	N/A
1/8/2019	Balkan Cannabis Corp.	ICC International Cannabis Corp.	31.42	100.0%	N/A	N/A	N/A	N/A
Median of the M&A Transaction Targets			\$10.49	100.0%	\$8.35	(\$5.77)	3.39x	-8.72x

 International

M&A transactions for each year

Year	Number of Acquisitions
2019	95*
2018	102
2017	34
2016	10
2015	8
2014	18
2013	3
2012	4
2011	2
2010	2

* As of September 30, 2019

Contact vspualding@singerlewak.com for a comprehensive list + description of cannabis mergers and acquisitions.

SINGERLEWAK is a nationally recognized full service accounting, advisory, tax and business valuation firm that has provided independent financial advisory and valuation services in thousands of situations for more than 50 years. These assignments include the valuation of companies and pass-through entities, their securities, and their intangible assets ranging in size from small, closely-held businesses and start-ups, to corporations with market values over a billion dollars, covering almost every industry and all types of transactions. With the collective backgrounds of our managing directors and professional staff, SingerLewak brings substantial large deal experience to bear on our middle market transaction opinions. SingerLewak utilizes proprietary research, intensive due diligence, and the experience and insights of its professionals to produce thoughtful, well-documented opinions that have consistently withstood the scrutiny of clients and their advisors, investors, regulators, and courts.

This industry research is provided at no charge to SingerLewak valuation clients and cannabis contacts. Values obtained from Capital IQ database. Research or detailed information not covered in this report can be obtained for a fee. Contact Vanita Spaulding at vspaulding@singerlewak for additional information or questions in connection with this research report.

Definitions of Financial Terms Used in this Quarterly Industry Update:

Enterprise Value (EV): Market Value of Equity + Market Value of Debt — Cash

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA): Profitability metric sometimes also referred to as operating profit or operating earnings.

Gross Cash Flows: Net Income + Depreciation and Amortization Expense

Latest Twelve Months (LTM): Financial information is as of the latest twelve months through the date of this Quarterly Industry Update.

Gross Profit (GP): Revenues — Cost of Goods Sold

Market Value of Invested Capital (MVIC) – Market Value of Equity + Market Value of Debt + Cash and Cash Equivalents; or EV+Cash

Price (P): Price is stated in US Dollars as of the report date.

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**BUREAU OF CANNABIS CONTROL
TEXT OF REGULATIONS**

**CALIFORNIA CODE OF REGULATIONS
TITLE 16
DIVISION 42. BUREAU OF CANNABIS
CONTROL**

ORDER OF ADOPTION

Adopt Sections 5000, 5001, 5002, 5003, 5004, 5005, 5006, 5007, 5007.1, 5007.2, 5008, 5009, 5010, 5010.1, 5010.2, 5010.3, 5011, 5012, 5013, 5014, 5015, 5016, 5017, 5018, 5019, 5020, 5021, 5022, 5023, 5024, 5024.1, 5025, 5026, 5027, 5028, 5030, 5031, 5032, 5033, 5034, 5035, 5036, 5037, 5038, 5039, 5040, 5040.1, 5041, 5041.1, 5042, 5043, 5044, 5045, 5046, 5047, 5048, 5049, 5050, 5051, 5052, 5052.1, 5053, 5054, 5300, 5301, 5302, 5303, 5303.1, 5304, 5305, 5305.1, 5306, 5307, 5307.1, 5307.2, 5308, 5309, 5310, 5311, 5312, 5313, 5314, 5315, 5400, 5402, 5403, 5403.1, 5404, 5405, 5406, 5407, 5408, 5409, 5410, 5411, 5412, 5413, 5414, 5415, 5415.1, 5416, 5417, 5418, 5419, 5420, 5421, 5422, 5423, 5424, 5426, 5427, 5500, 5501, 5502, 5503, 5504, 5505, 5506, 5506.1, 5507, 5600, 5601, 5602, 5603, 5604, 5700, 5701, 5702, 5703, 5704, 5705, 5706, 5707, 5708, 5709, 5710, 5711, 5712, 5713, 5714, 5715, 5717, 5718, 5719, 5720, 5721, 5722, 5723, 5724, 5725, 5726, 5727, 5728, 5729, 5730, 5731, 5732, 5733, 5734, 5735, 5736, 5737, 5738, 5739, 5800, 5801, 5802, 5803, 5804, 5805, 5806, 5807, 5808, 5809, 5810, 5811, 5812, 5813, 5814, 5815, 5900, 5901, 5902, 5903, 5904, and 5905 of Title 16 of the California Code of Regulations to read as follows:

Chapter 1. ALL BUREAU LICENSEES

Article 1. Division Definitions

§ 5000. Definitions.

For the purposes of this division, the definitions in this section shall govern the construction of this division unless otherwise indicated.

- (a) “Act” means the Medicinal and Adult-Use Cannabis Regulation and Safety Act.
- (b) “Branded merchandise” means clothing, hats, pencils, pens, keychains, mugs, water bottles, beverage glasses, notepads, lanyards, cannabis accessories, or other types of merchandise approved by the Bureau with the name or logo of a commercial cannabis business licensed pursuant to the Act. Branded merchandise does not include items containing cannabis or any items that are considered food as defined by Health and Safety Code section 109935.
- (c) “Bureau” means the Bureau of Cannabis Control, previously named the Bureau of Marijuana Control, Bureau of Medical Cannabis Regulation, and Bureau of Medical Marijuana Regulation.
- (d) “Business day” is a day Monday through Friday from 8:00 a.m. to 5.00 p.m. Pacific Time, excluding state holidays, during which the Bureau is closed for business.

- (e) “Cannabis accessories” has the same meaning as in Health and Safety Code section 11018.2.
- (f) “Cannabis goods” means cannabis, including dried flower, and products containing cannabis.
- (g) “Cannabis waste” means waste that contains cannabis and that has been made unusable and unrecognizable in the manner prescribed in section 5054 of this division.
- (h) “Canopy” means the designated area(s) at a licensed premises that will contain mature plants at any point in time.
- (i) “Delivery employee” means an individual employed by a licensed retailer or licensed microbusiness authorized to engage in retail sales who delivers cannabis goods from the licensed retailer or licensed microbusiness premises to a customer at a physical address.
- (j) “Free cannabis goods” means any amount of cannabis goods provided to any person without cost or payment or exchange of any other thing of value.
- (k) “Immature cannabis plant” or “immature plant” means a plant that is nonflowering and is shorter and narrower than 18 inches. For purposes of this division, this definition is applicable to retail activities.
- (l) “Kief” means the resinous trichomes of cannabis that have been separated from the cannabis plant.
- (m) “Limited-access area” means an area in which cannabis goods are stored or held and is only accessible to a licensee and its employees and authorized individuals.
- (n) “Lot number” or “batch number” means a distinctive group of numbers, letters, or symbols or any combination of these that is unique to a group of cannabis goods.
- (o) “Medicinal cannabis patient” includes both a qualified patient as defined in Health and Safety Code section 11362.7 and a person in possession of a valid identification card issued under Health and Safety Code section 11362.71.
- (p) “Package” and “Packaging” means any container or wrapper that may be used for enclosing or containing any cannabis goods for final retail sale. “Package” and “packaging” does not include a shipping container or outer wrapping used solely for the transport of cannabis goods in bulk quantity to a licensee.
- (q) “Pre-roll” means any combination of the following rolled in paper: flower, shake, leaf, or kief that is obtained from accumulation in containers or sifted from loose, dry cannabis flower or leaf with a mesh screen or sieve.
- (r) “Promotional materials” means any form, letter, circular, pamphlet, publication, or other written material directed to a customer or prospective customer to induce retail sales. Promotional material does not include permitted signs, displays, decorations, cannabis accessories, or cannabis goods furnished by a licensed cultivator, licensed manufacturer, licensed distributor, licensed microbusiness, or licensed cannabis event organizer to a retail licensee for advertising purposes. Promotional materials shall have no intrinsic or secondary value.
- (s) “Publicly owned land” means any building or real property that is owned, leased, or occupied by a city, county, state, federal, or other government entity.

(t) “Residential area” is an area that is within 600 feet of any single-family or multifamily residence, other than commercial hotels, motels, and similar establishments for temporary lodging.

(u) “Retail area” means a building, room, or other area that is open to the public, upon the licensed retailer or licensed microbusiness premises authorized to engage in retail sales in which cannabis goods are sold or displayed.

(v) “Sublet” means to lease or rent all or part of a leased or rented property.

(w) “Tamper-evident” means that the cannabis goods packaging is sealed in a manner that prevents the packaging from being opened without obvious destruction of the seal.

(x) “Transport” means the physical movement of cannabis goods from one licensed premises to another licensed premises.

(y) “Vehicle alarm system” is a device or series of devices installed to discourage theft of the vehicle or its contents and is intended to summon general attention or to summon law enforcement as a result of an indication of an attempted breach of the vehicle.

(z) “Wholesale cost” has the same meaning as in regulation adopted by the California Department of Tax and Fee Administration for cannabis taxes.

Authority: Section 26013, Business and Professions Code. Reference: Section 26013, Business and Professions Code.

Article 2. Applications

§ 5001. Temporary Licenses.

(a) A temporary license is a conditional license that authorizes the licensee to engage in commercial cannabis activity as would be permitted under the privileges of a non-temporary license of the same type. A temporary licensee shall follow all applicable rules and regulations as would be required if the licensee held a non-temporary license of the same type.

(b) A temporary license does not obligate the Bureau to issue a non-temporary license nor does the temporary license create a vested right in the holder to either an extension of the temporary license or to the granting of a subsequent non-temporary license.

(c) A temporary license issued under this section shall be valid for 120 days from the effective date. No temporary license shall be effective prior to January 1, 2018.

(d) A temporary license may be extended by the Bureau for additional 90-day periods if a complete application for an annual license has been submitted to the Bureau pursuant to section 5002 of this division prior to the initial expiration date of the temporary license.

(e) The Bureau shall not issue any temporary licenses or extensions after December 31, 2018. Any temporary license issued or extended with an expiration date after December 31, 2018, will be valid until it expires, but shall not be extended beyond the expiration date.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code.

§ 5002. Annual License Application Requirements.

- (a) Applications may be completed and submitted online at www.bcc.ca.gov or completed in hard copy and submitted by delivering a printed copy to the Bureau's office(s).
- (b) Applicants who submit their applications online shall first register for a user account. To register for a user account, the applicant shall do all of the following:
- (1) Create a user name, password, and security question and answer;
 - (2) Provide an email address; and
 - (3) Provide the owner's first and last name, primary phone number, social security number or individual taxpayer identification number, date of birth, and mailing address.
- (c) An application must be completed by an owner as defined by section 5003 of this division. An application must be submitted to the Bureau for each location and each license type. An application for an annual cannabis license includes the following:
- (1) The name of the applicant. For applicants who are individuals, the applicant shall provide both the first and last name of the individual. For applicants who are business entities, the applicant shall provide the legal business name of the applicant.
 - (2) If applicable, the business trade name ("DBA") of the applicant.
 - (3) The commercial cannabis license that the applicant is applying for, and whether the applicant is requesting that the license be designated as medicinal, adult-use, or both. Testing laboratory applicants do not have to designate medicinal or adult-use, as testing laboratory licenses allow the holder to test both medicinal and adult-use cannabis.
 - (4) Payment of an application fee pursuant to section 5014 of this division.
 - (5) Whether the owner is serving or has previously served in the military. Disclosure of military service is voluntary. An applicant who has served as an active duty member of the Armed Forces of the United States and was honorably discharged and who can provide evidence of such honorable discharge shall have his or her application expedited pursuant to Business and Professions Code section 115.4.
 - (6) A list of the license types and the license numbers issued from the Bureau and all other state cannabis licensing authorities that the applicant holds, including the date the license was issued and the licensing authority that issued the license.
 - (7) Whether the applicant has been denied a license or has had a license suspended or revoked by the Bureau or any other state cannabis licensing authority. The applicant shall provide the type of license applied for, the name of the licensing authority that denied the application, and the date of denial.
 - (8) The physical address of the premises. If the Bureau is unable to confirm that the address provided is valid, then the applicant shall provide a document that confirms the physical address of the premises. Such a document may include a utility bill, printed information from the county assessor, deed, or title.
 - (9) The mailing address for the applicant, if different from the premises address.

- (10) The telephone number for the premises.
- (11) The website address and email address of the applicant's business.
- (12) The business' federal employer identification number.
- (13) Contact information for the applicant's designated primary contact person including the name, title, phone number, and email address of the individual.
- (14) A description of the business organizational structure of the applicant, such as partnership or corporation.
- (15) All business-formation documents, which may include, but are not limited to, articles of incorporation, bylaws, operating agreements, partnership agreements, and fictitious business name statements. The applicant shall also provide all documents filed with the California Secretary of State, which may include, but are not limited to, articles of incorporation, certificates of stock, articles of organization, certificates of limited partnership, and statements of partnership authority. If the commercial cannabis business is held in trust, the applicant shall provide a copy of the certificate of trust establishing trustee authority.
- (16) A list of every fictitious business name the applicant is operating under including the address where the business is located.
- (17) A commercial cannabis business that is a foreign corporation or foreign limited liability company shall include in its application a certificate of qualification, certificate of registration, or certificate of status issued by the California Secretary of State.
- (18) The applicant shall supply the following financial information:
 - (A) A list of funds belonging to the applicant held in savings, checking, or other accounts maintained by a financial institution. The applicant shall provide, for each account, the financial institution's name, the financial institution's address, account type, account number, and the amount of money in the account.
 - (B) A list of loans made to the applicant. For each loan, the applicant shall provide the amount of the loan, the date of the loan, term(s) of the loan, security provided for the loan, and the name, address, and phone number of the lender.
 - (C) A list of investments made into the applicant's commercial cannabis business. For each investment, the applicant shall provide the amount of the investment, the date of the investment, term(s) of the investment, and the name, address, and phone number of the investor.
 - (D) A list of all gifts of any kind given to the applicant for its use in conducting commercial cannabis activity. For each gift, the applicant shall provide the value of the gift or description of the gift, and the name, address, and phone number of the provider of the gift.
- (19) A complete list of every individual who has a financial interest in the commercial cannabis business as defined in section 5004 of this division, who is not an owner as defined in section 5003 of this division.
- (20) A complete list of every owner of the applicant as defined in section 5003 of this division. Each individual named on this list shall submit the following information:
 - (A) The full name of the owner.

- (B) The owner's title within the applicant entity.
- (C) The owner's date of birth and place of birth.
- (D) The owner's social security number or individual taxpayer identification number.
- (E) The owner's mailing address.
- (F) The owner's telephone number. This may include a number for the owner's home, business, or mobile telephone.
- (G) The owner's email address.
- (H) The owner's current employer.
- (I) The percentage of the ownership interest held in the applicant entity by the owner.
- (J) Whether the owner has an ownership or a financial interest as defined in sections 5003 and 5004, respectively, of this division in any other commercial cannabis business licensed under the Act.
- (K) A copy of the owner's government-issued identification. Acceptable forms of identification are a document issued by a federal, state, county, or municipal government that includes the name, date of birth, height, gender, and picture of the person, such as a driver license.
- (L) A detailed description of the owner's convictions. A conviction within the meaning of this section means a plea or verdict of guilty or a conviction following a plea of nolo contendere. Convictions dismissed under Penal Code section 1203.4 or equivalent non-California law must be disclosed. Convictions dismissed under Health and Safety Code section 11361.8 or equivalent non-California law must be disclosed. Juvenile adjudications and traffic infractions under \$300 that did not involve alcohol, dangerous drugs, or controlled substances do not need to be included. For each conviction, the owner shall provide the following:
 - (i) The date of conviction.
 - (ii) Dates of incarceration, if applicable.
 - (iii) Dates of probation, if applicable.
 - (iv) Dates of parole, if applicable.
 - (v) A detailed description of the offense for which the owner was convicted.
 - (vi) A statement of rehabilitation for each conviction. The statement of rehabilitation is to be written by the owner and may contain evidence that the owner would like the Bureau to consider that demonstrates the owner's fitness for licensure. Supporting evidence may be attached to the statement of rehabilitation and may include, but is not limited to, a certificate of rehabilitation under Penal Code section 4852.01, and dated letters of reference from employers, instructors, or professional counselors that contain valid contact information for the individual providing the reference.
- (M) If applicable, a detailed description of any administrative orders or civil judgments for violations of labor standards, any suspension of a commercial cannabis license, revocation of a

commercial cannabis license, or sanctions for unlicensed commercial cannabis activity by a licensing authority, local agency, or state agency against the applicant or a business entity in which the applicant was an owner or officer within the three years immediately preceding the date of the application.

(N) Attestation to the following statement: Under penalty of perjury, I hereby declare that the information contained within and submitted with the application is complete, true, and accurate. I understand that a misrepresentation of fact is cause for rejection of this application, denial of the license, or revocation of a license issued.

(21) Evidence that the applicant has the legal right to occupy and use the proposed location that complies with section 5007 of this division.

(22) Evidence that the proposed premises is in compliance with Business and Professions Code section 26054(b) and section 5026 of this division.

(23) For an applicant with 20 or more employees, the applicant shall attest that the applicant has entered into a labor peace agreement and will abide by the terms of the agreement. The applicant shall submit a copy of the page of the labor peace agreement that contains the signatures of the union representative and the applicant. For applicants who have not yet entered into a labor peace agreement, the applicant shall provide a notarized statement indicating that the applicant will enter into and abide by the terms of a labor peace agreement as soon as reasonably practicable after licensure.

(24) The applicant shall provide a valid seller's permit number issued by the California Department of Tax and Fee Administration, if applicable. If the applicant has not yet received a seller's permit, the applicant shall attest that the applicant is currently applying for a seller's permit.

(25) A diagram of the premises as required by section 5006 of this division.

(26) Proof of a bond as required by section 5008 of this division.

(27) For testing laboratory applications, the certificate(s) of accreditation as required by section 5702 of this division, or the information required for an interim license as required by section 5703 of this division.

(28) When an applicant provides a license, permit, or other authorization from the local jurisdiction where the licensed premises will be or is located, the Bureau will notify the applicable local jurisdiction to confirm the validity of the authorization. If the local jurisdiction does not respond within 10 calendar days, the Bureau shall consider the authorization valid.

(29) All license applications shall include a detailed description of the applicant's operating procedures. Applicants shall use and submit to the Bureau the following forms, which are incorporated by reference:

(A) Transportation Procedures, Form BCC-LIC-015 (New 10/18)

(B) Inventory Procedures, Form BCC-LIC-016 (New 7/18)

(C) Non-Laboratory Quality Control Procedures, Form BCC-LIC-017 (New 10/18)

(D) Security Procedures, Form BCC-LIC-018 (New 10/18)

(E) Delivery Procedures, Form BCC-LIC-020 (New 10/18)

(30) For applicants applying for a microbusiness license, the application shall include a detailed description of the applicant's operating procedures required by this section for each cannabis activity the applicant intends to engage in.

(31) For applicants applying for a testing laboratory license, in addition to the operating procedures required under subsection (c)(29) of this section, the standard application shall include the operating procedures required by Chapter 6 of this division.

(32) The limited waiver of sovereign immunity required by section 5009 of this division, if applicable.

(33) Evidence of exemption from, or compliance with, the California Environmental Quality Act as required by sections 5010-5010.3 of this division.

(34) The applicant's State Employer Identification Number (SEIN) issued by the California Employment Development Department.

(35) For an applicant with more than one employee, the applicant shall attest that the applicant employs, or will employ within one year of receiving a license, one supervisor and one employee who have successfully completed a Cal-OSHA 30-hour general industry outreach course offered by a training provider that is authorized by an OSHA Training Institute Education Center to provide the course.

Authority: Sections 115.4 and 26013, Business and Professions Code. Reference: Sections 115.4, 144, 26012, 26050, 26051.5 and 26055, Business and Professions Code.

§ 5003. Designation of Owner.

(a) All applicants for a commercial cannabis license shall have at a minimum one individual who meets the definition of "owner" under Business and Professions Code section 26001(a) and who will submit the information required of owners under section 5002 of this division.

(b) "Owner" means any of the following:

(1) A person with an aggregate ownership interest of 20 percent or more in the person applying for a license or a licensee, unless the interest is solely a security, lien, or encumbrance.

(2) The chief executive officer of a nonprofit or other entity.

(3) A member of the board of directors of a nonprofit.

(4) The trustee(s) and all persons who have control of the trust and/or the commercial cannabis business that is held in trust.

(5) An individual entitled to a share of at least 20 percent of the profits of the commercial cannabis business.

(6) An individual who will be participating in the direction, control, or management of the person applying for a license. Such an individual includes any of the following:

(A) A general partner of a commercial cannabis business that is organized as a partnership.

(B) A non-member manager or managing member of a commercial cannabis business that is organized as a limited liability company.

(C) An officer or director of a commercial cannabis business that is organized as a corporation.

(c) When an entity is an owner in a commercial cannabis business, all entities and individuals with a financial interest in the entity shall be disclosed to the Bureau and may be considered owners of the commercial cannabis business. For example, this includes all entities in a multi-layer business structure, as well as the chief executive officer, members of the board of directors, partners, trustees and all persons who have control of a trust, and managing members or non-member managers of the entity. Each entity disclosed as having a financial interest must disclose the identities of persons holding financial interests until only individuals remain.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26001 and, 26012, Business and Professions Code.

§ 5004. Financial Interest in a Commercial Cannabis Business.

(a) A financial interest means an agreement to receive a portion of the profits of a commercial cannabis business, an investment into a commercial cannabis business, a loan provided to a commercial cannabis business, or any other equity interest in a commercial cannabis business except as provided in subsection (d). For the purpose of this division, an agreement to receive a portion of the profits includes, but is not limited to, the following individuals:

(1) An employee who has entered into a profit share plan with the commercial cannabis business.

(2) A landlord who has entered into a lease agreement with the commercial cannabis business for a share of the profits.

(3) A consultant who is providing services to the commercial cannabis business for a share of the profits.

(4) A person acting as an agent, such as an accountant or attorney, for the commercial cannabis business for a share of the profits.

(5) A broker who is engaging in activities for the commercial cannabis business for a share of the profits.

(6) A salesperson who earns a commission.

(b) The license application shall include the name, birthdate, and government-issued identification type and number for all individuals who have a financial interest in a commercial cannabis business but are not owners as defined in section 5003(b) of this division. These individuals shall not be required to submit the information required of owners under section 5002(c)(20) of this division.

(c) When an entity has a financial interest in a commercial cannabis business, then all individuals who are owners of that entity shall be considered financial interest holders of the commercial cannabis business. For example, this includes all entities in a multi-layer business

structure, as well as the chief executive officer, members of the board of directors, partners, trustees and all persons who have control of a trust, and managing members or non-member managers of the entity. Each entity disclosed as having a financial interest must disclose the identities of persons holding financial interests until only individuals remain.

(d) Notwithstanding subsection (b), the following persons are not required to be listed on an application for licensure under section 5002(c)(19) of this division:

- (1) A bank or financial institution whose interest constitutes a loan;
- (2) Persons whose only financial interest in the commercial cannabis business is through an interest in a diversified mutual fund, blind trust, or similar instrument;
- (3) Persons whose only financial interest is a security interest, lien, or encumbrance on property that will be used by the commercial cannabis business; and
- (4) Persons who hold a share of stock that is less than 5 percent of the total shares in a publicly traded company.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26051.5, Business and Professions Code.

§ 5005. Personnel Prohibited from Holding Licenses.

(a) A license authorized by the Act and issued by the Bureau may not be held by, or issued to, any person holding office in, or employed by, any agency of the State of California or any of its political subdivisions when the duties of such person have to do with the enforcement of the Act or any other penal provisions of law of this State prohibiting or regulating the sale, use, possession, transportation, distribution, testing, manufacturing, or cultivation of cannabis goods.

(b) This section applies to, but is not limited to, any person employed in the State of California Department of Justice as a peace officer, in any district attorney's office, in any city attorney's office, in any sheriff's office, or in any local police department.

(c) No person listed in subsection (a) or (b) of this section may have any ownership interest, directly or indirectly, in any business to be operated or conducted under a cannabis license.

(d) This section does not apply to any person who holds a license in the capacity of executor, administrator, or guardian.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code.

§ 5006. Premises Diagram.

(a) An applicant shall submit to the Bureau, with the application, a complete and detailed diagram of the proposed premises. The diagram shall be used by the Bureau to determine whether the premises meets the requirements under this division and the Act. The Bureau shall deny an application if the premises does not qualify for licensure pursuant to Business and Professions Code section 26057.

(b) The diagram shall show the boundaries of the property and the proposed premises to

be licensed, showing all boundaries, dimensions, entrances and exits, interior partitions, walls, rooms, windows, and doorways, and shall include a brief statement or description of the principal activity to be conducted therein.

(c) The diagram shall show and identify commercial cannabis activities that will take place in each area of the premises, and identify limited-access areas. Commercial cannabis activities that shall be identified on the diagram include the following, if applicable to the business operations: storage, batch sampling, loading or unloading of shipments, packaging and labeling, customer sales, loading for deliveries, extraction, infusion, cultivation, and processing.

(d) The diagram shall show where all cameras are located and assign a number to each camera for identification purposes unless the premises is exempt from the video surveillance requirement pursuant to section 5315 of this division.

(e) The diagram shall be to scale.

(f) The diagram shall not contain any highlighting and the markings on the diagram shall be in black-and-white print.

(g) If the proposed premises consists of only a portion of a property, the diagram must be labeled indicating which part of the property is the proposed premises and what the remaining property is used for.

(h) If the proposed premises consists of only a portion of a property that will contain two or more licensed premises, the diagram shall clearly show the designated entrances and walls under the exclusive control of the applicant for the premises, as well as the designated entrances and walls for each additional premises. The diagram shall also show all proposed common or shared areas of the property. Such areas may include lobbies, bathrooms, hallways, and breakrooms.

(i) If the proposed premises will be a microbusiness that includes cultivation activities, in addition to the requirements of this section, the premises diagram shall also include all the required information for a premises diagram under section 5501(d) of this division.

(j) If a proposed premises is located on only a portion of a property that also includes a residence, the diagram shall clearly show the designated buildings for the premises and the residence.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26051.5, Business and Professions Code.

§ 5007. Landowner Approval.

(a) If the applicant is not the landowner of the real property upon which the premises is located, the applicant shall provide to the Bureau a document from the landowner or the landowner's agent that states that the applicant has the right to occupy the property and acknowledges that the applicant may use the property for the commercial cannabis activity for which the applicant is applying for licensure. An applicant shall also provide a copy of the rental agreement, as applicable.

(b) If the applicant is the landowner of the real property upon which the premises is located, the applicant shall provide to the Bureau a copy of the title or deed to the property.

(c) If the landowner is a trust, the landowner approval shall come from the person who

holds equitable title in the real property.

Authority: Section 26013, Business and Professions Code. Reference: Section 26051.5, Business and Professions Code.

§ 5007.1. Electronic Signature.

The Bureau will accept an electronic signature that complies with Civil Code section 1633.2(h) on any documents required to be submitted to the Bureau and that are submitted electronically, except documents that are required to be notarized.

Authority: Section 26013, Business and Professions Code. Reference: Section 26013, Business and Professions Code.

§ 5007.2. Use of Legal Business Name.

Applicants and licensees shall use their legal business name on all documents related to commercial cannabis activity.

Authority: Section 26013, Business and Professions Code. Reference: Section 26013, Business and Professions Code.

§ 5008. Bond.

An applicant shall provide proof of having obtained a surety bond of at least \$5,000 payable to the State of California to ensure payment of the cost incurred for the destruction of cannabis goods necessitated by a violation of the Act or the regulations adopted thereunder. All bonds required under this regulation must be issued by a corporate surety licensed to transact surety business in the State of California and shall be issued on the Commercial Cannabis Licensee Bond form under Title 11, California Code of Regulations, Article 56, section 118.1. A bond shall be required for each license.

Authority: Section 26013, Business and Professions Code. Reference: Section 26051.5, Business and Professions Code.

§ 5009. Limited Waiver of Sovereign Immunity.

(a) Any applicant or licensee that may fall within the scope of sovereign immunity that may be asserted by a federally recognized tribe or other sovereign entity must waive any sovereign immunity defense that the applicant or licensee may have, may be asserted on its behalf, or may otherwise be asserted in any state administrative or judicial enforcement actions against the applicant or licensee, regardless of the form of relief sought, whether monetary or otherwise, under the state laws and regulations governing commercial cannabis activity. The applicant or licensee must submit a written waiver of sovereign immunity to the Bureau with any license application or renewal, which is valid for the period of the license. The written waiver shall include that the applicant or licensee has the lawful authority to enter into the waiver required by this section, the applicant or licensee hereby waives sovereign immunity, and the applicant or licensee agrees to do all of the following:

(1) Provide documentation to the Bureau that establishes that the applicant or licensee has the lawful authority to enter into the waiver required by this section;

(2) Conduct all commercial cannabis activity in full compliance with the state laws and regulations governing commercial cannabis activity, including submission to all enforcement provisions thereof;

(3) Allow access as required by state statute or regulation by persons or entities charged with duties under the state laws and regulations governing commercial cannabis activity to any licensed premises or property at which the applicant conducts any commercial cannabis activity, including licensed premises or property where records of commercial cannabis activity are maintained by or for the applicant or licensee;

(4) Provide any and all records, reports, and other documents as may be required under the state laws and regulations governing commercial cannabis activity;

(5) Conduct commercial cannabis activity with other state commercial cannabis licensees only, unless otherwise specified by state law;

(6) Meet all of the requirements for licensure under the state laws and regulations governing the conduct of commercial cannabis activity, and provide truthful and accurate documentation and other information of the applicant's qualifications and suitability for licensure as may be requested; and

(7) Submit to the personal and subject matter jurisdiction of the California courts to address any matter related to the waiver or the commercial cannabis application, license, or activity, and that all such matters and proceedings shall be governed, construed and enforced in accordance with California substantive and procedural law, including but not limited to the Medicinal and Adult- Use Regulation and Safety Act and the Administrative Procedure Act.

(b) The Bureau shall not approve an application for a state license if approval of the license would violate the provisions of any local ordinance or regulation adopted in accordance with Business and Professions Code section 26200 that is issued by the county or, if within a city, the city, within which the licensed premises is to be located.

(c) Any applicant or licensee must immediately notify the Bureau of any changes that may materially affect the applicant or licensee's compliance with subsection (a) of this section.

(d) Any failure by an applicant or licensee to comply with the requirements of subsections (b) or (c) of this section shall be a basis for denial of an application or renewal or discipline of a licensee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050 and 26051.5, Business and Professions Code.

§ 5010. Compliance with the California Environmental Quality Act (CEQA).

(a) For purposes of complying with the California Environmental Quality Act (CEQA):

(1) "Project" means the commercial cannabis activity or activities for which an annual license application is submitted to the Bureau and which requires the Bureau to engage in discretionary review.

(2) “CEQA Guidelines” means the Guidelines for Implementation of the California Environmental Quality Act codified at Title 14, California Code of Regulations, section 15000 et seq.

(3) “Environmental document” has the same meaning as section 15361 of the CEQA Guidelines. Environmental documents are prepared by the applicant or the local jurisdiction that analyze the commercial cannabis activity or activities and which assess whether the project has the potential to generate significant adverse environmental impacts.

(b) An applicant may provide evidence of compliance with CEQA by submitting a copy of an environmental document previously certified or adopted by the local jurisdiction that evaluated the project.

(c) If a previously certified or adopted environmental document is not available or does not exist, and if the Bureau does not determine that the project is exempt from CEQA as provided in section 5010.2 of this division, the applicant shall provide information to enable the Bureau to determine what type of environmental document should be prepared by submitting the CEQA Project-Specific Information Form, BCC-LIC-025 (New 10/18), incorporated herein by reference. Such information shall include at least the following:

(1) The project location and surrounding land use, which shall:

(A) Describe the project location, including street address, city, county, Assessor’s Parcel Number, major cross streets, general plan designation, zoning designation, and any other physical description that clearly indicates the project site location.

(B) Describe the surrounding land uses and zoning designations within a one-half mile radius of the project and list all abutting land uses.

(C) Include a vicinity map and aerial image to show the project location.

(D) Include photographs, not larger than 8 ½ by 11 inches, of existing visual conditions as observed from publicly accessible vantage point(s).

(2) A project description, which shall:

(A) Describe the activities included in the project application and identify any other commercial cannabis activity or activities occurring at the proposed premises.

(B) Quantify the project size (total floor area of the project), and the lot size on which the project is located, in square feet.

(C) List and describe any other related public agency permits and approvals, including any entitlements, required for this project, including those required by a planning commission, local air district, or regional water board.

(D) Identify whether the applicant is licensed by, or has applied for licensure from, the California Department of Food and Agriculture or the State Department of Public Health to engage in commercial cannabis activity at the proposed premises.

(E) Estimate the number of anticipated employees onsite, occupancy during operating hours, and frequency of deliveries or shipments originating from and/or arriving to the project site, and describe the anticipated transportation activity at the project site including the effects of the

project related to public transit, bicycle, or pedestrian facilities.

(F) Identify the location, type, and quantity of hazardous materials, as defined by Health and Safety Code section 25260, that are stored, used, or disposed of at the project site and a copy of the Hazardous Material Business Plan (HMBP) prepared for the proposed premises, if any.

(G) Discuss whether the project will increase the quantity and type of solid waste, as defined by Public Resources Code section 40191, or hazardous waste, as defined by Health and Safety Code section 25117, that is generated or stored onsite.

(H) Describe the project's anticipated operational energy needs, identify the source of energy supplied for the project and the anticipated amount of energy per day, and explain whether the project will require an increase in energy demand and the need for additional energy resources.

(3) The Bureau shall consider, for purposes of evaluating compliance with CEQA, both the individual and cumulative impacts of all commercial cannabis activities occurring at the proposed premises.

Authority: Section 26013, Business and Professions Code. Reference: Section 26055, Business and Professions Code.

§ 5010.1. Review of Previously Prepared Environmental Documents Pursuant to CEQA.

(a) When the project has been evaluated in a previously certified or adopted environmental document, the Bureau will evaluate the project as a responsible agency as provided in section 15096 of the CEQA Guidelines.

(b) The Bureau may require subsequent environmental review if one or more of the events outlined in Public Resources Code section 21166 or section 15162 of the CEQA Guidelines occurs.

Authority: Section 26013, Business and Professions Code. Reference: Section 26055, Business and Professions Code; and Section 21166, Public Resources Code.

§ 5010.2 CEQA Exempt Projects.

(a) An applicant may submit documentation to the Bureau demonstrating that the project is exempt from further environmental review pursuant to CEQA, because the project falls within a class of projects determined not to have significant effect on the environment, by submitting the CEQA Exemption Petition, BCC-LIC-026 (New 10/18), incorporated herein by reference.

(b) Documentation submitted to the Bureau in support of a determination that the project is exempt from further environmental review under CEQA shall, at minimum, include the following information:

(1) Project location and surrounding land use, as required in section 5010 of this division;

(2) Project description, as required in section 5010 of this division; and

(3) A written justification to support a determination that the project is categorically exempt. The written justification shall list the category and class the exemption falls under and shall explain how the project fits the specified exemption. The justification shall also demonstrate that none of

the exceptions to categorical exemptions described in section 15300.2 of the CEQA Guidelines apply to the project.

(c) Upon review, if the Bureau determines that the project is exempt from further CEQA review, and approves an application for annual licensure, the Bureau will file a Notice of Exemption with the State Clearinghouse within 5 business days after approval of the project as required by section 15062(c) of the CEQA Guidelines.

Authority: Section 26013, Business and Professions Code. Reference: Section 26055, Business and Professions Code.

§ 5010.3 Preparation of CEQA Environmental Documents for Applicant.

If the Bureau determines that a project does not qualify for an exemption, or that the circumstances described in Public Resources Code section 21166 and section 15162 of the CEQA Guidelines require subsequent environmental review, the Bureau may charge the applicant for the costs of preparation for any supplemental environmental document as well as the Bureau's costs for procedures to comply with CEQA, unless the Bureau specifies otherwise.

Authority: Section 26013, Business and Professions Code. Reference: Section 26055, Business and Professions Code.

§ 5011. Additional Information.

The Bureau may request additional information and documents from the applicant. The Bureau will provide the applicant a deadline for submittal of additional information. The Bureau will consider the complexity of the information requested and the ease with which the information can be obtained and transmitted to the Bureau by the applicant in determining the deadline.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26031, 26050 and 26051.5, Business and Professions Code.

§ 5012. Incomplete Applications.

(a) If the Bureau determines that the application is incomplete, the Bureau may provide notice to the applicant in accordance with Business and Professions Code section 124.

(b) If the Bureau issues a notice pursuant to Business and Professions Code section 124, an applicant has one year from the date of the notice in subsection (a) of this section to correct all deficiencies. If the applicant fails to correct the deficiencies within the one-year period and has not responded to the Bureau's attempts to contact the applicant, the application shall be considered abandoned under Business and Professions Code section 142.

(c) An applicant may reapply at any time following an abandoned application.

(d) The Bureau will not refund application fees for an incomplete or abandoned application.

Authority: Section 26013, Business and Professions Code. Reference: Sections 124, 142, 26050 and 26051.5, Business and Professions Code.

§ 5013. Withdrawal of Application.

- (a) An applicant may withdraw an application at any time prior to the Bureau’s issuance of a license or denial of a license.
- (b) Requests to withdraw an application must be submitted to the Bureau in writing, dated, and signed by the applicant.
- (c) In accordance with Business and Professions Code section 118, withdrawal of an application shall not, unless the Bureau has consented in writing to such withdrawal, deprive the Bureau of its authority to institute or continue a proceeding against the applicant for the denial of the license upon any ground provided by law or to enter an order denying the license upon any such ground.
- (d) The Bureau will not refund application fees for a withdrawn application.
- (e) An applicant may reapply at any time following the withdrawal of an application and will be required to submit a new application and fee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 118 and 26050, Business and Professions Code.

Article 3. Licensing

§ 5014. Fees.

- (a) The application fee for an annual license under section 5002 of this division, a cannabis event organizer license under section 5600 of this division, a temporary cannabis event license under section 5601 of this division for each event, and physical modification of the premises under section 5027 of this division shall be paid by an applicant or licensee as provided by this division. Applicants and licensees shall pay the appropriate fee as outlined in this section.

**Application Fee
Schedule**

License Type	Fee Per Application
All Annual Licenses	\$ 1,000
Cannabis Event Organizer License	\$ 1,000
Temporary Cannabis Event License	\$ 1,000
Physical Modification of Premises	\$ 500

- (b) The annual licensing fee for each license shall be paid by an applicant or licensee after the Bureau has approved the application. The Bureau shall not issue the license until the annual licensing fee has been paid.
- (c) To determine the appropriate license fee due, the applicant or licensee shall first estimate the gross revenue for the 12-month license period of the license. Based on the license type sought, the applicant or licensee shall identify the appropriate tier category in which their

expected gross revenue belongs, as identified in the Annual License Fee Schedule chart found in this section. The license fee associated with the licensing tier category the applicant or licensee has identified using their expected gross revenue shall be the license fee due for the application or renewal.

Annual License Fee Schedule

License Type	Gross Revenue (\$ Max. Per License)	Fee Per License
Testing Laboratory Type 8	Less than or equal to \$160,000	\$3,000
	More than \$160,000 and less or equal to \$320,000	\$6,000
	More than \$320,000 and less or equal to \$480,000	\$8,000
	More than \$480,000 and less or equal to \$800,000	\$13,000
	More than \$800,000 and less or equal to \$1.2 million	\$20,000
	More than \$1.2 million and less or equal to \$2.0 million	\$32,000
	More than \$2.0 million and less or equal to \$2.8 million	\$48,000
	More than \$2.8 million and less or equal to \$4.4 million	\$72,000
	More than \$4.4 million	\$112,000
Distributor Type 11 Type 13 (unless only engaging in transport only self-distribution)	Less than or equal to \$1.0 million	\$1,500
	More than \$1.0 million and less or equal to \$2.5 million	\$6,000
	More than \$2.5 million and less or equal to \$5.0 million	\$11,250
	More than \$5.0 million and less or equal to \$10.0 million	\$22,500
	More than \$10.0 million and less or equal to \$20.0 million	\$45,000
	More than \$20.0 million and less or equal to \$30.0 million	\$75,000

	More than \$30.0 million and less or equal to \$50.0 million	\$120,000
	More than \$50.0 million and less or equal to \$70.0 million	\$180,000
	More than \$70.0 million	\$240,000
Distributor Transport Only Self-Distribution Type 13	Less than or equal to \$1,000	\$200
	More than \$1,000 and less or equal to \$3,000	\$500
	More than \$3,000	\$1,000
Retailer Type 9 Type 10	Less than or equal to \$500,000	\$2,500
	More than \$500,000 and less or equal to \$750,000	\$5,500
	More than \$750,000 and less or equal to \$1.0 million	\$7,500
	More than \$1.0 million and less or equal to \$1.5 million	\$11,000
	More than \$1.5 million and less or equal to \$2.0 million	\$14,500
	More than \$2.0 million and less or equal to \$3.0 million	\$22,500
	More than \$3.0 million and less or equal to \$4.0 million	\$30,500
	More than \$4.0 million and less or equal to \$5.0 million	\$38,500
	More than \$5.0 million and less or equal to \$6.0 million	\$46,500
	More than \$6.0 million and less or equal to \$7.5 million	\$57,000
	More than \$7.5 million	\$96,000
Microbusiness Type 12	Less than or equal to \$1.0 million	\$5,000
	More than \$1.0 and less or equal to \$2.0 million	\$12,000
	More than \$2.0 and less or equal to \$3.00 million	\$20,000

	More than \$3.0 and less or equal to \$4.0 million	\$32,000
	More than \$4.0 and less or equal to \$6.0 million	\$45,000
	More than \$6.0 and less or equal to \$7.0 million	\$60,000
	More than \$7.0 and less or equal to \$10.0 million	\$80,000
	More than \$10.0 and less or equal to \$20.0 million	\$100,000
	More than \$20.0 and less or equal to \$30.0 million	\$120,000
	More than \$30.0 and less or equal to \$40.0 million	\$140,000
	More than \$40.0 and less or equal to \$50.0 million	\$160,000
	More than \$50.0 and less or equal to \$60.0 million	\$180,000
	More than \$60.0 and less than or equal to \$80.0 million	\$220,000
	More than \$80 million	\$300,000

(d) Notwithstanding the fees identified above, cannabis event organizers shall pay the appropriate fee as outlined in this section.

Annual License Fee Schedule for Cannabis Event Organizers

License Type	Planned Operations (Number of Operations)	Fee Per License
Cannabis Event Organizer	0-5 events annually	\$3,000
	6-10 events annually	\$5,000
	11-20 events annually	\$9,000
	Greater than 20 events annually	\$20,000

(e) All fees are nonrefundable.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26051.5 and 26180, Business and Professions Code.

§ 5015. Payment of Fees.

- (a) Any fee specified in this division shall be made to the Bureau of Cannabis Control by cash, check, money order, debit card, or credit card. Check and money order payments may be made out to the Bureau of Cannabis Control or the Department of Consumer Affairs.
- (b) If the fee is paid by debit or credit card:
 - (1) The payment shall be made through the Bureau's online licensing system; and
 - (2) The applicant or licensee may be required to pay any associated processing or convenience fees to the third-party vendor processing the payment on behalf of the Bureau.
- (c) Failure to pay the appropriate licensing fee is grounds for discipline. If the Bureau determines that the licensee paid an amount less than the appropriate licensing fee under section 5014 of this division, the licensee will be required to pay the balance of the appropriate fee and a penalty fee of 50 percent of the appropriate licensing fee. The Bureau in its discretion may waive the penalty fee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26051.5 and 26180, Business and Professions Code.

§ 5016. Priority Licensing.

- (a) Priority licensing is available for annual licenses only, and is not applicable to any temporary or cannabis event organizer license.
- (b) To be eligible for priority licensing, an applicant must be able to demonstrate that the applicant operated in compliance with the Compassionate Use Act of 1996 and its implementing laws before September 1, 2016. Eligibility for priority licensing shall be established by one of the following methods:
 - (1) The applicant is included on the list provided to the Bureau by the local jurisdiction in response to the Bureau's request required by Business and Professions Code section 26054.2.
 - (2) If the local jurisdiction does not provide a list to the Bureau or the applicant's name does not appear on the list provided to the Bureau, the applicant shall provide to the Bureau evidence of operation in compliance with the Compassionate Use Act of 1996. Such evidence shall be in the form of a document issued or signed by the applicant's local jurisdiction that contains the following:
 - (A) Name of the applicant;
 - (B) Address of the premises to be licensed;
 - (C) License type(s) that the applicant is applying to the Bureau for;
 - (D) Name of the local jurisdiction;
 - (E) Name of the local jurisdiction office that is responsible for enforcing compliance with the Compassionate Use Act of 1996;
 - (F) Name and contact information for the person authorized by the local jurisdiction to sign on its behalf;

- (G) Signature of the person authorized to sign on behalf of the local jurisdiction; and
- (H) A statement to the effect of: “The above–named party is currently conducting commercial cannabis activity in this jurisdiction and has been operating in compliance with the Compassionate Use Act of 1996 since before September 1, 2016.”
- (c) The Bureau shall not provide priority licensing pursuant to this section after December 31, 2019.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26054.2, Business and Professions Code.

§ 5017. Substantially Related Offenses and Criteria for Rehabilitation.

- (a) For the purpose of license denial, convictions that are substantially related to the qualifications, functions, or duties of the business for which the application is made include:
 - (1) A violent felony conviction, as specified in Penal Code section 667.5(c).
 - (2) A serious felony conviction, as specified in Penal Code section 1192.7(c).
 - (3) A felony conviction involving fraud, deceit, or embezzlement.
 - (4) A felony conviction for hiring, employing, or using a minor in transporting, carrying, selling, giving away, preparing for sale, or peddling, any controlled substance to a minor; or selling, offering to sell, furnishing, offering to furnish, administering, or giving any controlled substance to a minor.
 - (5) A felony conviction for drug trafficking with enhancements pursuant to Health and Safety Code section 11370.4 or 11379.8.
- (b) Except as provided in subsections (a)(4) and (a)(5) of this section and notwithstanding Chapter 2 (commencing with Section 480) of Division 1.5 of the Business and Professions Code, a prior conviction, where the sentence, including any term of probation, incarceration, or supervised release, is completed, for possession of, possession for sale, sale, manufacture, transportation, or cultivation of a controlled substance is not considered substantially related, and shall not be the sole ground for denial of a license. Conviction for any controlled substance felony subsequent to licensure shall be grounds for revocation of a license or denial of the renewal of a license.
- (c) When evaluating whether an applicant who has been convicted of a criminal offense that is substantially related to the qualifications, functions, or duties of the business for which the application is made should be issued a license, the Bureau shall consider the following criteria of rehabilitation:
 - (1) The nature and severity of the act or offense;
 - (2) Whether the person has a felony conviction based on possession or use of cannabis or cannabis products that would not be a felony if the person was convicted of the offense on the date of the person’s application;
 - (3) The applicant’s criminal record as a whole;

(4) Evidence of any act committed subsequent to the act or offense under consideration that could be considered grounds for denial, suspension, or revocation of a commercial cannabis activity license;

(5) The time that has elapsed since commission of the act or offense;

(6) The extent to which the applicant has complied with any terms of parole, probation, restitution, or any other sanctions lawfully imposed against the applicant;

(7) If applicable, evidence of dismissal under Penal Code sections 1203.4, 1203.4a, 1203.41 or another state's similar law;

(8) If applicable, a certificate of rehabilitation obtained under Penal Code section 4852.01 or another state's similar law; and

(9) Other evidence of rehabilitation submitted by the applicant.

(d) If an applicant has been denied a license based on a conviction, the applicant may request a hearing pursuant to Business and Professions Code section 26058 to determine if the applicant should be issued a license.

Authority: Section 26013, Business and Professions Code. Reference: Sections 482, 26012 and 26057, Business and Professions Code.

§ 5018. Additional Grounds for Denial of a License.

In addition to the reasons for denial in Business and Professions Code section 26057, a license may be denied for the following reasons:

(a) The applicant's proposed premises does not fully comply with standards set in regulation.

(b) The applicant's proposed or licensed premises is substantially different from the diagram of the proposed premises submitted by the applicant, in that the size, layout, location of common

entryways, doorways, or passage ways means of public entry or exit, or identification of limited-access areas within the licensed premises is not the same.

(c) The applicant denied the Bureau access to the licensed premises.

(d) The applicant made a material misrepresentation on the application.

(e) The applicant did not correct the deficiencies within the application in accordance with sections 5002 and 5012 of this division.

(f) The applicant has been denied a license, permit, or other authorization to engage in commercial cannabis activity by a state or local licensing authority.

(g) The applicant's proposed premises is not in compliance with Division 13 (commencing with Section 21000) of the Public Resources Code.

(h) The applicant has failed to remit taxes as required under the Revenue and Taxation Code.

(i) The applicant may be denied a license for any violations of law related to the operations of the commercial cannabis business or for any violations of law related to licensure.

Authority: Section 26013, Business and Professions Code. Reference: Sections 480, 490, 26012, 26030 and 26050, Business and Professions Code.

§ 5019. Excessive Concentration.

(a) In determining whether to grant, deny, or renew a license for a retail premises or microbusiness premises authorized to engage in retail sales, the Bureau shall consider if an excessive concentration exists in the area where the licensee will operate. For the purposes of this section “excessive concentration” applies when either of the following conditions exist:

(1) The ratio of licensees to population within the census tract or census division in which the applicant premises is located exceeds the ratio of licensees to population in the county in which the applicant premises is located, unless denial of the application would unduly limit the development of the legal market so as to perpetuate the illegal market for cannabis goods.

(2) The ratio of retail licenses or microbusiness licenses to the population within the census tract, census division, or jurisdiction exceeds that allowable by local ordinance adopted under Business and Professions Code section 26200.

(b) “Population Within the Census Tract or Census Division” as used in this section means the population as determined by the most recent United States decennial or special census. Such population determination shall not operate to prevent an applicant from establishing that an increase of resident population has occurred within the census tract or census division.

(c) “Population in the County” as used in this section shall be determined by the most recent annual population estimate for California counties published by the Demographic Research Unit, State Department of Finance.

(d) Beginning July 1, 2018, the Bureau shall calculate the ratios described in subsection (a) of this section once every six months using the most current available data. The Bureau’s consideration of whether to grant, deny, or renew a license shall be based upon the most recent ratio calculated by the Bureau on the date of the Bureau’s decision.

(e) The existence of an excessive concentration shall not be considered in determining whether to grant, deny, or extend a temporary license under Business and Professions Code section 26050.1.

(f) The applicant may provide reliable evidence establishing, to the satisfaction of the Bureau, that a denial of a license would unduly limit the development of the legal market so as to perpetuate the illegal market for cannabis goods.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26051, Business and Professions Code.

§ 5020. Renewal of License.

(a) To timely renew a license, a completed license renewal form and annual license fee pursuant to section 5014 of this division shall be received by the Bureau from the licensee no earlier than 60 calendar days before the expiration of the license and no later than 5:00 p.m. Pacific Time on the last business day before the expiration of the license if the renewal form is submitted to the Bureau at its office(s), or no later than 11:59 p.m. on the last business day before the expiration of the license if the renewal form is submitted to the Bureau through its

electronic licensing system. Failure to receive a notice for license renewal does not relieve a licensee of the obligation to renew all licenses as required.

(b) In the event the license is not submitted for renewal prior to the expiration date, the licensee must not sell, transfer, transport, manufacture, test, or distribute any commercial cannabis goods until the license is renewed.

(c) A licensee may submit a license renewal form up to 30 calendar days after the license expires. Any late renewal form will be subject to a late fee equal to 50 percent of the applicable licensing fee required by subsection (a) of this section.

(d) The license renewal form shall contain the following:

(1) The name of the licensee. For licensees who are individuals, the applicant shall provide both the first and last name of the individual. For licensees who are business entities, the licensee shall provide the legal business name of the applicant.

(2) The license number and expiration date.

(3) The licensee's address of record and licensed premises address.

(4) Documentation demonstrating the licensee's gross revenue for the current licensed period, such as a copy of the licensee's state tax return filed with the California Department of Tax and Fee Administration.

(5) Documentation of any change to any item listed in the original application under section 5002 of this division that has not been reported to the Bureau through another process pursuant to the Act or this division.

(6) An attestation that all information provided to the Bureau in the license renewal form and the original application under section 5002 of this division or subsequent notification under sections 5023 and 5024 of this division is accurate and current.

(7) A limited waiver of sovereign immunity pursuant to section 5009 of this division.

(8) For a licensee with more than one employee, the licensee shall attest that it employs, or will employ within one year of renewing the license, one supervisor and one employee who has successfully completed a Cal-OSHA 30-hour general industry outreach course offered by a training provider that is authorized by an OSHA Training Institute Education Center to provide the course.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26050, Business and Professions Code.

§ 5021. Denial of License.

(a) The Bureau may deny an application for a new license or a renewal of a license for any reason specified in Business and Professions Code section 26057, and on any additional grounds including grounds for denial under section 5018 of this division, and grounds for discipline under the Act or this division.

(b) Upon denial of an application for a license or renewal of a license, the Bureau shall notify the applicant in writing of the reasons for denial, and the right to a hearing to contest the denial.

(c) The applicant may request a hearing to contest the denial by submitting a written request to the Bureau.

(1) The written request for a hearing must be postmarked within 30 calendar days of service of the notification of denial.

(2) If the written request for a hearing is not received within the required timeframe, the applicant's right to a hearing is waived.

(3) Upon timely receipt of the written request for hearing, the Bureau shall set a date for hearing to be conducted in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

Authority: Section 26013, Business and Professions Code; Reference: Sections 26012, 26057 and 26058, Business and Professions Code.

§ 5022. Cancellation of License.

(a) Every licensee who abandons, quits, or closes the licensed premises for a period exceeding 30 consecutive calendar days shall request in writing that the Bureau cancel the license, within 14 calendar days after closing, quitting, or abandoning the licensed premises, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), incorporated herein by reference. The Bureau may revoke the license of a licensee who fails to comply with the provisions of this section. Upon cancellation or revocation of the license, the licensee shall not display and shall destroy the license certificate.

(b) The Bureau may cancel a license at any time upon request by the licensee if there are no outstanding fines or fees due to the Bureau and no disciplinary action is pending.

(c) If a licensee must close the licensed premises for a period exceeding 30 consecutive calendar days to make renovations or repairs, the Bureau may allow the licensee to retain the license if the licensee complies with section 5027 of this division.

(d) A person whose license has been cancelled or revoked pursuant to subsection (a) of this section may submit to the Bureau a written request for the license to be reinstated. Any request shall be submitted to the Bureau prior to the expiration date listed on the cancelled or revoked license. The written request shall specify the reason the licensee failed to comply with subsection (a) of this section and why the license should be reinstated. The Bureau in its discretion may reinstate the license.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26050, Business and Professions Code.

§ 5023. Business Modifications.

Business modifications to items contained in the application shall be made in accordance with the following:

(a) Changes to standard operating procedures may be made without providing notification to the Bureau, except at renewal as required under section 5020 of this division. Licensees shall maintain a copy of all current and prior operating procedures as required by section 5037 of

this division.

(b) If at the time of licensure, a licensee employed less than 20 employees and later employs 20 or more employees, the licensee shall provide to the Bureau a document attesting that the licensee has entered into a labor peace agreement and will abide by the terms of the agreement, as soon as reasonably practicable once employing 20 or more employees. Once the licensee has entered into the labor peace agreement, the licensee shall provide the Bureau with a copy of the page of the labor peace agreement that contains the signatures of the union representative and the applicant.

(c) Licenses are not transferrable or assignable to another person or owner. In the event of the sale or other transfer of the business or operations covered by the licensee, changes in ownership shall be made in accordance with the following:

(1) If one or more of the owners of a license change, the new owners shall submit the information required under section 5002(c)(20) for each new owner to the Bureau within 14 calendar days of the effective date of the ownership change. The business may continue to operate under the active license while the Bureau reviews the qualifications of the new owner(s) in accordance with the Act and these regulations to determine whether the change would constitute grounds for denial of the license, if at least one existing owner is not transferring his or her ownership interest and will remain as an owner under the new ownership structure. If all owners will be transferring their ownership interest, the business shall not operate under the new ownership structure until a new license application has been submitted to and approved by the Bureau, and all application and license fees for the new application have been paid.

(A) A change in ownership occurs when a new person meets the definition of owner in section 5003 of this division.

(B) A change in ownership does not occur when one or more owners leave the business by transferring their ownership interest to the other existing owner(s).

(2) In cases where one or more owners leave the business by transferring their ownership interest to the other existing owner(s), the owner or owners that are transferring their interest shall provide a signed statement to the Bureau confirming that they have transferred their interest.

(d) When there is a change in persons with financial interest(s) in the commercial cannabis business that do not meet the requirements for a new license application under this section, the licensee shall submit the information required by sections 5002(c)(19) and 5004 of this division to the Bureau within 14 calendar days of the change.

(e) When any of the following changes occur, the licensee shall notify the Bureau within 14 calendar days of the change:

(1) Any change to contact information from the information provided to the Bureau in the original application.

(2) Any change in name if the licensee is an individual, or any change in legal business name if the licensee is a business entity.

(3) Any change in business trade name (DBA) or fictitious business names.

(4) Any change to financial information including funds, loans, investments, and gifts required in the original application under section 5002(c)(18) of this division.

(5) Any change in the bond required under section 5008 of this division.

(6) Any change or lapse in insurance coverage required under section 5308 of this division.

(f) Licensees may request to add an A-designation or M-designation to their license by sending a notification to the Bureau signed by at least one owner as defined in section 5003 of this division. A licensee shall not operate under the requested designation until they have received approval from the Bureau.

(g) Microbusiness licensees may add a commercial cannabis activity to their license or remove a commercial cannabis activity from their license if doing so is consistent with the requirement set forth in section 5500(a) of this division that licensees engage in at least three (3) commercial cannabis activities. Licensees shall request the modification by completing a request to modify the licensed premises pursuant to section 5027 of this division. A licensee shall not engage in a new commercial cannabis activity until they have paid for the modification and received approval from the Bureau.

(h) Licenses may not be transferred from one premises to another. Licensees shall not operate out of a new premises until they have been issued a new license.

(i) For any business modification or notification under this section, licensees shall use and submit to the Bureau the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference, unless the change can be made through the Bureau's online system.

Authority: Section 26013, Business and Professions Code. Reference: Sections 136 and 26012, Business and Professions Code.

§ 5024. Death, Incapacity, or Insolvency of a Licensee.

(a) In the event of the death, incapacity, receivership, assignment for the benefit of creditors or other event rendering one or more owners incapable of performing the duties associated with the license, the owner or owners' successor in interest (e.g., appointed guardian, executor, administrator, receiver, trustee, or assignee) shall notify the Bureau in writing, within 14 calendar days, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

(b) To continue operations or cancel the existing license, the successor in interest shall submit to the Bureau the following:

(1) The name of the successor in interest.

(2) The name of the owner(s) for which the successor in interest is succeeding and the license number;

(3) The phone number, mailing address, and email address of the successor in interest; and

(4) Documentation demonstrating that the owner(s) is incapable of performing the duties associated with the license such as a death certificate or a court order, and documentation demonstrating that the person making the request is the owner or owners' successor in interest such as a court order appointing guardianship, receivership, or a will or trust agreement.

(c) The Bureau may give the successor in interest written approval to continue operations on the licensed business premises for a period of time specified by the Bureau:

(1) If the successor in interest or another person has applied for a license from the Bureau for the licensed premises and that application is under review;

(2) If the successor in interest needs additional time to destroy or sell cannabis goods; or

(3) At the discretion of the Bureau.

(d) The successor in interest is held subject to all terms and conditions under which a state cannabis license is held pursuant to the Act.

(e) The approval creates no vested right to the issuance of a state cannabis license.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code.

§ 5024.1. Cannabis Goods After Termination of License.

In the event a license is terminated for any reason while cannabis goods remain on the premises, the following actions may be taken:

(a) The cannabis goods may be destroyed by the former licensee; or

(b) A licensed distributor or licensed microbusiness authorized to engage in distribution may be authorized by the Bureau to purchase and distribute the former licensee's entire inventory stock in accordance with the following:

(1) A licensed distributor or licensed microbusiness authorized to engage in distribution shall, within 14 calendar days of the termination of the former licensee's license, submit a written request to the Bureau, on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated by reference, for authorization to purchase the cannabis goods from the former licensee; and

(2) Upon approval from the Bureau, the licensed distributor or licensed microbusiness authorized to engage in distribution shall transport the cannabis goods to their premises, arrange for laboratory testing, and perform quality assurance in accordance with Chapter 2 of this division. If the cannabis goods have already been tested in accordance with Chapter 6 of this division and have a valid certificate of analysis for regulatory compliance testing that is less than 12 months old, the cannabis goods are not required to undergo additional testing.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5 and 26013, Business and Professions Code.

§ 5025. Premises.

(a) Each license shall have a designated licensed premises, with a distinct street address and suite number if applicable, for the licensee's commercial cannabis activity. Each licensed premises shall be subject to inspection by the Bureau.

(b) The Bureau may allow a licensee to conduct both adult-use and medicinal commercial cannabis activity on the same licensed premises if all of the following

criteria are met:

- (1) The licensee holds both an A-designation and an M-designation on the license for the identical type of commercial cannabis activity; and
 - (2) The licensee only conducts one type of commercial cannabis activity on the licensed premises.
- (c) Licensed retailers and licensed microbusinesses authorized to engage in retail sales shall only serve customers who are within the licensed premises, or at a delivery address that meets the requirements of this division.
- (1) The sale and delivery of cannabis goods shall not occur through a pass-out window or a slide-out tray to the exterior of the licensed premises.
 - (2) Licensed retailers or licensed microbusinesses authorized to engage in retail sales shall not operate as or with a drive-in or drive-through at which cannabis goods are sold to persons within or about a motor vehicle.
 - (3) No cannabis goods shall be sold and/or delivered by any means or method to any person within a motor vehicle.
- (d) Alcoholic beverages as defined in Business and Professions Code section 23004 shall not be stored or consumed on a licensed premises.
- (e) Any licensed premises that is adjacent to another premises engaging in manufacturing or cultivation shall be separated from those premises by walls, and any doors leading to the cultivation or manufacturing premises shall remain closed.
- (f) Cannabis shall not be dispersed in the air throughout the premises or throughout a portion of the premises by an oil diffuser or any other vaporizing device that is intended to disperse the vapor throughout the premises or throughout a portion of the premises. This section shall not be interpreted to prohibit cannabis consumption on the premises of a licensed retailer or licensed microbusiness authorized to engage in retail sales that is conducted in accordance with Business and Professions Code section 26200(g).
- (g) Notwithstanding subsection (c) of this section, an applicant or licensee may have a drive-in or drive-through window only if, prior to June 1, 2018:
- (1) The licensee or applicant received a license or permit from the local jurisdiction for a premises including a drive-in or drive-through window which was disclosed on the local application; or
 - (2) The licensee or applicant has submitted an application to the local jurisdiction for a license or permit which, at the time of submission of the application, included information that a drive-in or drive-through window was already part of, or proposed to be part of, the premises, and after June 1, 2018, the local jurisdiction approves the premises with a drive-in or drive-through window.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26001, 26012 and 26053, Business and Professions Code.

§ 5026. Premises Location.

(a) A premises licensed under this division shall not be located within a 600-foot radius of a school providing instruction in kindergarten or any grades 1 through 12, day care center, or youth center that is in existence at the time the license is issued.

(b) Notwithstanding subsection (a) of this section, if a local jurisdiction has issued a license or permit to conduct commercial cannabis activity at a premises that is located within a 600-foot radius of a school providing instruction in kindergarten or any grades 1 through 12, day care center, or youth center, the Bureau may approve the premises for licensure if the following conditions are met:

(1) The applicant submits a copy of a valid license or permit from the local jurisdiction with the application for licensure; and

(2) The local jurisdiction notifies the Bureau that the applicant is in compliance with all applicable local ordinances and regulations pursuant to Business and Professions Code section 26055(g)(2)(C).

(c) A licensed premises shall not be in a location that requires persons to pass through a business that sells alcohol or tobacco or a private residence to access the licensed premises.

(d) A licensed premises shall not be in a location that requires persons to pass through the licensed premises to access a business that sells alcohol or tobacco or a private residence.

(e) A licensed premises shall not be located within a private residence.

(f) Licensees shall ensure that the Bureau has immediate access to their licensed premises. If the Bureau is denied access to a licensee's premises for any reason, the licensee shall be held responsible and subject to discipline. If the Bureau is denied access to one licensee's premises because of another licensee's refusal to grant access when the only access to one licensed premises is through another licensed premises, all licensees shall be held responsible and subject to discipline.

(g) Nothing in this section shall be interpreted to prohibit two or more licensed premises from occupying separate portions of the same parcel of land or sharing common use areas, such as a bathroom, breakroom, hallway, or building entrance.

(h) All structures included as part of the licensed premises shall be permanently affixed to the land by a method that would cause the structure to ordinarily remain affixed for an indefinite period of time. Structures that will not be considered to be permanent structures include, but are not limited to, shipping containers that are not affixed to the land, modular buildings that are not affixed to the land, structures that rest on wheels, or any structure that can be readily moved.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26051.5, 26054 and 26055, Business and Professions Code.

§ 5027. Physical Modification of Premises.

(a) A licensee shall not, without the prior written approval of the Bureau, make a physical change, alteration, or modification of the licensed premises that materially or substantially alters the licensed premises or the use of the licensed premises from the premises diagram originally filed with the license application. A licensee whose licensed premises is to be materially or substantially changed, modified, or altered is responsible for filing a request for premises modification with the Bureau.

(b) Material or substantial changes, alterations, or modifications requiring approval include, but are not limited to:

(1) The removal, creation, or relocation of a common entryway, doorway, passage, or a means of public entry or exit, when such common entryway, doorway, or passage alters or changes limited-access areas within the licensed premises;

(2) The removal, creation, or relocation of a wall or barrier; or

(3) Changing the activities conducted in or the use of an area identified in the last premises diagram provided to the Bureau.

(c) A licensee shall request approval of a physical change, alteration, or modification in writing, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference, and the request shall include:

(1) A new premises diagram that conforms to requirements in section 5006 of this division; and

(2) A fee pursuant to section 5014 of this division.

(d) A licensee shall provide additional documentation requested by the Bureau to evaluate the licensee's request to modify the licensed premises.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26055, Business and Professions Code.

§ 5028. Subletting of Premises.

A licensee shall not sublet any area designated as the licensed premises for the licensee's commercial cannabis activity.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26070, Business and Professions Code.

§ 5030. Licensee's Responsibility for Acts of Employees and Agents.

In construing and enforcing the provisions of the Act and the regulations in this division, the act, omission, or failure of an agent, officer, representative, or other person acting for or employed by a licensee, within the scope of his or her employment or office, shall in every case be deemed the act, omission, or failure of the licensee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26031 and 26110, Business and Professions Code.

§ 5031. Age Restriction.

Employees or persons retained by a licensee to work within or on a licensed premises or to handle cannabis goods shall be at least 21 years of age.

Authority: Section 26013, Business and Professions Code. Reference: Section 26140, Business and Professions Code.

§ 5032. Commercial Cannabis Activity.

(a) All commercial cannabis activity shall be conducted between licensees. Licensed retailers

and licensed microbusinesses authorized to engage in retail sales may conduct commercial cannabis activity with customers in accordance with Chapter 3 of this division.

(b) Licensees shall not conduct commercial cannabis activities on behalf of, at the request of, or pursuant to a contract with any person who is not licensed under the Act.

(c) Licensees may conduct business with other licensees irrespective of the M-designation or A-designation on their licenses.

(d) Licensed distributors or licensed microbusinesses authorized to engage in distribution shall only transport and sell cannabis goods designated as “For Medical Use Only,” pursuant to the requirements prescribed by the State Department of Public Health in regulation, to M-designated retailers or M-designated microbusinesses authorized to engage in retail sales.;

(e) Products designated as “For Medical Use Only,” pursuant to requirements prescribed by the State Department of Public Health in regulation, shall only be sold to medicinal customers by M-designated retailers or M-designated microbusinesses authorized to engage in retail sales.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26001, 26013 and 26053, Business and Professions Code.

§ 5033. Storage of Inventory.

(a) All inventory stored on the licensed premises shall be secured in a limited-access area.

(b) A licensee shall not store cannabis goods outdoors.

(c) Employee break rooms, changing facilities, and bathrooms shall be separated from all storage areas.

(d) Each location where cannabis goods are stored must be separately licensed.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26070, Business and Professions Code.

§ 5034. Significant Discrepancy in Inventory.

A determination by a licensee on whether a discrepancy in inventory is significant shall be made in accordance with the following:

(a) A significant discrepancy in inventory means a difference in actual inventory compared to records pertaining to inventory of at least 3 percent of the average monthly sales of the licensee.

(b) For the purposes of this section, average monthly sales shall be calculated by taking a per month average of the total sales for the previous 6 months. If the licensee has not been in operation for at least 6 months, only the months in which the licensee was operating shall be used in determining average monthly sales.

(c) For the purposes of this section, the licensee’s acquisition price shall be used to determine the value of cannabis goods in a licensee’s inventory.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070,

Business and Professions Code.

§ 5035. Notification of Criminal Acts, Civil Judgments, Violations of Labor Standards, and Revocation of a Local License, Permit, or Other Authorization After Licensure.

(a) A licensee shall ensure that the Bureau is notified in writing of a criminal conviction of any owner, either by mail or electronic mail, within 48 hours of the conviction. The written notification to the Bureau shall include the date of conviction, the court docket number, the name of the court in which the licensee was convicted, and the specific offense(s) for which the licensee was convicted.

(b) A licensee shall ensure that the Bureau is notified in writing of a civil penalty or judgment rendered against the licensee or any owner in their individual capacity, either by mail or electronic mail, within 48 hours of delivery of the verdict or entry of judgment, whichever is sooner. The written notification shall include the date of verdict or entry of judgment, the court docket number, the name of the court in which the matter was adjudicated, and a description of the civil penalty or judgment rendered against the licensee.

(c) A licensee shall ensure that the Bureau is notified in writing of an administrative order or civil judgment for violations of labor standards against the licensee or any owner in their individual capacity, either by mail or electronic mail, within 48 hours of delivery of the order. The written notification shall include the date of the order, the name of the agency issuing the order, and a description of the administrative penalty or judgment rendered against the licensee.

(d) A licensee shall ensure that the Bureau is notified in writing of the revocation of a local license, permit, or other authorization, either by mail or electronic mail, within 48 hours of receiving notice of the revocation. The written notification shall include the name of the local agency involved, a written explanation of the proceeding or enforcement action, and the specific violation(s) that led to revocation.

(e) For any notification required under this section, licensees shall use and submit to the Bureau the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26030 and 26031, Business and Professions Code.

§ 5036. Notification of Theft, Loss, and Criminal Activity.

(a) A licensee shall notify the Bureau and local law enforcement within 24 hours of discovery of any of the following situations:

(1) The licensee discovers a significant discrepancy, as defined in section 5034 of this division, in its inventory.

(2) The licensee discovers diversion, theft, loss, or any other criminal activity pertaining to the operations of the licensee.

(3) The licensee discovers diversion, theft, loss, or any other criminal activity by an agent or employee of the licensee pertaining to the operations of the licensee.

(4) The licensee discovers loss or unauthorized alteration of records related to cannabis

goods, customers, or the licensee's employees or agents.

(5) The licensee discovers any other breach of security.

(b) The notification to the Bureau pursuant to subsection (a) of this section shall be submitted on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference, and shall include the date and time of occurrence of the theft, loss, or criminal activity, the name of the local law enforcement agency that was notified, and a description of the incident including, where applicable, the item(s) that were taken or lost.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5037. Record Retention.

(a) Each licensee shall keep and maintain the following records related to commercial cannabis activity for at least seven years:

(1) Financial records including, but not limited to, bank statements, sales invoices, receipts, tax records, and all records required by the California Department of Tax and Fee Administration

(formerly Board of Equalization) under title 18, California Code of Regulations, sections 1698 and 4901.

(2) Personnel records, including each employee's full name, social security or individual tax payer identification number, date employment begins, and date of termination of employment if applicable.

(3) Training records including, but not limited to, the content of the training provided and the names of the employees that received the training.

(4) Contracts with other licensees regarding commercial cannabis activity.

(5) Permits, licenses, and other local authorizations to conduct the licensee's commercial cannabis activity.

(6) Security records, except for surveillance recordings required pursuant to section 5044 of this division.

(7) Records relating to the composting or destruction of cannabis goods.

(8) Documentation for data or information entered into the track and trace system.

(9) All other documents prepared or executed by an owner or their employees or assignees in connection with the licensed commercial cannabis business.

(b) All required records shall be prepared and retained in accordance with the following conditions:

(1) Records shall be legible; and

(2) Records shall be stored in a secured area where the records are protected from debris, moisture, contamination, hazardous waste, fire, and theft.

(c) The Bureau may make any examination of the books and records of any licensee as it deems necessary to perform its duties under the Act.

(d) All records are subject to review by the Bureau any time the licensee is exercising the privileges of the license or at any other time as mutually agreed to by the Bureau and the licensee. Prior notice by the Bureau to review records is not necessary. The Bureau may review records outside of the licensee's standard daily business hours.

(e) Records shall be kept in a manner that allows records to be produced for the Bureau immediately upon request at the licensed premises in either hard copy or electronic form, whichever the Bureau requests.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26160 and 26161, Business and Professions Code.

§ 5038. Disaster Relief.

(a) If a licensee is unable to comply with any licensing requirements due to a disaster, the licensee may notify the Bureau of this inability to comply and request relief from the specific licensing requirement.

(b) The Bureau may exercise its discretion to provide temporary relief from specific regulatory requirements in this division and from other licensing requirements when allowed by law.

(c) Temporary relief from specific licensing requirements shall be issued for a reasonable amount of time in order to allow the licensee to recover from the disaster.

(d) The Bureau may require that certain conditions be followed in order for a licensee to receive temporary relief from specific licensing requirements.

(e) A licensee shall not be subject to an enforcement action for a violation of a licensing requirement in which the licensee has received temporary relief.

(f) For the purposes of this section, "disaster" means condition of extreme peril to the safety of persons and property within the state or a county, city and county, or city caused by such conditions as air pollution, fire, flood, storm, tidal wave, epidemic, riot, drought, terrorism, sudden and severe energy shortage, plant or animal infestation or disease, Governor's warning of an earthquake or volcanic prediction, or an earthquake, or similar public calamity, other than conditions resulting from a labor controversy, for which the Governor has proclaimed a state of emergency in accordance with Government Code sections 8558 and 8625, or for which a local governing body has proclaimed a local emergency in accordance with Government Code sections 8558 and 8630.

(g) A licensed premises that has been vacated by a licensee due to a disaster shall not be deemed to have been abandoned or quit under section 5022 of this division.

(h) Notwithstanding subsection (a) of this section, if a licensee needs to move cannabis goods stored on the licensed premises to another location immediately to prevent loss, theft, or degradation of the cannabis goods from the disaster, the licensee may move the cannabis goods without obtaining prior approval from the Bureau if the following conditions are met:

(1) The cannabis goods are moved to a secure location where access to the cannabis goods

can be restricted to the licensee, its employees, and contractors;

(2) The licensee notifies the Bureau in writing, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference, that the cannabis goods have been moved and that the licensee is requesting relief from complying with specific licensing requirements pursuant to subsection (a) of this section within 24 hours of moving the cannabis goods;

(3) The licensee agrees to grant the Bureau access to the location where the cannabis goods have been moved to for inspection; and

(4) The licensee submits in writing the Notification and Request Form, BCC-LIC-027 (New 10/18), incorporated herein by reference, to the Bureau within 14 calendar days of moving the cannabis goods a request for temporary relief that clearly indicates what statutory and regulatory sections relief is requested from, the time period for which the relief is requested, and the reasons relief is needed for the specified amount of time.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code.

Article 4. Posting and Advertising

§ 5039. License Posting Requirement.

Upon issuance of any license, the licensee shall prominently display the license on the licensed premises where it can be viewed by state and local agencies. If the licensed premises is open to the public, the license shall be displayed in an area that is within plain sight of the public.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code.

§ 5040. Advertising Placement.

(a) Any advertising or marketing, as defined in Business and Professions Code section 26150, that is placed in broadcast, cable, radio, print, and digital communications:

(1) Shall only be displayed after a licensee has obtained reliable up-to-date audience composition data demonstrating that at least 71.6 percent of the audience viewing the advertising or marketing is reasonably expected to be 21 years of age or older;

(2) Shall not use any depictions or images of minors or anyone under 21 years of age;

(3) Shall not contain the use of objects, such as toys, inflatables, movie characters, cartoon characters, or include any other display, depiction, or image designed in any manner likely to be appealing to minors or anyone under 21 years of age; and

(4) Shall not advertise free cannabis goods or giveaways of any type of products, including non-cannabis products. This includes promotions such as:

(A) Buy one product, get one product free;

(B) Free product with any donation; and

(C) Contests, sweepstakes, or raffles.

(b) In addition to the requirements for advertising and marketing in subsection (a) of this section, all outdoor signs, including billboards, shall:

(1) Be affixed to a building or permanent structure;

(2) Comply with the provisions of the Outdoor Advertising Act, commencing with section 5200 of the Business and Professions Code, if applicable; and

(3) Not be located within a 15-mile radius of the California border on an Interstate Highway or on a State Highway that crosses the California border.

(c) For the purposes of this section, “reliable up-to-date audience composition data” means data regarding the age and location demographics of the audience viewing a particular advertising or marketing medium. “Reliable up-to-date audience composition data” does not include data from the most recent United States decennial or special census, or the annual population estimate for California counties published by the Demographic Research Unit, State Department of Finance.

(d) Immediately upon request, a licensee shall provide to the Bureau audience composition data as required in subsection (a) of this section for advertising or marketing placed by the licensee.

(e) If the Bureau determines that audience composition data for advertising or marketing provided by a licensee does not comply with the requirements of subsection (a) of this section, or the licensee fails to provide audience composition data to the Bureau upon request, the licensee shall remove the advertising or marketing placement in question.

(f) In construing and enforcing the advertising provisions of the Act and this division, any action, omission, or failure of an advertising agent, representative, or contractor retained by the licensee shall in every case be deemed the act, omission, or failure of the licensee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26151 and 26152, Business and Professions Code.

§ 5040.1. Marketing Cannabis Goods as Alcoholic Products.

Licensees shall not sell or transport cannabis goods that are labeled as beer, wine, liquor, spirits, or any other term that may create a misleading impression that the product is an alcoholic beverage as defined in Division 9 of the Business and Professions Code.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26054, 26151 and 26152, Business and Professions Code.

§ 5041. Age Confirmation in Advertising.

(a) Prior to any advertising or marketing from the licensee involving direct, individualized communication or dialogue, the licensee shall use age affirmation to verify that the recipient is 21 years of age or older.

(b) For the purposes of this section, direct, individualized communication or dialogue may occur through any form of communication, including in-person, telephone, physical mail, or electronic.

(c) A method of age verification is not necessary for a communication if the licensee can

verify that the licensee has previously had the intended recipient undergo a method of age affirmation and the licensee is reasonably certain that the communication will only be received by the intended recipient.

(d) A licensee shall use a method of age affirmation before having a potential customer added to a mailing list, subscribe, or otherwise consent to receiving direct, individualized communication or dialogue controlled by a licensee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26151 and 26152, Business and Professions Code.

§ 5041.1 Branded Merchandise Approval.

(a) If a licensed distributor, licensed retailer, or licensed microbusiness authorized to engage in distribution or retail sales wishes to sell branded merchandise that is not listed in section 5000, subsection (b), of this division, the licensee must receive written approval from the Bureau.

(b) To obtain approval, a licensee must submit a written request to the Bureau for approval to sell a specific item of branded merchandise and provide a photograph of the branded merchandise.

Requests may be submitted by mail to the Bureau office or by email to bcc@dca.ca.gov.

(c) The licensee shall not sell the merchandise until receiving written approval from the Bureau for the specific item of branded merchandise.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013 and 26152, Business and Professions Code.

Article 5. Security Measures

§ 5042. Limited-Access Areas.

(a) Licensees shall ensure that only employees of the licensee and other authorized individuals access the limited-access areas of the licensed premises.

(b) For the purpose of this section, authorized individuals include outside vendors, contractors, or other individuals conducting business that requires access to the limited-access areas.

(c) An individual who enters the limited-access area and is not employed by the licensee shall be escorted by an employee of the licensee at all times while within the limited-access area.

(d) A licensee shall maintain a record of all authorized individuals who are not employees of the licensee who enter the limited-access areas. The record shall include the name of the individual, the company the individual works for, the reason the individual entered the limited-access area, the date, and the times the individual entered and exited the limited-access area. These records shall be made available to the Bureau immediately upon request.

(e) A licensee shall not receive consideration or compensation for permitting an individual to enter the limited-access areas.

(f) Entrances to all limited-access areas shall have a solid door and a lock meeting the requirements of section 5046 of this division. The door shall remain closed when not in

use during regular business hours.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26160, Business and Professions Code.

§ 5043. Licensee Employee Badge Requirement.

All agents, officers, or other persons acting for or employed by a licensee shall display a laminated or plastic-coated identification badge issued by the licensee at all times while engaging in commercial cannabis activity. The identification badge shall, at a minimum, include the licensee's "doing business as" name and license number, the employee's first name, an employee number exclusively assigned to that employee for identification purposes, and a color photograph of the employee that clearly shows the full front of the employee's face and that is at least 1 inch in width and 1.5 inches in height.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5044. Video Surveillance System.

(a) Each licensed premises shall have a digital video surveillance system with a minimum camera resolution of 1280 × 720 pixels.

(b) The video surveillance system shall at all times be able to effectively and clearly record images of the area under surveillance.

(c) Each camera shall be permanently mounted and in a fixed location. Each camera shall be placed in a location that allows the camera to clearly record activity occurring within 20 feet of all points of entry and exit on the licensed premises, and allows for the clear and certain identification of any person and activities in all areas required to be filmed under subsection (d) of this section.

(d) Areas that shall be recorded on the video surveillance system include the following:

(1) Areas where cannabis goods are weighed, packed, stored, loaded, and unloaded for transportation, prepared, or moved within the licensed premises;

(2) Limited-access areas;

(3) Security rooms;

(4) Areas storing a surveillance-system storage device with at least one camera recording the access points to the secured surveillance recording area; and

(5) Entrances and exits to the licensed premises, which shall be recorded from both indoor and outdoor vantage points.

(e) Licensed retailers and licensed microbusinesses authorized to engage in retail sales shall also record point-of-sale areas and areas where cannabis goods are displayed for sale on the video surveillance system. At each point-of-sale location, camera placement must allow for the recording of the facial features of any person purchasing or selling cannabis goods, or any person in the retail area, with sufficient clarity to determine identity.

- (f) Cameras shall record continuously 24 hours per day and at a minimum of 15 frames per second (FPS).
- (g) The physical media or storage device on which surveillance recordings are stored shall be secured in a manner to protect the recording from tampering or theft.
- (h) Surveillance recordings shall be kept for a minimum of 90 calendar days.
- (i) Surveillance recordings are subject to inspection by the Bureau, and shall be kept in a manner that allows the Bureau to view and obtain copies of the recordings at the licensed premises immediately upon request. The licensee shall also send or otherwise provide copies of the recordings to the Bureau upon request within the time specified by the Bureau.
- (j) Recorded images shall clearly and accurately display the time and date. Time is to be measured in accordance with the standards issued by the United States National Institute of Standards and Technology.
- (k) The video surveillance system shall be equipped with a failure notification system that provides notification to the licensee of any interruption or failure of the video surveillance system or video surveillance-system storage device.
- (l) If multiple licensed premises are contained within the same building, a single video surveillance system covering the entire building may be used by all of the licensees under the following conditions:
- (1) Each applicant or licensee shall disclose on their premises diagram where the surveillance recordings are stored.
 - (2) Each applicant or licensee shall include in their security operating procedures, submitted with the application pursuant to section 5002(c)(29)(D) of this division, an explanation of how the video surveillance system will be shared, including who is responsible for monitoring the video footage and storing any video recordings.
 - (3) All licensees shall have immediate access to the surveillance recordings to produce them pursuant to subsection (i) of this section.
 - (4) All licensees shall be held responsible and subject to discipline for any violations of the video surveillance requirements.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5045. Security Personnel.

- (a) A licensed retailer or licensed microbusiness authorized to engage in retail sales shall hire or contract for security personnel who are at least 21 years of age to provide on-site security services for the licensed retail premises during the hours of operation. All security personnel hired or contracted for by the licensee shall be licensed by the Bureau of Security and Investigative Services and shall comply with Chapters 11.4 and 11.5 of Division 3 of the Business and Professions Code.
- (b) Notwithstanding subsection (a) of this section, a licensed non-storefront retailer or licensed microbusiness who is not engaged in storefront retail sale is not required to hire or contract for

security personnel.

(c) If multiple licensed premises are contained within the same building, security personnel may be shared by all of the licensees to cover the entire building under the following conditions:

(1) Each licensee shall include in their security operating procedures, submitted with the application pursuant to section 5002(c)(29)(D) of this division, an explanation of how security personnel will be shared, including who is responsible for employing or contracting the security personnel.

(2) All licensees shall be held responsible and subject to discipline for any violations of the security personnel requirements.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5046. Locks.

A licensee shall ensure that the limited-access areas described in section 5042 of this division can be securely locked using commercial-grade, nonresidential door locks. A licensee shall also use commercial-grade, nonresidential door locks on all points of entry and exit to the licensed premises.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5047. Alarm System.

(a) A licensee shall maintain an alarm system as defined in Business and Professions Code section 7590.1(n) at the licensed premises.

(b) A licensee shall ensure a licensed alarm company operator or one or more of its registered alarm agents installs, maintains, monitors, and responds to the alarm system.

(c) Upon request, a licensee shall make available to the Bureau all information related to the alarm system, monitoring, and alarm activity.

(d) If multiple licensed premises are contained within the same building, a single alarm system covering the entire building may be used by all of the licensees under the following conditions:

(1) Each licensee shall include in their security operating procedures, submitted with the application pursuant to section 5002(c)(29)(D) of this division, an explanation of how the alarm system will be shared, including who is responsible for contracting with the alarm company.

(2) All licensees shall have access to and be able to provide the information under subsection (c) of this section.

(3) All licensees shall be held responsible and subject to discipline for any violations of the alarm system requirements.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070,

Business and Professions Code.

Article 6. Track and Trace Requirements

§ 5048. Track and Trace System.

(a) A licensee shall create and maintain an active and functional account within the track and trace system prior to engaging in any commercial cannabis activity, including the purchase, sale, test, packaging, transfer, transport, return, destruction, or disposal, of any cannabis goods.

(b) A licensee shall designate one individual owner as the track and trace system account manager. The account manager may authorize additional owners or employees as track and trace system users and shall ensure that each user is trained on the track and trace system prior to its access or use.

(1) The account manager shall attend and successfully complete all required track and trace system training, including any orientation and continuing education.

(2) If the account manager did not complete the required track and trace system training prior to receiving their annual license, the account manager shall sign up for and complete state mandated training, as prescribed by the Bureau, within five calendar days of license issuance.

(c) The account manager and each user shall be assigned a unique log-on, consisting of a username and password. The account manager or each user accessing the track and trace system shall only do so under his or her assigned log-on, and shall not use or access a log-on of any other individual. No account manager or user shall share or transfer his or her log-on, username, or password, to be used by any other individual for any reason.

(d) The account manager shall maintain a complete, accurate, and up-to-date list of all track and trace system users, consisting of their full names and usernames.

(e) A licensee shall monitor all compliance notifications from the track and trace system, and timely resolve the issues detailed in the compliance notification.

(1) A licensee shall keep a record, independent of the track and trace system, of all compliance notifications received from the track and trace system, and how and when compliance was achieved.

(2) If a licensee is unable to resolve a compliance notification within three business days of receiving the notification, the licensee shall notify the Bureau immediately, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

(f) A licensee is accountable for all actions its owners or employees take while logged into or using the track and trace system, or otherwise while conducting track and trace activities.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26067, 26070, 26160 and 26161, Business and Professions Code.

§ 5049. Track and Trace Reporting.

(a) A licensee shall record in the track and trace system all commercial cannabis

activity, including:

- (1) Packaging of cannabis goods.
- (2) Sale and transfer of cannabis goods.
- (3) Transportation of cannabis goods to a licensee.
- (4) Receipt of cannabis goods.
- (5) Return of cannabis goods.
- (6) Destruction and disposal of cannabis goods.
- (7) Laboratory testing and results.
- (8) Any other activity as required pursuant to this division, or by any other licensing authority.

(b) The following information shall be recorded for each activity entered in the track and trace system:

- (1) Name and type of the cannabis goods.
- (2) Unique identifier of the cannabis goods.
- (3) Amount of the cannabis goods, by weight or count, and total wholesale cost of the cannabis goods, as applicable.
- (4) Date and time of the activity or transaction.
- (5) Name and license number of other licensees involved in the activity or transaction.
- (6) If the cannabis goods are being transported:
 - (A) The licensee shall transport pursuant to a shipping manifest generated through the track and trace system, that includes items (1) through (5) of this subsection, as well as:
 - (i) The name, license number, and licensed premises address of the originating licensee.
 - (ii) The name, license number, and licensed premises address of the licensee transporting the cannabis goods.
 - (iii) The name, license number, and licensed premises address of the destination licensee receiving the cannabis goods into inventory or storage.
 - (iv) The date and time of departure from the licensed premises and approximate date and time of departure from each subsequent licensed premises, if any.
 - (v) Arrival date and estimated time of arrival at each licensed premises.
 - (vi) Driver license number of the personnel transporting the cannabis goods, and the make, model, and license plate number of the vehicle used for transport.
 - (B) Upon pick-up or receipt of cannabis goods for transport, storage, or inventory, a licensee shall ensure that the cannabis goods received are as described in the shipping manifest, and shall record acceptance or receipt, and acknowledgment of the cannabis goods in the track and

trace system.

(C) If there are any discrepancies between the type or quantity of cannabis goods specified in the shipping manifest and the type or quantity received by the licensee, the licensee shall record and document the discrepancy in the track and trace system and in any relevant business record.

(7) If cannabis goods are being destroyed or disposed of, the licensee shall record in the track and trace system the following additional information:

(A) The name of the employee performing the destruction or disposal.

(B) The reason for destruction and disposal.

(C) The entity disposing of the cannabis waste.

(8) Description for any adjustments made in the track and trace system, including, but not limited to:

(A) Spoilage or fouling of the cannabis goods.

(B) Any event resulting in damage, exposure, or compromise of the cannabis goods.

(9) Any other information as required pursuant to this division, or by any other applicable licensing authorities.

(c) Unless otherwise specified, all transactions must be entered into the track and trace system within 24 hours of occurrence.

(d) Licensees shall only enter and record complete and accurate information into the track and trace system, and shall correct any known errors entered into the track and trace system immediately upon discovery.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26067, 26070, 26160, and 26161, Business and Professions Code.

§ 5050. Loss of Connectivity.

(a) If at any point a licensee loses connectivity to the track and trace system for any reason, the licensee shall prepare and maintain comprehensive records detailing all commercial cannabis activities that were conducted during the loss of connectivity.

(b) The licensee shall notify the Bureau immediately for any loss of connectivity, and shall not transport, receive, or deliver any cannabis goods until such time as connectivity is restored. Licensees shall submit such notices on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated by reference.:

(c) Once connectivity has been restored, the licensee shall:

(1) Within three calendar days, enter all commercial cannabis activity that occurred during the loss of connectivity into the track and trace system.

(2) Document the cause for loss of connectivity, and the date and time for when connectivity to the track and trace system was lost and when it was restored.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26067, 26070 and 26160, Business and Professions Code.

§ 5051. Track and Trace System Reconciliation.

(a) In addition to other inventory reconciliation requirements under this division, a licensee shall reconcile the physical inventory of cannabis goods at the licensed premises with the records in the track and trace database at least once every 30 calendar days.

(b) If a licensee finds a discrepancy between its physical inventory and the track and trace system database, the licensee shall conduct an audit, and notify the Bureau of any reportable activity pursuant to section 5036 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26067, 26070 and 26160, Business and Professions Code.

§ 5052. Temporary Licenses; Licensees in Operation at Time of Licensure.

(a) A licensee operating under a temporary license issued pursuant to section 5001 of this division is not required to record commercial cannabis activity in the track and trace system as otherwise required by this article.

(b) Temporary licensees shall track and record all commercial cannabis activities and information required pursuant to this division and any other provision of law, at a minimum, on paper receipts, invoices, or manifests.

(c) Any commercial cannabis activity conducted between annual license holders shall be recorded in the track and trace system.

(d) Any licensee in operation at the time the annual license is issued shall enter all inventory into the track and trace system no later than 30 calendar days after the track and trace system account manager attends the training required pursuant to section 5048 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26050.1, 26067, 26070, 26160 and 26161, Business and Professions Code.

Article 7. Returns and Destruction

§ 5052.1. Acceptance of Shipments.

(a) Licensees shall accept or reject, in whole, shipments of cannabis goods.

(b) Notwithstanding subsection (a) of this section, partial shipments of cannabis goods shall be rejected in the following circumstances:

(1) If a licensee receives a shipment containing cannabis goods that differ from those listed on the sales invoice or receipt, the licensee shall reject the portion of the shipment that is not accurately reflected on the sales invoice or receipt.

(2) If a licensee receives a shipment containing any cannabis goods that were damaged during transportation, the licensee shall reject that portion of the shipment that was damaged.

(3) If a licensee receives a shipment containing cannabis goods that is non-compliant with

labeling requirements or exceeds its provided expiration date, the licensee shall reject the portion of the shipment that is non-compliant with labeling requirements or expired.

(c) The licensee rejecting a shipment of cannabis goods, whether in whole or in part, shall record in the track and trace system, as required by Chapter 1, Article 6 of this division, and indicate on any relevant manifest, invoice, or sales receipt, the specific reason for rejection.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013, 26067, 26070 and 26161, Business and Professions Code.

§ 5053. Returns Between Licensees.

(a) If a licensee discovers that a manufactured cannabis good that was purchased from another licensee is defective, the purchasing licensee may return the manufactured cannabis good to the selling licensee only in exchange for a non-defective version of the same type of manufactured cannabis good or in exchange for a manufactured cannabis good of equal value.

(b) Except as provided in subsection (a) of this section, a licensee shall not return cannabis goods purchased from another licensee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013 and 26070, Business and Professions Code.

§ 5054. Destruction of Cannabis Goods Prior to Disposal.

(a) Licensees shall not dispose of cannabis goods, unless disposed of as cannabis waste, defined under section 5000(g) of this division.

(b) Cannabis waste shall be stored, managed, and disposed of in accordance with all applicable waste management laws, including, but not limited to, Division 30 of the Public Resources Code.

(c) Cannabis goods intended for disposal shall remain on the licensed premises until rendered into cannabis waste. The licensee shall ensure that:

(1) Access to the cannabis goods is restricted to the licensee, its employees or agents; and

(2) Storage of the cannabis goods allocated for disposal is separate and distinct from other cannabis goods.

(d) To be rendered as cannabis waste for proper disposal, including disposal as defined under Public Resources Code section 40192, cannabis goods shall first be destroyed on the licensed premises. This includes, at a minimum, removing or separating the cannabis goods from any packaging or container and rendering it unrecognizable and unusable. Nothing in this subsection shall be construed to require vape cartridges to be emptied of cannabis oil prior to disposal, provided that the vape cartridge itself is unusable at the time of disposal.

(e) Cannabis waste on the licensed premises shall be secured in a receptacle or area that is restricted to the licensee, its employees, or an authorized waste hauler.

(f) A licensee shall report all cannabis waste activities, up to and including disposal, into the track and trace system, as required under Chapter 1, Article 6 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013

and 26070, Business and Professions Code.

Chapter 2. DISTRIBUTORS

§ 5300. Distribution Activities.

A licensed distributor shall distribute only cannabis goods, cannabis accessories, and licensees' branded merchandise or promotional materials.

Authority: Sections 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5301. Storage Services.

(a) A licensed distributor may provide storage services, including storage-only services that are unrelated to the quality assurance and laboratory testing processes, to a licensed cultivator, licensed manufacturer, licensed microbusiness, licensed retailer, or another licensed distributor.

(b) A licensed distributor may provide storage services to other licensees for cannabis goods packaged as they will be sold at retail, cannabis accessories, and licensees' branded merchandise or promotional materials only.

(c) A licensed distributor shall ensure that each batch of cannabis goods that are stored for another licensee are stored in accordance with section 5302 of this division.

(d) Notwithstanding subsection (b) of this section, a licensed distributor shall not store live plants, except for seeds, on the licensed premises.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26110, Business and Professions Code.

§ 5302. Storage of Batches for Testing.

(a) A licensed distributor shall ensure that all cannabis goods batches are stored separately and distinctly from other cannabis goods batches on the licensed distributor's premises.

(b) A licensed distributor shall ensure a label with the following information is physically attached to each container of each batch:

(1) The name, license number, and licensed premises address of the licensed manufacturer or licensed cultivator who provided the batch;

(2) The date of entry into the licensed distributor's storage area;

(3) The unique identifiers and batch number associated with the batch;

(4) A description of the cannabis goods with enough detail to easily identify the batch;

(5) The weight of or quantity of units in the batch; and

(6) The best-by, sell-by, or expiration date of the batch, if any.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26110

and 26120, Business and Professions Code.

§ 5303. Packaging, Labeling, and Rolling.

(a) A licensed distributor may package, re-package, label, and re-label cannabis, including pre-rolls, for retail sale. All packages of cannabis, including pre-rolls, shall comply with the following:

(1) Until January 1, 2020, all packages shall meet the following requirements:

(A) The package shall protect the cannabis, including pre-rolls, from contamination and shall not expose the cannabis or pre-rolls to any harmful substance.

(B) The package shall be tamper-evident.

(C) If the package of cannabis or pre-rolls contains more than one serving, then the packaging shall be resealable.

(D) The package shall not imitate any package used for goods that are typically marketed to children.

(2) Beginning January 1, 2020, all packages shall meet the requirements of subsection (a)(1) of this section and shall also meet the following requirements:

(A) The package shall be child-resistant until the package is first opened. For purposes of this division, the following packages are considered child-resistant:

(i) Any package that has been certified as child-resistant under the requirements of the Poison Prevention Packaging Act of 1970 Regulations (16 C.F.R. §1700.15(b)(1)) (Rev. July 1995), which is hereby incorporated by reference.

(ii) Plastic packaging that is at least 4 mils thick and heat-sealed without an easy-open tab, dimple, corner, or flap.

(B) The package shall be labeled with the statement “This package is not child-resistant after opening.”

(3) Notwithstanding subsections (a)(1)-(a)(2) of this section, immature plants and seeds shall not be required to be packaged in child-resistant, tamper-evident, and resealable packaging.

(b) A licensed distributor shall not process cannabis, but may roll pre-rolls that consist exclusively of any combination of flower, shake, leaf, or kief. Pre-rolls shall be rolled prior to regulatory compliance testing.

(c) Licensed distributors may label and re-label a package containing manufactured cannabis goods with the amount of cannabinoids and terpenoids based on regulatory compliance testing results.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013 and 26120, Business and Professions Code.

§ 5303.1. Net Weight of Dried Flower.

For purposes of this division, the net weight on any package of dried flower shall not be considered inaccurate if the actual weight is within plus or minus 3% of the labeled weight.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013, 26120 and 26152, Business and Professions Code.

§ 5304. Testing Arrangements.

After taking physical possession of a cannabis goods batch, the licensed distributor shall contact a licensed testing laboratory and arrange for a laboratory employee to come to the licensed distributor's licensed premises to select a representative sample for laboratory testing.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26104 and 26110, Business and Professions Code.

§ 5305. Testing Sample.

- (a) The licensed distributor shall ensure that the batch size from which the sample is taken meets the requirements of this division.
- (b) A licensed distributor or an employee of the licensed distributor shall be physically present to observe the laboratory employee obtain the sample of cannabis goods for testing and shall ensure that the increments are taken from throughout the batch.
- (c) The sampling shall be video recorded with the batch number stated verbally or in writing on the video at the beginning of the video and a visible time and date indication on the video recording footage. The video recordings shall be maintained for 90 calendar days by the licensed distributor.
- (d) After the sample has been selected, both the licensed distributor and the laboratory employee shall sign and date the chain of custody form pursuant to section 5706 of this division, attesting to the sample selection having occurred.
- (e) A licensed distributor shall not assist the laboratory employee nor touch the cannabis goods or the sampling equipment while the laboratory employee is obtaining the sample.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26104 and 26110, Business and Professions Code.

§ 5305.1 Re-sampling.

Once a sample has been obtained from a batch for regulatory compliance testing, a licensed distributor may not arrange for or allow another licensed testing laboratory to sample or re-sample the same batch for regulatory compliance testing, unless all of the requirements of section 5705 subsection (g) of this division are met.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5306. Laboratory Testing Results.

- (a) A sample batch "passes" a laboratory test when the sample meets specifications in Chapter 6 of this division.
- (b) When a batch from a manufactured or harvest batch passes, the cannabis goods may be transported to one or more licensed retailers, licensed distributors, or licensed microbusinesses. A printed copy of the certificate of analysis for regulatory compliance testing shall

accompany the batch and be provided to the licensee receiving the cannabis goods.

(c) A batch “fails” a laboratory test when the sample does not meet specifications in Chapter 6 of this division.

(d) If a failed batch may be remediated pursuant to section 5727 of this division, a licensed distributor may transport or arrange for the transportation of the batch to a licensed manufacturer for remediation in accordance with the following:

(1) The licensed distributor shall ensure that a corrective action plan is submitted by a licensed manufacturer to the State Department of Public Health, or by a licensed microbusiness authorized to engage in manufacturing to the Bureau, within 30 calendar days of issuance of the certificate of analysis for regulatory compliance testing by the licensed testing laboratory.

(2) The licensed distributor shall ensure that the licensed manufacturer or licensed microbusiness authorized to engage in manufacturing begins remediating the cannabis goods within 30 calendar days of receiving approval from the State Department of Public Health or the Bureau to remediate the cannabis goods.

(3) If the licensed distributor is unable to arrange for a licensed manufacturer or licensed microbusiness authorized to engage in manufacturing to remediate the cannabis goods within 30 calendar days of issuance of the certificate of analysis for regulatory compliance testing by the licensed testing laboratory, the licensed distributor shall destroy the cannabis goods immediately.

(e) A licensed distributor shall destroy a batch that failed laboratory testing and cannot be remediated pursuant to section 5727 of this division within 30 calendar days of issuance of the certificate of analysis for regulatory compliance testing by the licensed testing laboratory.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070, 26100, 26104 and 26110, Business and Professions Code.

§ 5307. Quality-Assurance Review.

When a licensed distributor receives a certificate of analysis for regulatory compliance testing from the licensed testing laboratory or upon transfer from another licensed distributor stating that the batch meets specifications required by law, the licensed distributor shall ensure the following before transporting the cannabis goods, packaged as they will be sold at retail, to one or more licensed retailers or licensed microbusinesses authorized to engage in retail sales:

(a) The certificate of analysis for regulatory compliance testing that the licensed distributor received from the licensed testing laboratory or another licensed distributor is the certificate of analysis that corresponds to the batch;

(b) The date on the certificate of analysis for the regulatory compliance testing is less than 12 months old;

(c) The label on the cannabis goods is consistent with the certificate of analysis for regulatory compliance testing regarding cannabinoid content and contaminants required to be listed by law as follows:

(1) If the cannabis goods are labeled with the content for cannabinoids, terpenoids, Total THC, and/or Total CBD prior to receiving the certificate of analysis for regulatory compliance testing,

the licensed distributor shall ensure that the labeled amounts are accurate in accordance with section 5307.1 of this division, and

(2) If the cannabis goods are not labeled with the content for cannabinoids, terpenoids, Total THC, and/or Total CBD prior to receiving the certificate of analysis for regulatory compliance testing, the licensed distributor shall label the cannabis goods with the amounts listed on the certificate of analysis pursuant to section 5303 of this division;

(d) The packaging and labeling of the cannabis goods complies with Business and Professions Code Section 26120 and all applicable regulations within this division as well as California Code of Regulations, Title 3, Division 8 and Title 17, Division 1, Chapter 13, except cannabis goods are not required to be labeled or otherwise identified as medicinal products prior to retail sale unless the cannabis goods must be labeled as such pursuant to the requirements prescribed by the State Department of Public Health in regulation;

(e) The cannabis goods have not exceeded their expiration or sell-by date if one is provided;

(f) The weight or count of the cannabis batch comports with that in the track and trace system. A licensed distributor shall use scales as required by the Business and Professions Code; and

(g) All events prior to receipt of the certificate of analysis for regulatory compliance testing have been entered into the track and trace system.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070, 26110 and 26120, Business and Professions Code.

§ 5307.1 Quality-Assurance Review for Labeling Cannabinoids and Terpenoids.

(a) For purposes of this division, any one cannabinoid, Total THC, and/or Total CBD claimed to be present on a label shall not be considered inaccurate if the difference in percentage on the certificate of analysis is plus or minus 10.0%.

(b) For purposes of this division, the terpenoid testing results on the label of any one terpenoid claimed to be present shall not be considered inaccurate if the difference in percentage on the certificate of analysis is plus or minus 10.0%.

(c) For purposes of this section, the difference in percent shall be calculated using the following equation:

$$\text{Difference in percent} = \left| \frac{\text{laboratory measurement} - \text{label claim}}{\text{label claim}} \right| \times 100\%$$

For purposes of this section, Total THC and Total CBD shall have the same meaning as defined in Chapter 6 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100 and 26110, Business and Professions Code.

§ 5307.2. Licensed Distributor to Licensed Distributor Transfers.

Cannabis goods, packaged as they will be sold at retail, that have undergone and passed regulatory compliance testing and have an accompanying certificate of analysis may be transferred to one or more licensed distributors. However, cannabis goods that have not been transported to retail within 12 months of the date on the certificate of analysis must be destroyed

or retested by the licensed distributor in possession of the cannabis goods.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26110, Business and Professions Code.

§ 5308. Insurance Requirements.

(a) An applicant for a distributor license shall provide the Bureau with a certificate of insurance that shows the types of insurance coverage and minimum amounts that have been secured as required by this section, and documentation establishing compliance with subsection (d) of this section.

(b) A distributor licensee shall at all times carry and maintain commercial general liability insurance in the aggregate in an amount no less than \$2,000,000 and in an amount no less than \$1,000,000 for each loss.

(c) A distributor licensee shall maintain the insurance required in subsection (b) of this section from an insurance company that is:

(1) A non-admitted insurer that meets the requirements of Insurance Code section 1765.1 or 1765.2, and the insurance is placed pursuant to Insurance Code section 1763 and through a surplus line broker licensed under Insurance Code section 1765;

(2) An insurer qualified to do business in California by the Secretary of State and authorized by the Insurance Commissioner to write the liability and property classes of insurance as defined by Insurance Code sections 102, 103, 107, 114, 108, and 120; or

(3) A registered risk retention group compliant with the California Risk Retention Act of 1991. (See California Insurance Code sections 125-140.)

(d) Admitted insurers and risk retention groups must show proof of capitalization in the amount of at least \$10,000,000.

(e) A distributor licensee shall notify the Bureau in writing, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference, within 14 calendar days of a lapse in insurance in accordance with section 5023.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26051.5 and 26070, Business and Professions Code.

§ 5309. Inventory Accounting.

(a) A licensed distributor shall be able to account for all inventory and provide that information to the Bureau upon request.

(b) To account for inventory, a licensed distributor shall ensure all batches of cannabis goods are stored in accordance with section 5302 of this division and shall be able to provide the Bureau with the status of the batch as follows:

(1) The batch is being held in storage for another licensee;

(2) The batch is awaiting sampling for regulatory compliance testing;

- (3) The batch has been sampled and is awaiting testing results;
- (4) The batch has passed testing;
- (5) The batch has failed testing and is awaiting approval for remediation;
- (6) The batch has failed testing and is awaiting destruction; and
- (7) The batch is being stored or held for any other lawful purpose under the Act or this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26160, Business and Professions Code.

§ 5310. Records.

In addition to the records required by section 5037 of this division, a licensed distributor shall maintain the following records:

- (a) Records relating to branding, packaging and labeling;
- (b) Inventory logs and records;
- (c) Transportation bills of lading and shipping manifests for completed transports and for cannabis goods in transit;
- (d) Vehicle and trailer ownership records;
- (e) Quality-assurance records;
- (f) Records relating to destruction and disposal of cannabis goods;
- (g) Laboratory-testing records;
- (h) Warehouse receipts; and
- (i) Records relating to tax payments collected and paid under Revenue and Taxation Code sections 34011 and 34012.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

§ 5311. Requirements for the Transportation of Cannabis Goods.

The following requirements apply when transporting cannabis goods between licensees or licensed premises:

- (a) Transportation shall only be conducted by persons holding a distributor license under the Act, or employees of those persons. All vehicles and trailers used for transportation shall be owned or leased, in accordance with the Vehicle Code, by the licensee.
- (b) Prior to transporting any cannabis goods, the licensed distributor shall have a completed sales invoice or receipt that meets the requirements of Business and Professions Code section

26161. The licensed distributor shall only transport cannabis goods listed on the sales invoice or receipt. The sales invoice or receipt may not be altered or changed once transport begins.

(c) All vehicles transporting cannabis goods for hire shall be required to have a motor carrier permit pursuant to Chapter 2 (commencing with Section 34620) of Division 14.85 of the Vehicle Code.

(d) Transportation by means of aircraft, watercraft, drone, rail, human powered vehicle, or unmanned vehicle is prohibited.

(e) Cannabis goods shall only be transported inside of a vehicle or trailer and shall not be visible or identifiable from outside of the vehicle or trailer.

(f) Cannabis goods shall be locked in a fully enclosed box, container, or cage that is secured to the inside of the vehicle or trailer. No portion of the enclosed box, container, or cage shall be comprised of any part of the body of the vehicle or trailer. For the purposes of this section, the inside of the vehicle includes the trunk.

(g) While left unattended, vehicles and trailers shall be locked and secured.

(h) A licensed distributor shall not leave a vehicle or trailer containing cannabis goods unattended in a residential area or parked overnight in a residential area.

(i) At a minimum, a licensed distributor shall have a vehicle alarm system on all transport vehicles and trailers. Motion detectors, pressure switches, duress, panic, and hold-up alarms may also be used.

(j) Packages or containers holding cannabis goods shall not be tampered with, or opened, during transport.

(k) A licensed distributor transporting cannabis goods shall only travel between licensees shipping or receiving cannabis goods and its own licensed premises when engaged in the transportation of cannabis goods. The licensed distributor may transport multiple shipments of cannabis goods at once in accordance with applicable laws. A licensed distributor shall not deviate from the travel requirements described in this section, except for necessary rest, fuel, or vehicle repair stops.

(l) Under no circumstances may non-cannabis goods, except for cannabis accessories and licensees' branded merchandise or promotional materials, be transported with cannabis goods.

(m) Vehicles and trailers transporting cannabis goods are subject to inspection by the Bureau at any licensed premises or during transport at any time.

(n) Notwithstanding subsections (d)—(f) of this section, if it is not operationally feasible to transport cannabis goods inside of a vehicle or trailer because the licensed premises that the cannabis goods will be transported from and the licensed premises that will be receiving the cannabis goods are located within the same building or on the same parcel of land, the cannabis goods may be transported by foot, hand truck, fork lift, or other similar means. A shipping manifest that complies with this division is required when transporting cannabis goods pursuant to this subsection.

(o) Notwithstanding subsection (d) of this section, transportation of cannabis goods may be

conducted via waterway to licensees located on Catalina Island. The provisions of this section and other sections regarding vehicle requirements also apply to vessels used to transport cannabis goods via waterway pursuant to this section.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5312. Required Transport Vehicle Information.

(a) In addition to the information required in section 5314 of this division, any licensed distributor who will be or is transporting cannabis goods shall provide the following information to the Bureau:

(1) Proof that the licensed distributor is the registered owner under the Vehicle Code for each vehicle and trailer used to transport cannabis goods;

(2) The year, make, model, license plate number, and numerical Vehicle Identification Number (VIN) for each vehicle and trailer used to transport cannabis goods; and

(3) Proof of insurance for each vehicle and trailer used to transport cannabis goods.

(b) The licensed distributor shall provide the Bureau with the information required by this section in writing for any new vehicle or trailer that will be used to transport cannabis goods prior to using the vehicle or trailer to transport cannabis goods.

(c) The licensed distributor shall provide the Bureau with any changes to the information required by this section in writing within 30 calendar days, submitted on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5313. Transport Personnel Requirements.

(a) No person under the age of 21 years old shall be in a commercial vehicle or trailer transporting cannabis goods; and

(b) Only a licensee, an employee of the licensed distributor, or security personnel who meets the requirements of section 5045 of this division shall be in a vehicle while transporting cannabis goods.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5314. Shipping Manifest.

(a) Prior to transporting cannabis goods, a licensed distributor shall generate a shipping manifest through the track and trace system for the following activities:

(1) Testing and sampling;

(2) Sale of cannabis goods to a licensee;

(3) Destruction or disposal of cannabis goods; and

(4) Any other activity, as required pursuant to this division, or by any other licensing authority.

(b) The licensed distributor shall transmit the shipping manifest to the Bureau and the licensee that will receive the cannabis goods prior to transporting the cannabis goods.

(c) The licensed distributor shall ensure and verify that the cannabis goods being taken into possession for transport at the originating licensed premises are as described and accurately reflected in the shipping manifest. For purposes of this section, the licensed distributor may verify that the cannabis goods are accurately reflected in the shipping manifest by confirming that the number of boxes of cannabis goods, type of cannabis goods, weight and/or units of cannabis goods matches the label on the boxes containing the cannabis goods.

(1) The licensed distributor shall not take into possession or transport:

(A) Any cannabis goods that are not on the shipping manifest; or

(B) Any cannabis goods that are less than or greater than the amount reflected on the shipping manifest.

(2) The licensed distributor is responsible for any discrepancies between the shipping manifest and the cannabis goods in its possession during transport, and subject to any enforcement or disciplinary action related to such discrepancy.

(3) A licensed distributor shall not void or change a shipping manifest after departing from the originating licensed premises.

(d) A shipping manifest shall accompany every transport of cannabis goods.

(e) Notwithstanding subsection (a) of this section, if a transporting licensed distributor has not obtained access to the track and trace system, the licensed distributor shall complete the shipping manifest outside of the track and trace system and transmit it to the Bureau and the licensee receiving the shipment by electronic mail.

(f) If the transporting licensed distributor has access to the track and trace system and the licensee receiving the shipment has not obtained access to the track and trace system, the licensed distributor shall complete the shipping manifest in the track and trace system and transmit it to the Bureau. However, the licensed distributor shall send a copy to the licensee receiving the shipment by electronic mail.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26067 and 26070, Business and Professions Code.

§ 5315. Distributor Transport Only License.

(a) A licensed distributor transport only licensee may transport cannabis goods between licensees; however, they shall not transport any cannabis goods except for immature cannabis plants and seeds to a licensed retailer or licensed microbusiness authorized to engage in retail sales.

(b) A complete application for a distributor transport only license shall include all the information required in an application for a distributor license.

(c) The licensing fee for a distributor transport only license will be based in part upon

whether the licensee intends to transport only cannabis goods that the licensee has cultivated or manufactured (self-distribution), or whether the licensee intends to transport cannabis goods cultivated or manufactured by other licensees.

(d) A distributor transport only licensee shall comply with all of the requirements for a holder of a distributor license, except for those related to quality assurance and testing.

(e) A distributor transport only licensee shall not hold title to any cannabis goods unless the licensee also holds a state-issued cultivation, manufacturing, retailer, or microbusiness license.

(f) Holding a distributor transport only license shall not authorize a licensee to:

(1) Engage in the delivery of cannabis goods as defined in Business and Professions Code section 26001(p);

(2) Engage in the wholesale, destruction, packaging, labeling, or storing of cannabis goods; or

(3) Arrange for the testing of cannabis goods by a testing laboratory.

(g) Notwithstanding subsection (e) of this section, a distributor transport only licensee who is licensed to engage in self-distribution and whose licensed premises will be on the same property as their licensed cultivation or licensed manufacturing premises shall not be required to comply with the security provisions contained in Chapter 1, Article 5 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26070, Business and Professions Code.

Chapter 3. RETAILERS

§ 5400. Access to Retailer Premises.

(a) Access to the licensed premises of a retailer with only an A-designation shall be limited to individuals who are at least 21 years of age.

(b) Access to the licensed premises of a retailer with only an M-designation shall be limited to individuals who are at least 18 years of age and have a valid physician's recommendation for medicinal cannabis, and individuals who are at least 21 years of age.

(c) Access to the licensed premises of a retailer with both an A- designation and an M-designation may include persons identified in subsections (a) and (b) of this section.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26140, Business and Professions Code.

§ 5402. Customer Access to the Retail Area.

(a) Individuals shall be granted access to the retail area to purchase cannabis goods only after the retailer or an employee of the retailer has confirmed the individual's age and identity pursuant to section 5404 of this division.

(b) The licensed retailer or at least one employee shall be physically present in the retail area at all times when individuals who are not employees of the licensed retailer are in the retail

area.

(c) All sales of cannabis goods must take place within the retail area of the retailer's licensed premises, except for cannabis goods sold through delivery, or a drive-in or drive-through window as authorized by section 5025(g) of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26140, Business and Professions Code.

§ 5403. Hours of Operation.

A licensed retailer shall sell and deliver cannabis goods only between the hours of 6:00 a.m. Pacific Time and 10:00 p.m. Pacific Time.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5403.1 Requirements While Not Open for Business.

At any time the licensed premises is not open for retail sales, a licensed retailer shall ensure that:

(a) The licensed premises is securely locked with commercial-grade, nonresidential door locks as required in section 5046 of this division;

(b) The licensed premises is equipped with an active alarm system pursuant to section 5047 of this division, which shall be activated when the licensed retailer or its employees are not on the licensed premises; and

(c) Only employees of the licensee and other authorized individuals are allowed access to the licensed premises. For the purposes of this section, authorized individuals include individuals employed by the licensee as well as any outside vendors, contractors, or other individuals conducting business that requires access to the licensed premises.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5404. Retail Customers.

(a) A licensed retailer shall only sell adult-use cannabis goods to individuals who are at least 21 years of age after confirming the customer's age and identity by inspecting a valid form of identification provided by the customer as required by subsection (c) of this section.

(b) A licensed retailer shall only sell medicinal cannabis goods to individuals who are at least 18 years of age and possesses a valid physician's recommendation after confirming the customer's age, identity, and physician's recommendation as required by subsection (c) of this section.

(c) Acceptable forms of identification include the following:

(1) A document issued by a federal, state, county, or municipal government, or a political subdivision or agency thereof, including, but not limited to, a valid motor vehicle operator's license, that contains the name, date of birth, height, gender, and photo of the person;

(2) A valid identification card issued to a member of the Armed Forces that includes the person's name, date of birth, and photo; or

(3) A valid passport issued by the United States or by a foreign government.

Authority: Section 26013, Business and Professions Code. Reference: Section 26140, Business and Professions Code.

§ 5405. Cannabis Goods Display.

(a) Cannabis goods for inspection and sale shall only be displayed in the retail area.

(b) Cannabis goods may be removed from their packaging and placed in containers to allow for customer inspection. The containers shall not be readily accessible to customers without assistance of retailer personnel. A container must be provided to the customer by the licensed retailer or its employees, who shall remain with the customer at all times that the container is being inspected by the customer.

(c) Cannabis goods removed from their packaging for display shall not be sold, shall not be consumed, and shall be destroyed pursuant to section 5054 of this division when the cannabis goods are no longer used for display.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

§ 5406. Cannabis Goods for Sale.

A licensed retailer shall not make any cannabis goods available for sale or delivery to a customer unless:

(a) The cannabis goods were received by the retail licensee from a licensed distributor or licensed microbusiness authorized to engage in distribution;

(b) The licensed retailer has verified that the cannabis goods have not exceeded their best-by, sell-by, or expiration date if one is provided;

(c) In the case of manufactured cannabis products, the product complies with all requirements of Business and Professions Code section 26130 and California Code of Regulations, Title 3, Division 8 and Title 17, Division 1, Chapter 13;

(d) The cannabis goods have undergone laboratory testing as required by the Act and Chapter 6 of this division;

(e) The batch number is labeled on the package of cannabis goods and matches the batch number on the corresponding certificate of analysis for regulatory compliance testing;

(f) The packaging and labeling of the cannabis goods complies with Business and Professions Code Section 26120 and all applicable regulations within this division as well as California Code of Regulations, Title 3, Division 8 and Title 17, Division 1, Chapter 13; and

(g) The cannabis goods comply with all applicable requirements found in the Act and applicable regulations.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26120, Business and Professions Code.

§ 5407. Sale of Non-Cannabis Goods.

In addition to cannabis goods, a licensed retailer may sell only cannabis accessories and licensee’s branded merchandise. Licensed retailers may provide customers with promotional materials.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070, 26151 and 26152, Business and Professions Code.

§ 5408. Sale of Live Plants and Seeds.

(a) A licensed retailer shall only sell live, immature cannabis plants and cannabis seeds if all of the following requirements are met:

- (1) The plant is not flowering;
- (2) The plant or seed originated from a nursery that holds a valid license from the Department of Food and Agriculture or a licensed microbusiness authorized to engage in cultivation; and
- (3) A label is affixed to the plant or package containing any seeds which states “This product has not been tested pursuant to the Medicinal and Adult-Use Cannabis Regulation and Safety Act.”

(b) A licensed retailer may not sell any other live plants.

(c) A licensed retailer shall not apply nor use any pesticide, nor cause any pesticide to be applied nor used, on live plants.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26100, Business and Professions Code.

§ 5409. Daily Limits.

(a) A licensed retailer shall not sell more than the following amounts to a single adult-use cannabis customer in a single day:

- (1) 28.5 grams of non-concentrated cannabis.
- (2) 8 grams of cannabis concentrate as defined in Business and Professions Code section 26001, including cannabis concentrate contained in cannabis products.
- (3) 6 immature cannabis plants.

(b) A licensed retailer shall not sell more than the following amounts to a single medicinal cannabis patient, or to a patient’s primary caregiver purchasing medicinal cannabis on behalf of the patient, in a single day:

- (1) 8 ounces of medicinal cannabis in the form of dried mature flowers or the plant conversion as provided in Health and Safety Code section 11362.77.

(2) 12 immature cannabis plants.

(c) Notwithstanding subsection (b) of this section, if a medicinal cannabis patient's valid physician's recommendation contains a different amount than the limits listed in this section, the medicinal cannabis patient may purchase an amount of medicinal cannabis consistent with the patient's needs as recommended by a physician and documented in the physician's recommendation.

(d) The limits provided in subsection (a) and subsection (b) of this section shall not be combined to allow a customer to purchase cannabis goods in excess of any of the limits provided in this section.

(e) For the purposes of this section, a licensed retailer shall be responsible for determining that the amount of cannabis concentrates found in manufactured cannabis products sold to customers comply with the requirements of this section.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code; and Sections 11362.1 and 11362.77, Health and Safety Code.

§ 5410. Customer Return of Cannabis Goods.

(a) For the purposes of this section, "customer return" means a customer's return of cannabis goods that were purchased from a licensed retailer, back to the licensed retailer the cannabis goods were purchased from.

(b) A licensed retailer may accept customer returns of cannabis goods that were previously sold to a customer.

(c) A licensed retailer shall not resell cannabis goods that have been returned.

(d) A licensed retailer shall treat any cannabis goods abandoned on the licensed retailer premises as a customer return.

(e) Defective manufactured cannabis products returned by customers to a licensed retailer may be destroyed pursuant to section 5054 of this division, or returned to the licensed distributor from whom the cannabis goods were obtained in accordance with section 5053 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5, 26012 and 26070, Business and Professions Code.

§ 5411. Free Cannabis Goods.

(a) A licensed retailer shall not provide free cannabis goods to any person. A licensed retailer shall not allow individuals who are not employed by the licensed retailer to provide free cannabis goods to any person on the licensed premises.

(b) Notwithstanding subsection (a) of this section, in order to provide access to medicinal cannabis patients who have difficulty accessing medicinal cannabis goods, a licensee who holds an M-Retailer license, an M-Retailer Non-storefront license, or an M-Microbusiness license that is authorized for retail sales may provide free medicinal cannabis goods if the following criteria are met:

(1) Free cannabis goods are provided only to a medicinal cannabis patient or primary caregiver for the patient in possession of an identification card issued under Section 11362.71 of the

Health and Safety Code.

- (2) The cannabis goods comply with all applicable laboratory testing requirements under this division.
- (3) Prior to being provided to the patient or primary caregiver, the cannabis goods have been properly recorded in the track and trace system as belonging to the licensed retailer.
- (4) The cannabis goods shall not leave the licensed premises unless placed in a resealable child-resistant opaque package as required for purchased cannabis goods under Business and Professions Code section 26070.1.
- (5) The cannabis goods shall be applied toward the daily purchase limit for a medicinal cannabis customer pursuant to section 5409 of this division.
- (6) The event shall be properly recorded in the licensed retailer's inventory records and the track and trace system.
- (c) In addition to the provision of free cannabis goods in subsection (b) of this section, a licensee may donate cannabis goods and the use of equipment in compliance with any compassionate use, equity, or other similar program administered by a local jurisdiction. The licensee shall ensure that all cannabis goods provided pursuant to this subsection comply with subsections (b)(2) and (b)(6) of this section.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013, 26153, and 26160, Business and Professions Code.

§ 5412. Prohibition on Packaging and Labeling by a Retailer.

- (a) A licensed retailer shall not accept, possess, or sell cannabis goods that are not packaged as they will be sold at final sale, in compliance with this division.
- (b) A licensed retailer shall not package or label cannabis goods.
- (c) Notwithstanding subsection (b) of this section, a licensed retailer may place a barcode or similar sticker on the packaging of cannabis goods to be used in inventory tracking. A barcode or similar sticker placed on the packaging of a cannabis goods shall not obscure any labels required by the Act or this division.

Authority: Section 26013, Business and Professions Code. Reference: Section 26120, Business and Professions Code.

§ 5413. Cannabis Goods Packaging and Exit Packaging.

- (a) All cannabis goods sold by a licensed retailer shall be in compliance with the packaging requirements.
- (b) Beginning January 1, 2020, a package containing cannabis goods shall be resealable, tamper-evident, and child resistant.
- (c) All cannabis goods purchased by a customer shall not leave the licensed retailer's premises unless the goods are placed in an opaque exit package.
- (d) Notwithstanding subsections (a)—(c) of this section, immature plants and seeds sold by a licensed retailer are not required to be placed in resealable, tamper-evident, child resistant

packaging.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070.1 and 26120, Business and Professions Code.

§ 5414. Non-Storefront Retailer.

(a) A non-storefront retailer licensee shall be authorized to conduct retail sales exclusively by delivery as defined in Business and Professions Code section 26001(p).

(b) A complete application for a non-storefront retailer license shall include all the information required in an application for a retailer license.

(c) A non-storefront retailer licensee shall comply with all the requirements applicable to retailer licensees, except for those provisions related to public access to the licensed premises and the retail area.

(d) The licensed premises of a non-storefront retailer licensee shall be closed to the public.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26070, Business and Professions Code.

§ 5415. Delivery Employees.

(a) All deliveries of cannabis goods shall be performed by a delivery employee who is directly employed by a licensed retailer.

(b) Each delivery employee of a licensed retailer shall be at least 21 years of age.

(c) All deliveries of cannabis goods shall be made in person. A delivery of cannabis goods shall not be made through the use of an unmanned vehicle.

(d) The process of delivery begins when the delivery employee leaves the retailer's licensed premises with the cannabis goods for delivery. The process of delivering ends when the delivery employee returns to the retailer's licensed premises after delivering the cannabis goods, or attempting to deliver cannabis goods, to the customer(s). During the process of delivery, the licensed retailer's delivery employee may not engage in any activities except for cannabis goods delivery and necessary rest, fuel, or vehicle repair stops.

(e) A delivery employee of a licensed retailer shall, during deliveries, carry a copy of the retailer's current license, the employee's government-issued identification, and an identification badge provided by the employer pursuant to section 5043 of this division.

(f) Prior to providing cannabis goods to a delivery customer, a delivery employee shall confirm the identity and age of the delivery customer as required by section 5404 of this division and ensure that all cannabis goods sold comply with requirements of section 5413 of this division.

(g) A licensed retailer shall maintain an accurate list of the retailer's delivery employees and shall provide the list to the Bureau upon request.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26090, Business and Professions Code.

§ 5415.1. Deliveries Facilitated by Technology Platforms.

(a) A licensed retailer or licensed microbusiness shall not sell or otherwise transfer any cannabis goods to a customer through the use of an unlicensed third party, intermediary business, broker, or any other business or entity.

(b) Notwithstanding subsection (a) of this section, a licensed retailer or licensed microbusiness may contract with a service that provides a technology platform to facilitate the sale and delivery of cannabis goods, in accordance with all of the following:

(1) The licensed retailer or licensed microbusiness does not allow for delivery of cannabis goods by the technology platform service provider.

(2) The licensed retailer or licensed microbusiness does not share in the profits of the sale of cannabis goods with the technology platform service provider, or otherwise provide for a percentage or portion of the cannabis goods sales to the technology platform service provider.

(3) The licensed retailer or licensed microbusiness shall not advertise or market cannabis goods in conjunction with the technology platform service provider, outside of the technology platform, and shall ensure that the technology platform service provider does not use the licensed retailer's or licensed microbusiness's license number or legal business name on any advertisement or marketing that primarily promotes the services of the technology platform.

(4) The licensed retailer or licensed microbusiness shall ensure the following information is provided to customers:

(A) Any cannabis goods advertised or offered for sale on or through the technology platform shall disclose, at a minimum, the licensed retailer's or licensed microbusiness's legal business name and license number.

(B) Customers placing an order for cannabis goods through the technology platform shall be able to easily identify the licensed retailer or licensed microbusiness that each cannabis good is being ordered or purchased from. This information shall be available to the customer prior to the customer placing an order or purchasing the cannabis goods.

(5) All required sales invoices and receipts, including any receipts provided to the customer, shall disclose, at a minimum, the licensed retailer's or licensed microbusiness's legal business name and license number.

(6) All other delivery, marketing, and advertising requirements under this division are complied with.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26001, 26070, 26090, 26151 and 26152, Business and Professions Code.

§ 5416. Delivery to a Physical Address.

(a) A delivery employee may only deliver cannabis goods to a physical address in California.

(b) A delivery employee shall not leave the State of California while possessing cannabis goods.

(c) A delivery employee shall not deliver cannabis goods to an address located on publicly owned land or any address on land or in a building leased by a public agency. This prohibition applies to land held in trust by the United States for a tribe or an individual tribal member unless the delivery is authorized by and consistent with applicable tribal law.

(d) A delivery employee may deliver to any jurisdiction within the State of California provided that such delivery is conducted in compliance with all delivery provisions of this division.

(e) A delivery employee shall not deliver cannabis goods to a school providing instruction in kindergarten or any grades 1 through 12, day care center, or youth center.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26090, Business and Professions Code.

§ 5417. Delivery Vehicle Requirements.

(a) A licensed retailer's delivery employee, carrying cannabis goods for delivery, shall only travel in an enclosed motor vehicle. Any vehicle used in the delivery of cannabis goods shall be operated by a delivery employee of the licensee. A vehicle used in the delivery of cannabis goods shall not have any marking or other indications on the exterior of the vehicle that may indicate that the delivery employee is carrying cannabis goods for delivery. Only the licensee or an employee of the retailer licensee for whom delivery is being performed shall be in the delivery vehicle.

(b) While carrying cannabis goods for delivery, a licensed retailer's delivery employee shall ensure the cannabis goods are not visible to the public. Cannabis goods shall be locked in a fully enclosed box, container, or cage that is secured on the inside of the vehicle. No portion of the enclosed box, container, or cage shall be comprised of any part of the body of the vehicle or trailer. For purposes of this section, the inside of the vehicle includes the trunk.

(c) A licensed retailer's delivery employee shall not leave cannabis goods in an unattended motor vehicle unless the motor vehicle is locked and equipped with an active vehicle alarm system. Any cannabis goods left in an unattended vehicle must be stored in a container as required in subsection (b) of this section.

(d) A vehicle used for the delivery of cannabis goods shall be outfitted with a dedicated Global Positioning System (GPS) device for identifying the geographic location of the delivery vehicle and recording a history of all locations traveled to by the delivery employee while engaged in delivery. A dedicated GPS device must be owned by the licensee and used for delivery only. The device shall be either permanently or temporarily affixed to the delivery vehicle and shall remain active and inside of the delivery vehicle at all times during delivery. At all times, the licensed retailer shall be able to identify the geographic location of all delivery vehicles that are making deliveries for the licensed retailer and document the history of all locations traveled to by a delivery employee while engaged in delivery. A licensed retailer shall provide this information to the Bureau upon request. The history of all locations traveled to by a delivery employee while engaging in delivery shall be maintained by the licensee for a minimum of 90 days.

(e) Upon request, a licensed retailer shall provide the Bureau with information regarding any motor vehicle used for the delivery of cannabis goods, including the vehicle's make, model, color, Vehicle Identification Number, license plate number and Department of Motor Vehicles registration information.

(f) Any motor vehicle used by a licensed retailer to deliver cannabis goods is subject to inspection by the Bureau. Vehicles used to deliver cannabis goods may be stopped and inspected by the Bureau at any licensed premises or during delivery.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26090, Business and Professions Code.

§ 5418. Cannabis Goods Carried During Delivery.

(a) A licensed retailer's delivery employee shall not carry cannabis goods in the delivery vehicle with a value in excess of \$5,000 at any time. The value of cannabis goods carried in the delivery vehicle for which a delivery order was not received and processed by the licensed retailer prior to the delivery employee departing from the licensed premises may not exceed \$3,000.

(b) For the purposes of this section, the value of cannabis goods shall be determined using the current retail price of all cannabis goods carried by, or within the delivery vehicle of, the licensed retailer's delivery employee.

(c) A delivery employee may only carry cannabis goods in the delivery vehicle and may only perform deliveries for one licensed retailer at a time. A delivery employee must depart and return to the same licensed premises before taking possession of any cannabis goods from another licensee to perform deliveries.

(d) A licensed retailer's delivery employee shall not leave the licensed premises with cannabis goods without at least one delivery order that has already been received and processed by the licensed retailer.

(e) Before leaving the licensed premises, the licensed retailer's delivery driver must have a delivery inventory ledger of all cannabis goods provided to the licensed retailer's delivery driver. For each cannabis good, the delivery inventory ledger shall include the type of good, the brand, the retail value, the track and trace identifier, and the weight, volume or other accurate measure of the cannabis good. All cannabis goods prepared for an order that was received and processed by the licensed retailer prior to the delivery driver's departure from the licensed premises must be clearly identified on the inventory ledger. After each customer delivery, the delivery inventory ledger must be updated to reflect the current inventory in possession of the licensed retailer's delivery driver. Delivery inventory ledgers may be maintained electronically.

(f) The licensed retailer's delivery driver shall maintain a log that includes all stops from the time the licensed retailer's delivery driver leaves the licensed premises to the time that the licensed retailer's delivery driver returns to the licensed premises, and the reason for each stop. The log shall be turned in to the licensed retailer when the licensed retailer's delivery driver returns to the licensed premises. The licensed retailer must maintain the log as a commercial cannabis activity record as required by this division. The log may be maintained electronically.

(g) Prior to arrival at any delivery location, the licensed retailer must have received a delivery request from the customer and provided the delivery request receipt to the licensed retailer's delivery driver electronically or in hard copy. The delivery request receipt provided to the licensed retailer's delivery driver shall contain all of the information required in section 5420 of this division, except for the date and time the delivery was made, and the signature of the customer.

(h) Immediately upon request by the Bureau or any law enforcement officer, the licensed

retailer's delivery driver shall provide:

- (1) All delivery inventory ledgers from the time the licensed retailer's delivery driver left the licensed premises up to the time of the request;
 - (2) All delivery request receipts for cannabis goods carried by the driver, in the delivery vehicle, or any deliveries that have already been made to customers; and
 - (3) The log of all stops from the time the licensed retailer's delivery driver left the licensed premises up to the time of the request.
- (i) If a licensed retailer's delivery driver does not have any delivery requests to be performed for a 30-minute period, the licensed retailer's delivery driver shall not make any additional deliveries and shall return to the licensed premises. Required meal breaks shall not count toward the 30-minute period.
 - (j) Upon returning to the licensed premises, all undelivered cannabis goods shall be returned to inventory and all necessary inventory and track-and-trace records shall be updated as appropriate that same day.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070, 26090 and 26160, Business and Professions Code.

§ 5419. Cannabis Consumption During Delivery.

A licensed retailer's delivery employees shall not consume cannabis goods while delivering cannabis goods to customers.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26090, Business and Professions Code.

§ 5420. Delivery Request Receipt.

A licensed retailer shall prepare a hard copy or electronic delivery request receipt for each delivery of cannabis goods.

- (a) The delivery request receipt shall contain the following:
 - (1) The name and address of the licensed retailer;
 - (2) The first name and employee number of the licensed retailer's delivery employee who delivered the order;
 - (3) The first name and employee number of the licensed retailer's employee who prepared the order for delivery;
 - (4) The first name of the customer and a licensed retailer-assigned customer number for the person who requested the delivery;
 - (5) The date and time the delivery request was made;
 - (6) The delivery address;
 - (7) A detailed description of all cannabis goods requested for delivery. The description shall

include the weight, volume, or any other accurate measure of the amount of all cannabis goods requested;

(8) The total amount paid for the delivery, including any taxes or fees, the cost of the cannabis goods, and any other charges related to the delivery; and

(9) Upon delivery, the date and time the delivery was made, and the handwritten or electronic signature of the customer who received the delivery.

(b) At the time of the delivery, the delivery employee of the retailer shall provide the customer who placed the order with a hard or electronic copy of the delivery request receipt. The delivery employee shall retain a hard or electronic copy of the signed delivery request receipt for the licensed retailer's records.

(c) For the purposes of this section, an employee number is a distinct number assigned by a licensed retailer to an employee that would allow the licensed retailer to identify the employee in documents or records using the employee number rather than the employee's full name. A licensed retailer shall be able to identify the employee associated with each employee number upon request from the Bureau.

(d) For the purposes of this section, a customer number is a distinct number assigned by a licensed retailer to a customer that would allow the licensed retailer to identify the customer in documents or records using the customer number rather than the customer's full name. A licensed retailer shall be able to identify the customer associated with each customer number upon request from the Bureau.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070, 26090 and 26160, Business and Professions Code.

§ 5421. Delivery Route.

While making deliveries of cannabis goods, a licensed retailer's delivery employee shall only travel from the retailer's licensed premises to the delivery address; from one delivery address to another delivery address; or from a delivery address back to the retailer's licensed premises. A delivery employee of a licensed retailer shall not deviate from the delivery path described in this section, except for necessary rest, fuel, or vehicle repair stops, or because road conditions make continued use of the route unsafe, impossible, or impracticable.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26090, Business and Professions Code.

§ 5422. Receiving Shipments of Inventory.

(a) A licensed retailer shall receive a shipment of cannabis goods only from a licensed distributor or licensed microbusiness authorized to engage in distribution.

(b) A licensed retailer shall accept shipments of cannabis goods only between the hours of 6:00 a.m. Pacific Time and 10:00 p.m. Pacific Time.

(c) During business hours, shipments of cannabis goods shall not enter the licensed premises through an entrance or exit that is available for use by the public.

(d) A licensed retailer whose licensed premises only has one entryway may be exempt from the

requirements of subsection (c) of this section if the licensed retailer obtains authorization from the local jurisdiction explicitly authorizing this activity. The licensed retailer shall be required to provide this authorization to the Bureau upon request. For this section to apply, the licensed premises must physically have only one entryway and cannot have any other entryways.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26070, Business and Professions Code.

§ 5423. Inventory Documentation.

A licensed retailer shall maintain an accurate record of its inventory. A licensed retailer shall provide the Bureau with the record of inventory immediately upon request. A licensed retailer shall keep a record of the following information for all cannabis goods the licensed retailer has in its inventory:

- (a) A description of each item such that the cannabis goods can easily be identified;
- (b) An accurate measurement of the quantity of the item;
- (c) The date and time the cannabis goods were received by the licensed retailer;
- (d) The sell-by or expiration date provided on the package of cannabis goods, if any;
- (e) The name and license number of the licensed distributor or licensed microbusiness that transported the cannabis goods to the licensed retailer; and
- (f) The price the licensed retailer paid for the cannabis goods, including taxes, delivery costs, and any other costs.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

§ 5424. Inventory Reconciliation.

- (a) A licensed retailer shall be able to account for all of its inventory.
- (b) In conducting an inventory reconciliation, a licensed retailer shall verify that the licensed retailer's physical inventory is consistent with the licensed retailer's records pertaining to inventory.
- (c) The result of inventory reconciliation shall be retained in the licensed retailer's records and shall be made available to the Bureau upon request.
- (d) If a licensed retailer identifies any evidence of theft, diversion, or loss, the licensed retailer shall notify the Bureau and law enforcement pursuant to section 5036 of this division.
- (e) If a significant discrepancy as defined in section 5034 of this division is discovered between a licensed retailer's physical inventory and the licensed retailer's inventory records, the licensed retailer shall notify the Bureau and law enforcement pursuant to section 5036 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

§ 5426. Records.

All licensed retailer-specific records in this chapter shall be maintained in accordance with section 5037 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

§ 5427. Retailer Premises to Retailer Premises Transfer.

- (a) A licensee who holds multiple retail licenses may arrange for the transfer of cannabis goods from one licensed retail premises to another licensed retail premises if both retail licenses are held under the same ownership.
- (b) Cannabis goods transferred to a licensed retail premises under subsection (a) of this section may be sold by the licensed retailer receiving the cannabis goods only if the cannabis goods comply with all requirements found in the Act and this division.
- (c) The transportation of cannabis goods under this section must comply with all requirements found within the Act and this division.
- (d) Any movement of cannabis goods under this section shall be properly entered into the state track and trace system.

Authority: Section 26013, Business and Professions Code. Reference: Section 26070, Business and Professions Code.

Chapter 4. MICROBUSINESS

§ 5500. Microbusiness.

- (a) In order to hold a microbusiness license, a licensee must engage in at least three (3) of the following commercial cannabis activities: cultivation, manufacturing, distribution, and retail sale. License types created by the California Department of Food and Agriculture or the State Department of Public Health in regulation shall not be considered qualifying commercial cannabis activities for purposes of obtaining a microbusiness license, except for the Type N manufacturing license.
- (b) An applicant for a microbusiness license shall indicate on the application for licensure which commercial cannabis activities the applicant intends to engage in.
- (c) An application for a microbusiness license shall include:
 - (1) For an application indicating that the applicant intends to engage in cultivation under the microbusiness license, all the required information under sections 5002, 5501, 5502 and 5503 of this division.
 - (2) For an application indicating that the applicant intends to engage in manufacturing under the microbusiness license, all the required information under sections 5002, and 5506 of this division.
 - (3) For an application indicating that the applicant intends to engage in distribution under the microbusiness license, all the required information for an application seeking a distributor license.
 - (4) For an application indicating that the applicant intends to engage in distribution, transport- only under the microbusiness license, all the required information for an

application seeking a distributor, transport-only license.

(5) For an application indicating that the applicant intends to engage in retail sale under the microbusiness license, all the required information for an application seeking a retailer license.

(6) For an application indicating that the applicant intends to engage in non-storefront retail sale under the microbusiness license, all the required information for an application seeking a non- storefront retailer license.

(d) All cultivation, manufacturing, distribution, and retail activities performed by a licensee under a microbusiness license shall occur on the same licensed premises.

(e) A holder of a microbusiness license shall comply with the following:

(1) A holder of a microbusiness license engaged in cultivation shall comply with all the rules and requirements applicable to the cultivation license type suitable for the cultivation activities of the licensee.

(2) A holder of a microbusiness license engaged in manufacturing shall comply with all the rules and requirements applicable to a Manufacturer 1 license in Division 1 of Title 17 of the California Code of Regulations.

(3) A holder of a microbusiness license engaged in distribution shall comply with all the rules and requirements applicable to a distributor license in this division.

(4) A holder of a microbusiness license engaged in retail sale shall comply with all the rules and requirements applicable to a retailer license, or a non-storefront retailer license if retail sales are conducted by delivery only, in this division.

(f) A holder of a microbusiness license may only engage in the commercial cannabis activity requested in the license application and approved by the Bureau at the time the license is issued. If the holder of a microbusiness license wants to engage in an additional commercial cannabis activity after the license is issued, the licensee shall submit a request for a modification of the licensed premises pursuant to section 5027 of this division.

(g) A holder of a microbusiness license shall comply with all the security rules and requirements applicable to the corresponding license type suitable for the activities of the licensee.

(h) Areas of the licensed premises for manufacturing and cultivation shall be separated from the distribution and retail areas by a wall and all doors between the areas shall remain closed when not in use.

(i) A suspension or revocation of a microbusiness licensee shall affect all commercial cannabis activities allowed pursuant to that license.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050, 26051.5 and 26070, Business and Professions Code.

§ 5501. Microbusiness Applications Including Cultivation Activities.

In addition to the information required in section 5002 of this division, an application for a microbusiness license to engage in cultivation shall include the following:

- (a) Evidence of enrollment with the applicable Regional Water Quality Control Board or State Water Resources Control Board for water quality protection programs or written verification from the appropriate Board that enrollment is not necessary.
- (b) Evidence that the applicant has conducted a hazardous materials record search of the EnviroStor database for the proposed premises. If hazardous sites were encountered, the applicant shall provide documentation of protocols implemented to protect employee health and safety.
- (c) For indoor and mixed-light cultivation, identification of all power sources for cultivation activities, including, but not limited to: illumination, heating, cooling, and ventilation.
- (d) A premises diagram pursuant to section 5006 of this division that shall also include:
 - (1) All roads and water crossings on the property.
 - (2) If the applicant is proposing to use a diversion from a waterbody, groundwater well, or rain catchment system as a water source for cultivation, the following locations on the property diagram with locations also provided as coordinates in either latitude and longitude or the California Coordinate System:
 - (A) Sources of water used, including the location of waterbody diversion(s), pump location(s), and distribution system; and
 - (B) Location, type, and capacity of each storage unit to be used for cultivation.
- (e) A proposed cultivation plan pursuant to section 5502 of this division.
- (f) Identification of all water sources used for cultivation activities and the applicable supplemental information for each source as required by section 5503 of this division:
 - (1) A retail water supplier;
 - (2) A groundwater well;
 - (3) A rainwater catchment system; or
 - (4) A diversion from a surface waterbody or an underground stream flowing in a known and definite channel.
- (g) A copy of any final lake or streambed alteration agreement issued by the California Department of Fish and Wildlife, pursuant to Fish and Game Code sections 1602 and 1617, or written verification from the California Department of Fish and Wildlife that a lake and streambed alteration agreement is not required.
- (h) An attestation that the applicant entity is an "agricultural employer" as defined by the Alatorre-Zenovich-Dunlap-Berman Agricultural Labor Relations Act of 1975; Division 2, Part 3.5 (commencing with Section 1140) of the Labor Code.
- (i) An attestation that the local fire department has been notified of the cultivation site if the applicant entity is an indoor license type.
- (j) An acknowledgement that the applicant understands that the information provided in the application that is relevant to the cultivation operation may be shared with the Department of

Food and Agriculture for purposes of evaluating the applicant's qualifications for licensure. If the Department of Food and Agriculture corresponds directly with the applicant on matters related to the application, the applicant shall agree to cooperate. The applicant shall further agree that the Department of Food and Agriculture may conduct inspections on the areas of the premises related to their respective oversight authority.

(k) If applicable, a detailed description of any fines or penalties for cultivation or production of a controlled substance on public or private land pursuant to Fish and Game Code section 12025 or 12025.1 against the applicant or a business entity in which the applicant was an owner or officer within 3 years preceding the date of application.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050, 26051.5 and 26070, Business and Professions Code.

§ 5502. Cultivation Plan Requirements.

A cultivation plan shall include all of the following:

(a) A detailed premises diagram showing all cultivation activity areas, boundaries, and dimensions in feet. The total area of the following cultivation activity areas shall be less than 10,000 square feet as provided in Business and Professions Code section 26070.

- (1) Canopy area(s) (which shall contain mature plants, at any point in time), including aggregate square footage if the canopy areas are noncontiguous.
- (2) Area(s) outside of the canopy where only immature plants shall be maintained, if applicable.
- (3) Designated pesticide and other agricultural chemical storage area(s).
- (4) Designated processing area(s) if the licensee will process on site.
- (5) Designated packaging area(s) if the licensee will package products on site.
- (6) Designated composting area(s) if the licensee will compost plant or cannabis waste on site.
- (7) Designated secured area(s) for cannabis waste if different than subsection (a)(6) of this section.
- (8) Designated area(s) for harvested cannabis storage.
- (9) Designated research and development area(s) which may contain mature plants for nursery only.
- (10) Designated seed production area(s) which may contain mature plants for nursery only.

(b) For purposes of subsection(a)(1) in this section, canopy shall be calculated in square feet and measured using clearly identifiable boundaries of all areas(s) that will contain mature plants at any point in time, including all of the space(s) within the boundaries. Canopy may be noncontiguous, but each unique area included in the total canopy calculation shall be separated by an identifiable boundary which include, but are not limited to: interior walls, shelves, greenhouse walls, hoop house walls, garden benches, hedgerows, fencing, garden beds, or garden plots. If mature plants are being cultivated using a shelving system, the surface area of each level shall be included in the total canopy calculation. Immature plants for cultivation activities of a microbusiness shall have the same definition as defined by the California Department of Food

and Agriculture in regulation.

(c) For indoor and mixed-light cultivation, a lighting diagram with the following information shall be included:

- (1) Location of all lights in the canopy area(s); and
 - (2) Maximum wattage, or wattage equivalent, of each light.
- (d) A pest management plan which shall include, but not be limited to, the following:
- (1) Product name and active ingredient(s) of all pesticides to be applied to cannabis during any stage of plant growth; and
 - (2) Integrated pest management protocols including chemical, biological, and cultural methods the applicant anticipates using to control or prevent the introduction of pests on the cultivation site.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26050, 26051.5 and 26070, Business and Professions Code.

§ 5503. Supplemental Water Source Information.

The following information shall be provided for each water source identified by the applicant:

- (a) Retail water supply sources:
 - (1) If the water source is a retail water supplier, as defined in Water Code section 13575, identify the retail water supplier.
 - (2) If the water source is a small retail water supplier, such as a delivery service, and is subject to Business and Professions Code section 26060.1(a)(1)(B):
 - (A) If the retail water supplier contract is for delivery or pickup of water from a surface water body or an underground stream flowing in a known and definite channel, provide all of the following:
 - (i) The name of the retail water supplier under the contract;
 - (ii) The geographic location coordinates in either latitude and longitude or the California Coordinate System of any point of diversion used by the retail water supplier to divert water delivered to the applicant under the contract;
 - (iii) The authorized place of use of any water right used by the retail water supplier to divert water delivered to the applicant under the contract; and
 - (iv) The maximum amount of water delivered to the applicant for cannabis cultivation in any year.
 - (B) If the retail water supplier contract is for delivery or pickup of water from a groundwater well, provide all of the following:
 - (i) The name of the retail water supplier;
 - (ii) The geographic location coordinates for any groundwater well used to supply water

delivered to the applicant, in either latitude and longitude or the California Coordinate System;

(iii) The maximum amount of water delivered to the applicant for cannabis cultivation in any year; and

(iv) A copy of the well log filed with the Department of Water Resources pursuant to Water Code section 13751 for each percolating groundwater well used to divert water delivered to the applicant. If no well log is available, the applicant shall provide evidence from the Department of Water Resources indicating that the Department of Water Resources does not have a record of the well log. When no well log is available, the State Water Resources Control Board may request additional information about the well.

(b) If the water source is a groundwater well:

(1) The groundwater well's geographic location coordinates in either latitude and longitude or the California Coordinate System; and

(2) A copy of the well log filed with the Department of Water Resources pursuant to Water Code section 13751. If no well log is available, the applicant shall provide evidence from the Department of Water Resources indicating that the Department of Water Resources does not have a record of the well log. If no well log is available, the State Water Resources Control Board may request additional information about the well.

(c) If the water source is a rainwater catchment system:

(1) The total square footage of the catchment footprint area(s);

(2) The total storage capacity, in gallons, of the catchment system(s); and

(3) A detailed description of the type, nature, and location of each catchment surface. Examples of catchment surfaces include a rooftop and greenhouse.

(d) If the water source is a diversion from a waterbody, provide any applicable statement, application, permit, license, or small irrigation use registration identification number(s), and either:

(1) A copy of any applicable registrations, permits, or licenses or proof of a pending application, issued under Part 2 (commencing with Section 1200) of Division 2 of the Water Code as evidence of approval of a water diversion by the State Water Resources Control Board;

(2) A copy of any statements of diversion and use filed with the State Water Resources Control Board before October 31, 2017, detailing the water diversion and use; or

(3) A copy of documentation submitted to the State Water Resources Control Board before October 31, 2017, demonstrating that the diversion is authorized under a riparian right and that no diversion occurred in any calendar year between January 1, 2010, and January 1, 2017.

(4) If the applicant has claimed an exception from the requirement to file a statement of diversion and use pursuant to Water Code section 5101, the applicant shall provide a copy of the documentation submitted to the State Water Resources Control Board before January 1, 2019, demonstrating that the diversion is subject to Water Code section 5101, subdivision (a), (c), (d), or (e).

Authority: Section 26013, Business and Professions Code. Reference: Sections 26050, 26051.5 and 26070, Business and Professions Code; and Section 13149, Water Code.

§ 5504. License Issuance in an Impacted Watershed.

If the State Water Resources Control Board or the Department of Fish and Wildlife finds, based on substantial evidence, that a licensed microbusiness' cannabis cultivation is causing significant adverse impacts on the environment in a watershed or other geographic area, the Bureau shall not issue new microbusiness licenses that include cultivation activities or increase the total number of plant identifiers within that watershed or area.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5, 26055 and 26070, Business and Professions Code.

§ 5505. Cultivation Records for Licensees Engaging in Cultivation Activities.

In addition to the records required by section 5037 of this division, a licensed microbusiness engaging in cultivation activities shall maintain the following records:

- (a) Cultivation plan(s);
- (b) All records evidencing compliance with the environmental protection measures required in sections 5501, 5502, 5503 and 5504 of this division; and
- (c) All unique identifiers (UID) assigned to product in inventory and all unassigned UIDs. UIDs associated with product that has been retired from the track and trace system must be retained for six (6) months after the date the tags were retired.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26069, 26160, and 26161, Business and Professions Code.

§ 5506 Microbusiness Applications Including Manufacturing Activities.

In addition to the information required in section 5002 of this division, an application for a microbusiness license that engages or will engage in manufacturing, shall include the following:

- (a) The type of activity conducted at the premises (extraction, infusion, packaging, and/or labeling).
- (b) The types of products that will be manufactured, packaged, or labeled.
- (c) The name, title, and phone number of the on-site individual who manages the operation of the premises.
- (d) The name, title, and phone number of an alternate contact person for the premises.
- (e) The number of employees at the premises.
- (f) The following information:
 - (1) A description of inventory control procedures sufficient to demonstrate how the applicant will comply with the requirements of section 40282 of Title 17 of the California Code of Regulations, or a copy of the standard operating procedure addressing inventory control;

- (2) A copy of the product quality plan that meets the requirements of section 40253 of Title 17 of the California Code of Regulations; and
- (3) A description of security procedures sufficient to demonstrate how the applicant will comply with the requirements of section 40200 of Title 17 of the California Code of Regulations, or a copy of the standard operating procedure addressing security procedures.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050, 26051.5, 26055 and 26070, Business and Professions Code.

§ 5506.1 Microbusiness Failed Manufactured Cannabis Product Batches.

A microbusiness licensee that engages or will engage in manufacturing shall handle failed manufactured cannabis product batches in accordance with the following:

- (a) A finished manufactured cannabis product batch that fails any laboratory testing requirement established by the Bureau pursuant to Business and Professions Code section 26100 shall be destroyed unless a corrective action plan for remediation or reprocessing is approved by the Bureau pursuant to subsection (d) of this section.
- (b) Remediation or reprocessing of a failed manufactured cannabis product batch or the use of a harvest batch that has failed any laboratory test shall comply with the requirements and procedures established by the Bureau in section 5727 of this division.
- (c) Edible cannabis products that fail laboratory testing requirements shall not be remediated or reprocessed and shall be destroyed. If any edible cannabis product that has failed laboratory testing is remediated, reprocessed, or otherwise mixed with another batch of cannabis product, such action shall render the final cannabis product adulterated, as defined in Business and Professions Code section 26131, regardless of the defect level of the final cannabis product.
- (d) A manufactured cannabis product batch or a harvest batch that fails laboratory testing or quality assurance review shall not be remediated or reprocessed unless the Bureau has approved a corrective action plan submitted by the microbusiness licensee. The corrective action plan shall include, at minimum, a description of how the product or harvest batch will be remediated so that the product or harvest batch, or any product produced therefrom, will meet all laboratory testing and quality assurance requirements. Corrective action plans will be reviewed by the Bureau on a case-by-case basis.
- (e) All remediation of harvest or manufactured cannabis product batches shall be documented in the microbusiness' manufacturing records. Remediated products, harvest batches, or products produced therefrom shall be tested and undergo quality assurance review in accordance with the requirements established by the Bureau in Chapter 2 of this division.
- (f) Notwithstanding subsection (c) of this section, if the edible cannabis products are orally- dissolving products, as defined in section 5700 of this division, and fail laboratory testing because the per-package limit of THC for adult-use products has been exceeded, the orally- dissolving products may be remediated by repackaging the orally-dissolving products as medicinal products in accordance with the following:
 - (1) A corrective action plan pursuant to subsection (d) of this section shall be submitted to and approved by the Bureau;

- (2) The orally-dissolving edible cannabis products batch is returned to the licensed microbusiness that packaged the products;
- (3) The orally-dissolving edible cannabis products are not altered in any way; and
- (4) The orally-dissolving edible cannabis product is labeled to accurately state the contents.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050 and 26070, Business and Professions Code.

§ 5507 Microbusiness Records for Licensees Engaging in Manufacturing Activities.

In addition to the records required by section 5037 of this division, a licensed microbusiness engaging in manufacturing activities shall maintain all records required to be maintained by manufacturers under Chapter 13, Division 1 of Title 17 of the California Code of Regulations.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

Chapter 5. CANNABIS EVENTS

§ 5600. Cannabis Event Organizer License.

- (a) To obtain a temporary cannabis event license, the event organizer must first apply for and obtain a cannabis event organizer license.
 - (b) A cannabis event organizer licensed under this section shall comply with chapter 1 of this division except for sections 5001-5002, 5006-5008, 5010-5010.3, 5016, 5019, 5025- 5028, 5032-5034, 5038, 5042, 5044, and 5046-5054.
 - (c) A cannabis event organizer licensee is not authorized or licensed to cultivate, distribute, manufacture, or retail cannabis or cannabis products without first obtaining the appropriate licenses or authorizations to engage in such commercial cannabis activities.
 - (d) A cannabis event organizer licensee shall comply with the record retention provisions of section 5037 of this division. Records shall be kept by the cannabis event organizer licensee in a manner that allows the records to be produced for the Bureau in either hard copy or electronic form, whichever the Bureau requests. Failure to produce records upon the Bureau's request may result in disciplinary action against the cannabis event organizer license and/or denial of a temporary cannabis event license.
 - (e) Cannabis event organizer applications may be completed online at www.bcc.ca.gov or by delivering a printed copy to the Bureau's office(s).
 - (f) Applicants who submit their applications online shall first register for a user account as provided by section 5002(b) of this division.
 - (g) An application must be completed by an owner as defined by section 5003 of this division. An application for a cannabis event organizer license includes the following:
 - (1) The name of the applicant. For applicants who are individuals, the applicant shall provide both the first and last name of the individual. For applicants who are business entities, the applicant shall provide the legal business name of the applicant.
- (2) If applicable, the business trade name ("DBA") of the applicant.

- (3) Payment of an application fee pursuant to section 5014 of this division.
 - (4) Whether the owner is serving or has previously served in the military. Disclosure of military service is voluntary. An applicant who has served as an active duty member of the Armed Forces of the United States and was honorably discharged and who can provide evidence of such honorable discharge shall have his or her application expedited pursuant to Business and Professions Code section 115.4.
 - (5) A list of the license types and the license numbers issued from the Bureau and all other state cannabis licensing authorities that the applicant holds, including the date the license was issued and the licensing authority that issued the license.
 - (6) Whether the applicant has been denied a license or has had a license suspended or revoked by the Bureau or any other state cannabis licensing authority. The applicant shall provide the type of license applied for, the name of the licensing authority that denied the application, and the date of denial.
- (7) The mailing address for the applicant.
- (8) The telephone number for the applicant.
- (9) The website address of the applicant's business, if applicable.
- (10) The email address for the applicant's business.
 - (11) Contact information for the applicant's designated primary contact person including the name, title, phone number, and email address of the individual.
- (12) The federal employer identification number for the applicant's business.
 - (13) A description of the business organizational structure of the applicant, such as partnership or corporation.
 - (14) All business-formation documents, which may include, but are not limited to, articles of incorporation, bylaws, operating agreements, partnership agreements, and fictitious business name statements. The applicant shall also provide all documents filed with the California Secretary of State, which may include, but are not limited to, articles of incorporation, certificates of stock, articles of organization, certificates of limited partnership, and statements of partnership authority. If the commercial cannabis business is held in trust, the applicant shall provide a copy of the certificate of trust establishing trustee authority.
 - (15) A list of every fictitious business name the applicant is operating under including the address where the business is located.
 - (16) A commercial cannabis business that is a foreign corporation shall include in its application the certificate of qualification, certificate of registration, or certificate of status issued by the California Secretary of State.
 - (17) The applicant shall supply the following financial information:
 - (A) A list of funds belonging to the applicant's cannabis event organizing business held in savings, checking, or other accounts maintained by a financial institution. The applicant shall provide, for each account, the financial institution's name, the financial institution's address, account type, account number, and the amount of money in the account.

(B) A list of loans made to the applicant for its use in cannabis event organizing activities. For each loan, the applicant shall provide the amount of the loan, the date of the loan, term(s) of the loan, security provided for the loan, and the name, address, and phone number of the lender.

(C) A list of investments made into the applicant's cannabis event organizing activities. For each investment, the applicant shall provide the amount of the investment, the date of the investment, term(s) of the investment, and the name, address, and phone number of the investor.

(D) A list of all gifts of any kind given to the applicant for its use in cannabis event organizing activities. For each gift, the applicant shall provide the value of the gift or description of the gift, and the name, address, and phone number of the provider of the gift.

(18) A complete list of every individual that has a financial interest in the cannabis event organizing business as defined in section 5004 of this division, who is not an owner as defined in section 5003 of this division.

(19) A complete list of every owner of the applicant as defined in section 5003 of this division. Each individual named on this list shall submit the following information:

(A) The full name of the owner.

(B) The owner's title within the applicant entity.

(C) The owner's date of birth and place of birth.

(D) The owner's social security number or individual taxpayer identification number.

(E) The owner's mailing address.

(F) The owner's telephone number. This may include a number for the owner's home, business, or mobile telephone.

(G) The owner's email address.

(H) The owner's current employer.

(I) The percentage of the ownership interest held in the applicant entity by the owner.

(J) Whether the owner has an ownership or a financial interest as defined in sections 5003 and 5004, respectively, of this division in any other commercial cannabis business licensed under the Act.

(K) A copy of the owner's government-issued identification. Acceptable forms of identification are a document issued by a federal, state, county, or municipal government that includes the name, date of birth, height, gender, and picture of the person, such as a driver license.

(L) A detailed description of the owner's convictions. A conviction within the meaning of this section means a plea or verdict of guilty or a conviction following a plea of nolo contendere. Convictions dismissed under Penal Code section 1203.4 or equivalent non-California law must be disclosed. Convictions dismissed under Health and Safety Code section 11361.8 or equivalent non-California law must be disclosed. Juvenile adjudications and traffic infractions under §300 that did not involve alcohol, dangerous drugs, or controlled substances do not need to be included. For each conviction, the owner shall provide the following:

- (i) The date of conviction.
 - (ii) Dates of incarceration, if applicable.
 - (iii) Dates of probation, if applicable.
 - (iv) Dates of parole, if applicable.
 - (v) A detailed description of the offense for which the owner was convicted.
 - (vi) A statement of rehabilitation for each conviction. The statement of rehabilitation is to be written by the owner and may contain evidence that the owner would like the Bureau to consider that demonstrates the owner's fitness for licensure. Supporting evidence may be attached to the statement of rehabilitation and may include, but is not limited to, a certificate of rehabilitation under Penal Code section 4852.01, and dated letters of reference from employers, instructors, or professional counselors that contain valid contact information for the individual providing the reference.
- (M) If applicable, a detailed description of any administrative orders or civil judgments for violations of labor standards, any suspension of a commercial cannabis license, revocation of a commercial cannabis license, or sanctions for unlicensed commercial cannabis activity by a licensing authority, local agency, or state agency against the applicant or a business entity in which the applicant was an owner or officer within the three years immediately preceding the date of the application.
- (N) Attestation to the following statement: Under penalty of perjury, I hereby declare that the information contained within and submitted with the application is complete, true, and accurate. I understand that a misrepresentation of fact is cause for rejection of this application, denial of the license, or revocation of a license issued.
- (20) For an applicant with 20 or more employees, the applicant shall attest that the applicant has entered into a labor peace agreement and will abide by the terms of the agreement. The applicant shall submit a copy of the page of the labor peace agreement that contains signatures of the union representative and the applicant. For applicants who have not yet entered into a labor peace agreement, the applicant shall provide a notarized statement indicating the applicant will enter into and abide by the terms of a labor peace agreement as soon as reasonably practicable after licensure.
- (21) The limited waiver of sovereign immunity required by section 5009 of this division, if applicable.
- (22) The applicant's State Employer Identification Number (SEIN) issued by the California Employment Development Department.
- (23) For an applicant with more than one employee, the applicant shall attest that the applicant employs, or will employ within one year of receiving a license, one supervisor and one employee who have successfully completed a Cal-OSHA 30-hour general industry outreach course offered by a training provider that is authorized by an OSHA Training Institute Education Center to provide the course.

Authority: Sections 115.4 and 26013, Business and Professions Code. Reference: Sections 115.4, 144, 26012 and 26200, Business and Professions Code.

§ 5601. Temporary Cannabis Event License.

- (a) A temporary cannabis event license authorizes a licensed cannabis event organizer to hold a temporary cannabis event where the onsite sale and consumption of cannabis goods is authorized at the location indicated on the license during the dates indicated on the license.
- (b) A temporary cannabis event license shall only be issued to a person who holds a cannabis event organizer license issued by the Bureau.
- (c) Violations of the requirements applicable to temporary cannabis events may result in disciplinary action against the cannabis event organizer license or any other licenses held by a licensee participating in the temporary cannabis event and responsible for a violation under this division or the Act.
- (d) A temporary cannabis event license shall only be issued for a single day or up to 4 consecutive days. No temporary cannabis event license will be issued for more than 4 days.
- (e) An application for a temporary cannabis event license shall be submitted to the Bureau no less than 60 calendar days before the first day of the temporary cannabis event.
- (f) A temporary cannabis event may only be held at a county fair event, district agricultural association event, or at another venue expressly approved by a local jurisdiction for the purpose of holding a temporary cannabis event.
- (g) A temporary cannabis event license shall not be issued for a premises that is licensed for the sale of alcohol or tobacco.
- (h) An application for a temporary cannabis event license shall include the following:
 - (1) The name of the applicant. For applicants who are individuals, the applicant shall provide both the first and last name of the individual. For applicants who are business entities, the applicant shall provide the legal business name of the applicant.
 - (2) The license number for each state cannabis license held by the applicant.
 - (3) The address of the location where the temporary cannabis event will be held.
 - (4) The name of the temporary cannabis event.
 - (5) A diagram of the physical layout of the temporary cannabis event. The diagram shall clearly indicate where the temporary cannabis event will be taking place on the location grounds, all entrances and exits that will be used by participants during the event, all cannabis consumption areas, and all retail areas where cannabis goods will be sold. The hours during which cannabis goods will be sold shall be noted on the diagram. The diagram shall also clearly indicate the area where cannabis waste will be stored, all areas where cannabis goods will be stored, and the specific location of each cannabis licensee who will be participating in the event. Each cannabis licensee participating in the event shall be identified with an assigned temporary cannabis event location number. The diagram shall not contain highlighting and the markings on the diagram shall be in black-and-white print.
 - (6) The dates and hours of operation for which the temporary cannabis event license is being sought. A temporary event license is required for any date in which the applicant engages in onsite cannabis sales or allows onsite cannabis consumption.
 - (7) Contact information for the applicant's designated primary contact person regarding the temporary event license, including the name, title, address, phone number, and email address of

the individual.

(8) Contact information for a designated contact person(s) who shall be onsite at the event and reachable by telephone at all times that the event is occurring.

(9) Written approval from the local jurisdiction authorizing the applicant to engage in onsite cannabis sales to, and onsite consumption by, persons 21 years of age or older at the temporary cannabis event at the proposed location.

(10) A list of all licensees and employees that will be providing onsite sales of cannabis goods at the temporary cannabis event.

(11) Attestation to the following statement: Under penalty of perjury, I hereby declare that the information contained within and submitted with the application is complete, true, and accurate. I understand that a misrepresentation of fact is cause for rejection of this application, denial of the license, or revocation of a license issued.

(i) If the list of licensees and employees participating in the temporary cannabis event changes after the application is submitted or after the license is issued, the applicant shall submit with the Notification and Request Form, BCC-LIC-027 (New 10/18), incorporated herein by reference, an updated list and an updated diagram, as required in subsection (f)(5) of this section, to the Bureau no less than 72 hours before the event. Licensees not on the list submitted to the Bureau shall not participate in the temporary cannabis event.

(j) The licensed cannabis event organizer shall hire or contract for security personnel to provide security services at the licensed temporary cannabis event. All security personnel hired or contracted for by the licensee shall be at least 21 years of age, licensed by the Bureau of Security and Investigative Services, and comply with Chapters 11.4 and 11.5 of Division 3 of the Business and Professions Code. Security personnel shall be present on the licensed premises at all times cannabis goods are available for sale and/or cannabis consumption is allowed on the licensed premises.

(k) A licensed cannabis event organizer shall maintain a clearly legible sign, not less than 7" x 11" in size reading, "No Persons Under 21 Allowed" at or near each public entrance to any area where the sale or consumption of cannabis goods is allowed. The lettering of the sign shall be no less than 1 inch in height.

(l) All cannabis waste generated at a temporary cannabis event shall be collected and disposed of in accordance with the requirements of section 5054 this division. The licensed cannabis event organizer may contract or arrange for the collection and disposal of cannabis waste generated during the temporary cannabis event.

(m) A licensed cannabis event organizer and all other licensees participating in a temporary cannabis event are required to comply with section 5037 of this division and all other applicable requirements in the Act and this division pertaining to recordkeeping.

(n) The Bureau may require the event organizer and all participants to cease operations without delay if, in the opinion of the Bureau or local law enforcement, it is necessary to protect the immediate public health and safety of the people of the state. Upon notification from the Bureau that the event is to cease operations, the event organizer shall immediately stop the event and all participants shall be removed from the premises within the time frame provided by the Bureau.

(o) Upon notification from the Bureau, the event organizer shall immediately expel from the event any person selling cannabis goods without a license from the Bureau that authorizes the

participant to sell cannabis goods. The event organizer or their representative shall remain with the person being expelled from the premises at all times until he or she vacates the premises. If the person does not vacate the premises, the Bureau may inform the event organizer that the event must cease operations. Upon notification from the Bureau that the event is to cease operations, the event organizer shall immediately stop the event and all participants shall be removed from the premises within the time frame provided by the Bureau.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26200, Business and Professions Code.

§ 5602. Temporary Cannabis Event Sales.

(a) Only persons age 21 or older may purchase and consume cannabis goods at a temporary cannabis event. Prior to selling cannabis goods to a customer, the licensee making the sale shall confirm, using valid identification as specified in section 5404 of this division, the age and identity of the customer.

(b) All sales of cannabis goods at a temporary cannabis event must occur in a retail area as designated in the premises diagram pursuant to section 5601(h)(5) of this division.

(c) Each sale at a temporary cannabis event shall be performed by a licensed retailer, a licensed non-storefront retailer, or licensed microbusiness that is authorized to engage in retail sales. The cannabis event organizer may also sell cannabis goods at the temporary cannabis event if the organizer separately holds a license authorizing the retail sale of cannabis goods.

(1) Licensed retailers or licensed microbusinesses shall only conduct sales activities within their specifically assigned area, identified in the diagram of the physical layout of the temporary cannabis event.

(2) Mobile sales activities via wagon, cart, or similar means are prohibited at the temporary cannabis event site.

(d) Licensed retailers or licensed microbusinesses must prominently display their temporary cannabis event location number and state license within plain sight of the public.

(e) All sales at a temporary cannabis event shall occur on the dates stated on the license and shall occur at the location stated on the license. All onsite sales of cannabis goods must comply with the hours of operation requirements of section 5403 of this division.

(f) Sale of alcohol or tobacco shall not be allowed on the licensed temporary cannabis event premises.

(g) The cannabis goods sold onsite at a temporary cannabis event shall be transported by a licensed distributor or licensed microbusiness in compliance with the Act and this division. All shipments of cannabis and non-cannabis goods intended for sale at a temporary cannabis event must be checked by the temporary cannabis event organizer staff to prevent prohibited items, such as alcohol and tobacco, from entering the licensed premises.

(h) Except small amounts of cannabis goods used for display, all cannabis goods for sale at a temporary cannabis event shall be stored in a secure, locked container that is not accessible to the public. Cannabis goods being stored by a licensee at a temporary cannabis event shall not be left unattended. Licensees may share the secure, locked container; however, each licensee using the container shall be held responsible for any violations of this section and subject to disciplinary

action.

- (i) All cannabis goods made available for sale at a cannabis event shall comply with all requirements for the retail sale of cannabis goods within the Act and section 5406 of this division.
- (j) All cannabis goods made available for sale at a temporary cannabis event shall comply with all track and trace requirements within the Act and this division.
- (k) All cannabis goods used for display at a temporary cannabis event shall comply with the requirements of section 5405 of this division.
- (l) All cannabis goods sold at a temporary cannabis event shall comply with section 5413 of this division.
- (m) All customer returns of cannabis goods at a temporary cannabis event shall comply with section 5410 of this division.
- (n) The daily sales limits under section 5409 of this division apply to all sales made at a temporary cannabis event.
- (o) A licensed retailer shall only provide free cannabis goods to a person at a temporary cannabis event if the licensed retailer complies with all requirements of section 5411 of this division.
- (p) The licensed cannabis event organizer shall be responsible for ensuring that all rules and requirements for the onsite sale of cannabis goods are followed.
- (q) Any compensation paid from a licensed retailer to a licensed cannabis event organizer for participation in a temporary cannabis event shall not be determined based on, or be contingent on, the sale of cannabis goods.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26070 and 26200, Business and Professions Code.

§ 5603. Temporary Cannabis Event Consumption.

- (a) Access to the area where cannabis consumption is allowed shall be restricted to persons 21 years of age or older.
- (b) The event organizer licensee shall ensure that cannabis consumption is not visible from any public place or non-age-restricted area.
- (c) Consumption of alcohol or tobacco shall not be allowed on the licensed premises.
- (d) All requirements for onsite cannabis consumption imposed by the relevant local jurisdiction shall be followed and smoking of cannabis goods shall be prohibited in any areas where smoking is prohibited by law.
- (e) The licensed cannabis event organizer, who holds the temporary cannabis event license, shall be responsible for ensuring that all rules and requirements for the onsite consumption of cannabis goods are followed.
- (f) A licensed cannabis event organizer and all other licensees participating in a temporary cannabis event are required to follow all applicable requirements in this division pertaining to

record keeping and waste management.

Authority: Section 26013, Business and Professions Code. Reference: Section 26200, Business and Professions Code.

§ 5604. Informational or Educational Cannabis Events.

(a) Informational or educational cannabis events where no sales of cannabis goods or consumption of cannabis goods is occurring are not required to be licensed by the Bureau.

(b) A person may display cannabis goods for informational or educational purposes consistent with Health and Safety Code sections 11362.1 and 11362.77.

Authority: Section 26013, Business and Professions Code. Reference: Section 26013, Business and Professions Code; and Sections 11362.1 and 11362.77, Health and Safety Code.

Chapter 6. TESTING LABORATORIES

Article 1. Chapter Definitions

§ 5700. Definitions.

In addition to the definitions in section 5000 of this division, the following definitions apply to this chapter.

(a) “Acceptance criteria” means the specified limits placed on the characteristics of an item or method that are used to determine data quality.

(b) “Accreditation body” means an impartial non-profit organization that operates in conformance with the International Organization for Standardization (ISO) / International Electrotechnical Commission (IEC) standard 17011 and is a signatory to the International Laboratory Accreditation Cooperation (ILAC) Mutual Recognition Arrangement (MRA) for Testing.

(c) “Accredited college or university” means a college or university accredited by a regional or national accrediting agency that is an accreditor recognized by the Secretary of the US Department of Education.

(d) “Action level” means the threshold value that provides the criterion for determining whether a sample passes or fails an analytical test.

(e) “Analyte” means a chemical, compound, element, bacteria, yeast, fungus, or toxin to be identified or measured.

(f) “Analytical batch” means a set of no more than 20 samples that is prepared together for the same analysis and are prepared with laboratory quality control (LQC) samples.

(g) “Analytical method” means a technique used qualitatively or quantitatively to determine the composition of a sample or a microbial contamination of a sample.

(h) “Analytical sequence” means a group of samples that are analyzed sequentially using the same instrument calibration curve.

- (i) “Cannabinoid” means a class of diverse chemical compounds derived from a cannabis plant.
- (j) “Cannabis concentrate” means cannabis that has undergone a process to concentrate one or more active cannabinoids, thereby increasing the product’s potency. For purposes of this chapter, “cannabis concentrate” includes, but is not limited to, the separated resinous trichomes of cannabis, tinctures, capsules, suppositories, extracts, vape cartridges, inhaled products (such as dab, shatter, and wax), and tablets as defined by the State Department of Public Health in regulation.
- (k) “CAS number” means the unique numerical identifier assigned to every chemical substance by Chemical Abstracts Service, a division of the American Chemical Society.
- (l) “CBD” means cannabidiol, CAS number 13956-29-1.
- (m) “CBDA” means cannabidiolic acid, CAS number 1244-58-2.
- (n) “CBG” means cannabigerol, CAS number 25654-31-3.
- (o) “CBN” means cannabinol, CAS number 521-35-7.
- (p) “Certificate of accreditation” means a document issued by an accreditation body that attests to the laboratory’s competence to carry out specific testing analysis.
- (q) “Certificate of analysis” (COA) means the report prepared by the laboratory about the analytical testing performed and results obtained by the laboratory.
- (r) “Certified reference material” means a reference material prepared by a certifying body or a party independent of the laboratory with ISO/IEC 17034 accreditation.
- (s) “Chain of Custody” (COC) means the chronological documentation that records the sequence of custody, control, transfer, analysis, and disposal of a sample.
- (t) “Coefficient of Determination” (commonly denoted as “ r^2 ”) means a statistical measure that determines how well the regression approximates the actual data points in the calibration curve, with a regression of 1 being a perfect fit.
- (u) “Continuing calibration verification” (CCV) means a type of quality control sample that includes each of the target method analytes that is a mid-range calibration standard which checks the continued validity of the initial calibration of the instrument.
- (v) “Corrective action” means an action taken by the laboratory to resolve, and prevent from recurrence, a problem with the technical operations of the laboratory.
- (w) “Exclusivity” means the specificity of the test method for validating microbial testing methods. It evaluates the ability of the method to distinguish the target organisms from similar but genetically distinct non-target organisms.
- (x) “Foreign material” means any filthy, putrid, or decomposed substance including hair, insects, excreta, or related adulterant that may be hazardous or cause illness or injury to the consumer.
- (y) “Frequency” means the number of items occurring in each category. Frequency may be

determined by analytical method or laboratory specific requirements for accuracy, precision of the analysis, or statistical calculation.

(z) “Good laboratory practice” (GLP) means a system of management controls for laboratories to ensure the uniformity, consistency, reliability, reproducibility, quality, and integrity of analyses performed by the testing laboratory.

(aa) “Inclusivity” means, related to microbiological method validation, the sensitivity of the test method. It evaluates the ability of the test method to detect a wide range of target organisms by a defined relatedness.

(bb) “Inhalable” means consumable in gaseous or vapor form through the lungs.

(cc) “Initial Calibration Verification” (ICV) means a solution of each of the target method analytes of known concentration that is obtained from a source external to the laboratory and different from the source of calibration standards.

(dd) “ISO/IEC” means the joint technical committee of the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC).

(ee) “ISO/IEC 17025” means the general requirements specified by the ISO/IEC for the competence of testing and calibration laboratories.

(ff) “ISO/IEC 17034” means the general requirements established by the ISO/IEC for the competence of reference material producers.

(gg) “ISO/IEC 17043” means the general requirements established by the ISO/IEC for proficiency testing.

(hh) “Laboratory” means “testing laboratory” as defined at Business and Professions Code section 26001(at).

(ii) “Laboratory Control Sample” (LCS) means a blank matrix to which known concentrations of each of the target method analytes are added. The spiked concentration must be at a mid-range concentration of the calibration curve for the target analytes. The LCS is analyzed in the same manner as the representative sample.

(jj) “Laboratory replicate sample” means a sub-sample taken of the representative sample used for laboratory quality control purposes to demonstrate reproducibility. It is prepared and analyzed in the identical manner as the representative sample. The results from replicate analyses are used to evaluate analytical precision.

(kk) “Laboratory employee” means any person directly employed by the laboratory for wages, salary, barter, or trade by the laboratory and who is not employed by any other licensee under the Act except for another testing laboratory. “Laboratory employee” does not mean an independent contractor, third party entity, or any other entity acting on behalf of the laboratory.

(ll) “Laboratory quality assurance” means the set of operating principles that enable laboratories to produce defensible data of known accuracy and precision and includes employee training, equipment preventative maintenance procedures, calibration procedures, and quality control testing, among other things.

(mm) “Limit of detection” (LOD) means the lowest quantity of a substance or analyte that can

be distinguished from the absence of that substance within a stated confidence limit.

(nn) “Limit of quantitation” (LOQ) means the minimum concentration of an analyte in a specific matrix that can be reliably quantified while also meeting predefined goals for bias and imprecision.

(oo) “Linear regression” means the determination, in analytical chemistry, of the best linear equation for calibration data to generate a calibration curve. The concentration of an analyte in a sample can then be determined by comparing a measurement of the unknown to the calibration curve. A linear regression uses the following equation:

$$y = mx + b; \text{ where } m = \text{slope, } b = \text{intercept}$$

(pp) “Matrix” means the substances that are present in a sample except for the analyte(s) of interest.

(qq) “Matrix spike sample” means a sample prepared by adding a known quantity of each of the target analyte to a sample matrix or to a matrix that is as closely representative of the matrix being analyzed as possible. The spiked concentration must be at a mid-range concentration of the calibration curve for the target analytes.

(rr) “Method blank” means an analyte free matrix to which all reagents are added in the same volumes or proportions as used in the sample preparation and is processed in exactly the same manner as the samples.

(ss) “Moisture content” means the percentage of water in a sample, by weight.

(tt) “Non-target organism” means an organism that the test method or analytical procedure is not testing for and can be used in evaluating the specificity of a test method.

(uu) “Orally-consumed product containing alcohol” means a liquid solution that contains more than 0.5% alcohol by volume as an ingredient, is not otherwise an alcoholic beverage as defined in Business and Professions Code section 23004, is packaged in a container no larger than two (2) fluid ounces and includes a capped calibrated dropper capable of accurately measuring servings.

(vv) “Orally-dissolving product” means an edible cannabis product that is intended to dissolve and release cannabinoids directly into the mouth, which allows them to enter the bloodstream through the tissue, such as sublingual lozenges or mouth strips. Orally dissolving products are not intended to be eaten or swallowed to enter the digestive system.

(ww) “Percent recovery” means the percentage of a measured concentration relative to the added (spiked) concentration in a reference material or matrix spike sample. A laboratory shall calculate the percent recovery by dividing the sample result by the expected result then multiplying the quotient by 100.

(xx) “Practical experience” means experience performing scientific analytical tests in a laboratory setting using equipment, instruments, kits, and materials routinely found in a laboratory. “Practical experience” includes experience in any type of laboratory setting and is not limited to cannabis-specific laboratories.

(yy) “Pre-roll” has the same meaning as in section 5000(q) of this division and also includes, for purposes of this chapter, pre-rolls infused with cannabis concentrate.

(zz) “Proficiency test” means an evaluation of a laboratory’s performance against pre-established criteria by means of interlaboratory comparisons of test measurements.

(aaa) “Proficiency test sample” means a sample that is prepared by a party independent of the testing laboratory with the ISO/IEC 17043 accreditation, where the concentration and identity of an analyte is known to the independent party, but is unknown to the testing laboratory and testing laboratory employees.

(bbb) “Quadratic regression” means the determination, in analytical chemistry, of the best parabola equation for calibration data to generate a calibration curve. The concentration of an analyte in a sample can then be determined by comparing a measurement of the unknown to the calibration curve. A quadratic regression uses the following equation:

$$y = ax^2 + bx + c; \text{ where } a, b, \text{ and } c \text{ are numerical coefficients}$$

(ccc) “Quality control” means the set of measures implemented within an analytical procedure to ensure that the measurement system is operating in a state of statistical control for which errors have been reduced to acceptable levels.

(ddd) “Quality control sample” means a sample that is produced and used by a laboratory for the purpose of assuring the quality of the data and results. Quality control samples include blank samples, matrix spike samples, laboratory control samples, replicate samples, and reference material samples.

(eee) “Reagent” means a compound or mixture added to a system to cause a chemical reaction or test if a reaction occurs. A reagent may be used to tell whether a specific chemical substance is present by causing a reaction to occur with the chemical substance.

(fff) “Reference material” means material containing a known concentration of an analyte of interest that is in solution or in a homogeneous matrix.

(ggg) “Reference method” means the method by which the performance of an alternate method is measured or evaluated.

(hhh) “Relative percent difference” (RPD) means the comparative statistic that is used to calculate precision or random error. RPD is calculated using the following equation:

$$RPD = \left| \frac{\text{representative sample measurement} - \text{replicate sample measurement}}{[\text{representative sample measurement} + \text{replicate sample measurement}] / 2} \right| \times 100\%$$

(iii) “Relative standard deviation” (RSD) means the standard deviation expressed as a percentage of the means recovery. RSD is calculated using the following equation:

$$RSD = (s / x) \times 100\%; \text{ where } s = \text{standard deviation and } x = \text{mean}$$

(jjj) “Representative” means a small quantity of the batch whose characteristics represent, as accurately as possible, the entire batch, thus allowing the results to be generalized.

(kkk) “Representative sample” means a sample that is comprised of several sample increments of cannabis goods that are collected from a batch for testing.

(lll) “Requester” means the person who submits a request to the laboratory for testing of cannabis goods from an entity licensed under the Act.

(mmm) “Reserve sample” means any portion of a representative sample that was not used in the testing process.

(nnn) “Sample” means a representative part of, or a single item from, a batch which is comprised of several sample increments.

(ooo) “Sample increment” means a portion of a batch that, together with other increments, makes up the sample.

(ppp) “Sampler” means the laboratory employee responsible for obtaining samples of cannabis goods from a licensed distributor or licensed microbusiness authorized to engage in distribution.

(qqq) “Sanitize” means to sterilize, disinfect, or make hygienic.

(rrr) “Scope of accreditation” means the tests or types of tests performed, materials or products tested, and the methods used for testing cannabis or cannabis products for which the accreditation has been granted.

(sss) “Standard operating procedure” (SOP) means a written document that provides detailed instructions for the performance of all aspects of an analysis, operation, or action.

(ttt) “Target organism” means an organism that is being tested for in an analytical procedure or test method.

(uuu) “THC” and “delta-9 THC” means tetrahydrocannabinol, CAS number 1972-08-3.

(vvv) “THCA” means tetrahydrocannabinolic acid, CAS number 23978-85-0.

(www) “Topical cannabis goods” means cannabis products intended to be applied to the skin and not intended to be ingested or inhaled. Liquid solutions that contain more than 0.5% alcohol by volume as an ingredient and are not otherwise an alcoholic beverage as defined in Business and Professions Code section 23004 shall only be considered topical cannabis goods if they are packaged in a container no larger than two (2) fluid ounces.

(xxx) “Total CBD” means the sum of CBD and CBDA. Total CBD is calculated using the following equation:

$$\text{Total CBD concentration (mg/g)} = (\text{CBDA concentration (mg/g)} \times 0.877) + \text{CBD concentration (mg/g)}$$

(yyy) “Total THC” means the sum of THC and THCA. Total THC is calculated using the following equation:

$$\text{Total THC concentration (mg/g)} = (\text{THCA concentration (mg/g)} \times 0.877) + \text{THC concentration (mg/g)}$$

(zzz) “Validation” means the confirmation by examination and objective evidence that the requirements for a specific intended use or analytical method are fulfilled.

(aaaa) “Water activity” means the measure of the quantity of water in a product that is available and therefore capable of supporting bacteria, yeasts, and fungi and which is reported in units Aw.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26013 and

26100, Business and Professions Code.

Article 2. Laboratory License

§ 5701. General Laboratory License Requirements.

(a) A licensed laboratory shall maintain ISO/IEC 17025 accreditation for the testing of the following:

- (1) Cannabinoids;
- (2) Heavy metals;
- (3) Microbial impurities;
- (4) Mycotoxins;
- (5) Residual pesticides;
- (6) Residual solvents and processing chemicals; and
- (7) If tested, terpenoids.

(b) Each testing laboratory licensed premises shall have ISO/IEC 17025 accreditation.

(c) A licensed laboratory shall retain, and make available to the Bureau upon request, all records associated with the licensee's ISO/IEC 17025 certificate of accreditation.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012 and 26100, Business and Professions Code.

§ 5702. Laboratory License Application.

In addition to the information required in section 5002 of this division, an application for a testing laboratory license includes the following:

(a) A valid certificate of accreditation, issued by an accreditation body, that attests to the laboratory's competence to perform testing, including all the required analytes for the following test methods:

- (1) Cannabinoids;
- (2) Heavy metals;
- (3) Microbial impurities;
- (4) Mycotoxins;
- (5) Residual pesticides;
- (6) Residual solvents and processing chemicals; and
- (7) If tested, terpenoids.

(b) Standard operating procedures for the following testing methods:

- (1) Cannabinoids;
 - (2) Foreign material;
 - (3) Heavy metals;
 - (4) Microbial impurities;
 - (5) Moisture content and water activity;
 - (6) Mycotoxins;
 - (7) Residual pesticides;
 - (8) Residual solvents and processing chemicals; and
 - (9) If tested, terpenoids.
- (c) Method validation reports for the following testing methods:

- (1) Cannabinoids;
- (2) Heavy metals;
- (3) Microbial impurities;
- (4) Water activity;
- (5) Mycotoxins;
- (6) Residual pesticides;
- (7) Residual solvents; and processing chemicals; and
- (8) If tested, terpenoids.

(d) Standard operating procedures for the sampling of cannabis goods.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26050, 26055, 26102 and 26104, Business and Professions Code.

§ 5703. Interim Testing Laboratory License.

(a) An applicant may apply for an interim license prior to receiving ISO/IEC 17025 accreditation provided that the applicant meets all other licensure requirements for a testing laboratory and submits to the Bureau an application in compliance with section 5002 of this division and an attestation that the applicant has or intends to seek ISO/IEC 17025 accreditation for all testing methods required by this division.

(b) An interim testing laboratory license shall be valid for 12 months. The annual license fee for an interim license shall be determined pursuant to the requirements in section 5014 of this division for determining the annual license fee for a testing laboratory license.

(c) To timely renew an interim license, a completed license renewal form and the annual renewal license fee pursuant to section 5014 of this division shall be received by the Bureau from the licensee no earlier than 60 calendar days before the expiration of the license and no later than

5:00 p.m. Pacific Time on the last business day before the expiration of the license if the renewal form is submitted to the Bureau at its office(s), or no later than 11:59 p.m. on the last business day before the expiration of the license if the renewal form is submitted to the Bureau through its electronic licensing system. Failure to receive a notice for license renewal does not relieve a licensee of the obligation to renew an interim license as required.

(d) In the event the license is not renewed prior to the expiration date, the licensee must not test any commercial cannabis goods until the license is renewed.

(e) A licensee may submit a license renewal form up to 30 calendar days after the license expires. Any late renewal form will be subject to a late fee equal to 50 percent of the applicable licensing fees required by subsection (c) of this section.

(f) The license renewal application shall contain the following:

(1) The name of the licensee. For licensees who are individuals, the applicant shall provide both the first and last name of the individual. For licensees who are business entities, the licensee shall provide the legal business name of the applicant;

(2) The license number and expiration date;

(3) The licensee's address of record and licensed premises address; and

(4) An attestation that all information provided to the Bureau in the original application under section 5002 of this division or subsequent notification under section 5023 of this division is accurate and current.

(g) The Bureau may renew an interim license for an initial renewal period of 12 months.

(h) After one renewal, the Bureau may renew the interim license for additional 12-month periods if the licensee has submitted an application for the ISO/IEC 17025 accreditation. In addition to the information required for a renewal form pursuant to subsection (f) of this section, any renewal request pursuant to this section shall also include an attestation that the licensee's application for each ISO/IEC 17025 is pending with the accrediting body, the name of the accrediting body, and the date the application was submitted to the accrediting body.

(i) The licensee shall notify the Bureau if the application for each ISO/IEC 17025 accreditation is granted or denied within 1 business day of receiving the decision from the accrediting body. The Licensee shall submit to the Bureau the information required, on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference. If the accrediting body grants or denies the licensee's application for any ISO/IEC 17025 accreditation before the expiration of the interim license, the Bureau may terminate the interim license at that time.

(j) The Bureau may revoke an interim license at any time.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26031, 26050 and 26102, Business and Professions Code.

Article 3. Sampling Cannabis and Cannabis Products

§ 5704. Sampling Standard Operating Procedures.

(a) The laboratory shall develop and implement a sampling standard operating procedure (SOP)

that describes the laboratory's method for obtaining representative samples of cannabis goods. The laboratory shall use and submit to the Bureau Sampling – Standard Operating Procedures, Form BCC-LIC-021 (New 7/18), which is incorporated herein by reference.

(b) The laboratory shall retain a copy of the sampling SOP on the licensed laboratory premises and ensure that the sampling SOP is accessible to the sampler during sampling.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26102, 26104 and 26110, Business and Professions Code.

§ 5705. General Sampling Requirements.

(a) The laboratory that obtains a representative sample from a licensed distributor or licensed microbusiness shall perform all the required testing at one licensed laboratory premises.

(b) The laboratory may obtain and analyze samples only from batches in final form as required by Business and Professions Code section 26100.

(c) The laboratory sampler shall collect a representative sample from each batch following the procedures specified in the laboratory's sampling standard operating procedure(s).

(d) The laboratory shall ensure that the sample is transported and subsequently stored at the licensed laboratory premises in a manner that prevents degradation, contamination, commingling, and tampering. If the cannabis good specifies on the label how the cannabis good shall be stored, the laboratory shall store the sample as indicated on the label.

(e) The laboratory shall complete a chain of custody form for each sample that the laboratory collects and analyzes.

(f) Once a representative sample has been obtained for regulatory compliance testing, the licensed testing laboratory that obtained the sample must complete the regulatory compliance testing.

(g) If a licensed laboratory is unable to competently complete the regulatory compliance testing after sampling and before a COA is issued, the licensed distributor or microbusiness authorized to engage in distribution who arranged for the testing of the batch(s) may request approval from the Bureau to have the impacted batch(s) re-sampled and tested by another licensed laboratory.

(1) The request shall be made in writing via email to bcc.labs@dca.ca.gov and shall include all of the following:

(A) The name and license number of the distributor;

(B) The batch numbers;

(C) The type and quantity of cannabis goods;

(D) The name and license number of the laboratory that took the initial sample and is not able to competently complete the regulatory compliance testing;

(E) The name and license number of the laboratory proposed to re-sample and complete the regulatory compliance testing for the batch(s); and

(F) The reason why the laboratory that initially took the sample cannot competently complete the regulatory compliance testing.

(2) The Bureau will review the request and determine if the laboratory that initially took the sample is unable to competently complete the regulatory compliance testing. If the Bureau determines that the laboratory is unable to competently complete the regulatory compliance testing, the Bureau, in its discretion, may approve the request in whole or part and set conditions for the re-sampling and testing.

(3) No re-sampling of any batch shall occur prior to the licensed distributor or licensed microbusiness authorized to engaged in distribution receiving written approval from the Bureau.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5706. Chain of Custody (COC).

(a) The laboratory shall develop and implement a COC protocol to ensure accurate documentation is recorded for the transport, handling, storage, and destruction of samples.

(b) The COC protocol shall require the use of a COC form. The sampler shall use a COC to record the following information for each sampled batch:

(1) Laboratory's name, licensed premises address, and license number;

(2) Date and time sampling started and ended;

(3) Licensed distributor or licensed microbusiness' name, licensed premises address, and license number;

(4) Licensed cultivator's, licensed manufacturer's, or licensed microbusiness' name, licensed premises address, and license number;

(5) Batch number of the batch from which the representative sample was obtained and assigned unique sample identifier;

(6) Sample matrix;

(7) Total batch size, by weight, or unit count;

(8) Total weight, or unit count of the representative sample;

(9) Sampling conditions or problems encountered during the sampling process, if any;

(10) Printed name and signature of the licensed distributor or licensed microbusiness' authorized to engage in distribution employee; and

(11) Printed name and signature of the sampler.

(c) Each time a sample changes custody between licensees, is transported, or is destroyed, the date, time, and the names and signatures of persons involved in these activities shall be recorded on the COC form.

(d) Once the custody of the sample changes between licensees, the COC form for that change of custody may not be altered.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26102, 26104 and 26110, Business and Professions Code.

§ 5707. Harvest Batch Sampling.

(a) The sampler shall obtain a representative sample from each prepacked or unpacked harvest batch. The representative sample must weigh 0.35% of the total harvest batch weight.

(b) A sampler may collect a representative sample greater than 0.35% of the total harvest batch weight of a prepacked or unpacked harvest batch if necessary to perform the required testing or to ensure that the samples obtained are representative.

(c) The prepacked or unpacked harvest batch from which a sample is obtained shall weigh no more than 50.0 pounds. Laboratory analyses of a sample collected from a harvest batch weighing more than 50.0 pounds shall be deemed invalid and the harvest batch from which the sample was obtained shall not be released for retail sale.

(d) When the sampler obtains a representative sample from an unpacked harvest batch, the sampler shall do all the following:

(1) Collect the number of sample increments relative to the unpacked harvest batch size as listed in the following table;

(2) Obtain sample increments from random and varying locations of the unpacked harvest batch, both vertically and horizontally. To the extent practicable, the sample increments obtained from an unpacked harvest batch shall be of equal weight; and

(3) To the extent practicable, collect an equal number of sample increments from each container if the unpacked harvest batch is stored in multiple containers.

Unpacked Harvest Batch Size (pounds)	Number of Increments (per sample)
≤ 10.0	8
10.1 – 20.0	16
20.1 – 30.0	23
30.1 – 40.0	29
40.1 – 50.0	34

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5708. Cannabis Product Batch and Pre-Roll Sampling.

- (a) The sampler shall obtain a representative sample from each cannabis product batch or pre-roll batch.
- (b) The sampler may collect a greater number of sample increments if necessary to perform the required testing or to ensure that the samples obtained are representative.
- (c) The cannabis product batch or pre-roll batch from which a representative sample is obtained shall contain no more than 150,000 units. Laboratory analyses of a sample collected from a cannabis product batch containing more than 150,000 units shall be deemed invalid and the cannabis product batch or pre-roll batch from which the representative sample was obtained shall not be released for retail sale.
- (d) The sampler shall obtain a representative sample of a cannabis product or pre-roll batch by collecting, at minimum, the number of sample increments relative to the batch size as listed in the following table. Each sample increment consists of 1 packaged unit.

Cannabis Product or Pre-roll Batch Size (units)	Number of Sample Increments (per sample)
≤ 50	2
51 – 150	3
151 – 500	5
501 – 1,200	8
1,201 – 3,200	13
3,201 – 10,000	20
10,001 – 35,000	32
35,001 – 150,000	50

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5709. Laboratory Transportation of Cannabis Goods Samples.

- (a) The following requirements apply when a licensed testing laboratory transports cannabis goods samples:
 - (1) While transporting cannabis goods samples, a licensed testing laboratory employee shall ensure the cannabis goods are not visible to the public. Cannabis goods shall be locked in a fully enclosed box, container, or cage that is secured to the inside of the vehicle or trailer. No portion of the enclosed box, container, or cage shall be comprised of any part of the body of the vehicle or trailer. For the purposes of this section, the inside of the vehicle includes the trunk.
 - (2) While left unattended, vehicles and trailers shall be locked and secured.
 - (3) The laboratory shall not leave a vehicle or trailer containing cannabis goods samples unattended in a residential area or parked overnight in a residential area.
 - (4) The laboratory shall ensure that any vehicle or trailer transporting cannabis goods samples has an alarm system.

(5) The laboratory shall ensure that packages or containers holding cannabis goods samples are neither tampered with, nor opened during transport.

(6) The laboratory transporting cannabis goods samples shall only travel between licensees for whom the laboratory is conducting regulatory compliance testing or quality assurance testing. A laboratory shall not deviate from the travel requirements described in this section, except for necessary rest, fuel, or vehicle repair stops.

(7) The laboratory may transport multiple cannabis goods samples obtained from multiple licensees at once.

(8) Vehicles or trailers transporting cannabis goods samples are subject to inspection by the Bureau at any licensed premises or during transport at any time.

(9) No person under the age of 21 years old shall be in a vehicle or trailer transporting cannabis goods samples.

(10) Only an employee of the laboratory or security personnel who meets the requirement of section 5045 of this division shall be in a vehicle while transporting cannabis goods samples.

(b) The laboratory shall provide the following required transport vehicle information to the Bureau:

(1) Proof that the laboratory is the registered owner under the Vehicle Code for each vehicle used to transport cannabis goods samples;

(2) The year, make, model, license plate number, and numerical Vehicle Identification Number (VIN) for each vehicle or trailer used to transport cannabis goods samples; and

(3) Proof of insurance for each vehicle used to transport cannabis goods samples.

(c) The laboratory shall provide the Bureau with the information required by this section in writing for any new vehicle or trailer that will be used to transport cannabis goods samples prior to using the vehicle or trailer.

(d) The laboratory shall provide the Bureau with the information required under subsection (c) of this section and with any changes to the information required by this section in writing within 30 calendar days, submitted on the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26102, 26104 and 26110, Business and Professions Code.

§ 5710. Laboratory Receipt of Samples Obtained from a Distributor or Microbusiness.

(a) The laboratory may accept and analyze a sample from a licensed distributor or licensed microbusiness authorized to engage in distribution for the required testing under section 5714 of this division only if there is an accompanying COC form for the sample.

(b) The laboratory employee who receives the sample shall date, print, and sign their name on the accompanying sample COC.

(c) The laboratory shall not analyze a sample obtained from a licensed distributor or licensed

microbusiness authorized to engage in distribution, and the batch from which the sample was obtained may not be released for retail sale, if any of the following occur:

- (1) The sample is received at the laboratory without the requisite COC form;
- (2) The tamper-evident material is broken prior to the sample being received at the laboratory; or
- (3) There is evidence of sample commingling, contamination, degradation, or a related occurrence rendering the sample unusable for analytical testing when the sample is received at the laboratory.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

Article 4. Standard Operating Procedures

§ 5711. Laboratory Analyses Standard Operating Procedures.

(a) The laboratory shall develop, implement, and maintain written standard operating procedures (SOP) for sample preparation and each required test method. The laboratory shall use and submit to the Bureau the following forms which are incorporated by reference:

- (1) Sample Preparation – Standard Operating Procedures, Form BCC-LIC-022 (New 7/18), which is incorporated herein by reference; and
 - (2) Test Methods – Standard Operating Procedures, Form BCC-LIC-023 (New 7/18), which is incorporated herein by reference.
- (b) The laboratory shall keep each SOP at the licensed laboratory premises and ensure that each SOP is accessible to laboratory employees during operating hours.
- (c) The laboratory shall make each SOP available for inspection by the Bureau upon request, as well as any other SOPs associated with the licensee’s ISO/IEC 17025 certificate of accreditation.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26100, 26102, 26104 and 26110, Business and Professions Code.

§ 5712. Test Methods.

- (a) The laboratory shall develop, implement, and validate test methods for the analyses of samples as required under this division.
- (b) To the extent practicable, the laboratory test methods shall comport with the following guidelines:
- (1) US Food and Drug Administration’s *Bacterial Analytical Manual*, 2016;
 - (2) AOAC International’s *Official Methods of Analysis for Contaminant Testing of AOAC International*, 20th Edition, 2016; and
 - (3) United States Pharmacopeia and the National Formulary’s *Methods of Analysis for Contaminant Testing*, 2016.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26102,

§ 5713. Validation of Test Methods.

(a) The laboratory may use a nonstandard, amplified, or modified test method or a method that is designed or developed by the laboratory to validate the methods for analyses of samples.

(b) The laboratory shall follow the guidelines set forth in the US Food and Drug Administration’s *Guidelines for the Validation of Analytical Methods for the Detection of Microbial Pathogens in Foods and Feeds*, 2nd Edition, April 2015, incorporated herein by reference, to validate test methods for the microbial analysis of samples. The laboratory shall include and address the criteria listed in the following table when validating test methods for microbial analyses of samples.

Criteria	Requirement
Number of target organisms; inclusivity	5
Number of non-target organisms; exclusivity	5
Number of analyte levels per matrix: Qualitative methods	3 levels: high and low inoculum levels and 1 uninoculated level
Number of analyte levels per matrix: Quantitative methods	4 levels: low, medium and high inoculum levels and 1 uninoculated level
Replicates per food at each level tested	2 or more replicates per level

(c) The laboratory shall follow the guidelines set forth in the US Food and Drug Administration’s *Guidelines for the Validation of Chemical Methods for the FDA FVM Program*, 2nd Edition, April 2015, incorporated herein by reference, to validate test methods for chemical analysis of samples.

(1) The laboratory shall include and address the following criteria to validate test methods for chemical analyses of samples:

(A) Accuracy;

(B) Precision;

(C) Linearity and range;

(i) The Coefficient of Determination (r^2) for all calibration curves shall be greater than or equal to 0.99.

(ii) Linear regression or quadratic regression shall only be used for calibration curves. Curves shall not be weighted at all or only weighted at $1/x$.

(iii) LOQ for analytes tested shall be within the range of the calibration curve.

(D) Calibration standard;

(i) For calibration curves, there shall be a minimum of five calibration standards, not including zero; and

(ii) Each calibration curve must include an Initial Calibration Verification (ICV). The percent recovery must be between 70% to 130%.

(E) Sensitivity and selectivity;

(F) Limit of detection and limit of quantitation;

(G) Recovery;

(H) Reproducibility; and

(I) Robustness.

(2) The laboratory shall use certified reference materials to validate the following chemical analyses. The test method used for analysis is valid if the percent recovery of the certified reference material is between 80% to 120% for all required analytes.

(A) Cannabinoids, if available;

(B) Heavy metals;

(C) Microbial impurities;

(D) Mycotoxins;

(E) Residual pesticides;

(F) Residual solvents and processing chemicals; and

(G) Terpenoids, if available.

(d) The laboratory shall generate a validation report for each test method. Each validation report shall include the following information:

(1) Instrument calibration data, if any;

(2) Raw data, including instrument raw data, for each test method, if any;

(3) Cannabis reference materials or certified reference material results;

(4) Data and calculations pertaining to LOD and LOQ determinations, if any;

(5) LQC report, as described in this chapter, for the validation of each method; and

(6) Worksheets, forms, pictures, or copies of laboratory notebook pages and any other documentation necessary to meet the requirements described in subsections (b) and (c) of this section.

(7) The supervisory or management laboratory employee shall review, approve, sign, and date the validation report for each test method.

(8) Upon new test methods or altered test methods being used in the laboratory, the new validation report shall be submitted to the Bureau within 5 business days, accompanied by the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by

reference.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26100, 26104 and 26110, Business and Professions Code.

Article 5. Laboratory Testing and Reporting

§ 5714. Required Testing.

- (a) All sample increments collected must be homogenized prior to sample analyses, notwithstanding foreign material testing.
- (b) The laboratory shall test each representative sample for the following:
 - (1) Cannabinoids;
 - (2) Foreign material;
 - (3) Heavy metals;
 - (4) Microbial impurities;
 - (5) Mycotoxins;
 - (6) Moisture content and water activity;
 - (7) Residual pesticides;
 - (8) Residual solvents and processing chemicals; and
 - (9) If applicable, terpenoids.
- (c) The laboratory shall report the results of each analysis performed by the laboratory on the certificate of analysis.
- (d) The laboratory that obtained the representative sample shall complete all required testing for each representative sample for regulatory compliance testing.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5715. Phase-In of Required Laboratory Testing.

- (a) Cannabis goods shall not be sold or transferred to a licensed retailer or licensed microbusiness, or released for retail sale, unless a representative sample of the cannabis goods has undergone and passed all testing as required by this section.
- (b) All cannabis harvested on or after January 1, 2018, and all cannabis products manufactured on or after January 1, 2018, shall be tested for the following analytes, if applicable:
 - (1) Cannabinoids as required in section 5724 of this division;
 - (2) Moisture content as required in section 5717 of this division;

(3) Category II Residual Solvents and Processing Chemicals as required in section 5718 of this division;

(4) Category I Residual Pesticides as required in section 5719 of this division; and

(5) Microbial Impurities as required in section 5720 of this division.

(c) In addition to the requirements of subsection (b) of this section, all cannabis harvested on or after July 1, 2018, and all cannabis products manufactured on or after July 1, 2018, shall be tested for the following analytes, if applicable:

(1) Category I Residual Solvents and Processing Chemicals as required in section 5718 of this division;

(2) Category II Residual Pesticides as required in section 5719 of this division; and

(3) Foreign Material as required in section 5722 of this division.

(d) In addition to the requirements in subsections (b) and (c) of this section, all cannabis harvested on or after December 31, 2018, and all cannabis products manufactured on or after December 31, 2018, shall be tested for the following analytes, if applicable:

(1) Terpenoids as required in section 5725 of this division;

(2) Mycotoxins as required in section 5721 of this division;

(3) Heavy Metals as required in section 5723 of this division; and

(4) Water Activity as required in section 5717 of this division.

(e) Licensees may have a sample of cannabis goods tested for analytes that are not yet required to be tested. However, if the sample fails any additional test(s) not required pursuant to this section on the date of testing, the batch from which the sample was collected fails testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5717. Moisture Content and Water Activity Testing.

(a) The laboratory shall analyze at minimum 0.5 grams of the representative sample of dried flower to determine the level of water activity and the percentage of moisture content.

(1) The dried flower sample, including pre-rolls, shall be deemed to have passed water activity testing if the water activity does not exceed 0.65 Aw. The laboratory shall report the result of the water activity test on the certificate of analysis (COA) and indicate “pass” or “fail” on the COA.

(2) The laboratory shall report the result of the moisture content test on the COA as a percentage.

(b) The laboratory shall analyze at least 0.5 grams of the representative sample of solid edible cannabis products to determine the level of water activity. A solid edible cannabis product shall be deemed to have passed water activity testing if the water activity does not exceed 0.85 Aw.

The laboratory shall report the result of the water activity test on the COA and indicate “pass” or “fail” on the COA.

(c) If the sample fails water activity testing, the batch from which the sample was collected fails water activity testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5718. Residual Solvents and Processing Chemicals Testing.

(a) The laboratory shall analyze at minimum 0.25 grams of the representative sample of cannabis product or pre-rolls to determine whether residual solvents or processing chemicals are present.

(b) The laboratory shall report the result of the residual solvents and processing chemicals testing in unit micrograms per gram (µg/g) on the COA and indicate “pass” or “fail” on the COA.

(c) The sample shall be deemed to have passed the residual solvents and processing chemicals testing if the presence of any residual solvent or processing chemical listed in the following tables in Category I and Category II does not exceed the indicated action levels.

(1) Notwithstanding subsection (c), the limit for ethanol does not apply to cannabis goods that are intended to be orally-consumed products containing alcohol as defined in section 5700 of this division.

(2) Notwithstanding subsection (c), the limit for ethanol or isopropyl alcohol does not apply to cannabis goods that are intended to be topical cannabis goods as defined in section 5700 of this division.

Category I Residual Solvent or Processing Chemical	CAS No.	Cannabis Product or Pre-Roll Action Level (µg/g)
1,2-Dichloroethane	107-06-2	1.0
Benzene	71-43-2	1.0
Chloroform	67-66-3	1.0
Ethylene oxide	75-21-8	1.0
Methylene chloride	75-09-2	1.0
Trichloroethylene	79-01-6	1.0

Category II Residual Solvent or Processing Chemical	CAS No.	Cannabis Product or Pre-roll Action Level (µg/g)
Acetone	67-64-1	5000

Acetonitrile	75-05-8	410
Butane	106-97-8	5000
Ethanol	64-17-5	5000
Ethyl acetate	141-78-6	5000
Ethyl ether	60-29-7	5000
Heptane	142-82-5	5000
Hexane	110-54-3	290
Isopropyl alcohol	67-63-0	5000
Methanol	67-56-1	3000
Pentane	109-66-0	5000
Propane	74-98-6	5000
Toluene	108-88-3	890
Total xylenes (ortho-, meta-, para-)	1330-20-7	2170

(d) If the sample fails residual solvents and processing chemicals testing, the batch from which the sample was collected fails residual solvents and processing chemicals testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5719. Residual Pesticides Testing.

(a) The laboratory shall analyze at minimum 0.5 grams of the representative sample of cannabis goods to determine whether residual pesticides are present.

(b) The laboratory shall report whether any Category I Residual Pesticides are detected above the limit of detection (LOD) and shall report the result of the Category II Residual Pesticides testing in unit micrograms per gram ($\mu\text{g/g}$) on the COA. The laboratory shall indicate “pass” or “fail” on the COA.

(c) The laboratory shall establish a limit of quantitation (LOQ) of 0.10 $\mu\text{g/g}$ or lower for all Category I Residual Pesticides.

(d) The sample shall be deemed to have passed the residual pesticides testing if both of the following conditions are met:

(1) The presence of any residual pesticide listed in the following tables in Category I are not detected, and

(2) The presence of any residual pesticide listed in the following tables in Category II does not exceed the indicated action levels.

Category I Residual Pesticide	CAS No.
Aldicarb	116-06-3
Carbofuran	1563-66-2
Chlordane	57-74-9
Chlorfenapyr	122453-73-0
Chlorpyrifos	2921-88-2
Coumaphos	56-72-4
Daminozide	1596-84-5
DDVP (Dichlorvos)	62-73-7
Dimethoate	60-51-5
Ethoprop(hos)	13194-48-4
Etofenprox	80844-07-1
Fenoxycarb	72490-01-8
Fipronil	120068-37-3
Imazalil	35554-44-0
Methiocarb	2032-65-7
Methyl parathion	298-00-0
Mevinphos	7786-34-7
Paclobutrazol	76738-62-0
Propoxur	114-26-1
Spiroxamine	118134-30-8
Thiacloprid	111988-49-9

Category II Residual Pesticide	CAS No.	Action Level (µg/g)	
		Inhalable Cannabis Goods	Other Cannabis Goods
Abamectin	71751-41-2	0.1	0.3
Acephate	30560-19-1	0.1	5

Acequinocyl	57960-19-7	0.1	4
Acetamiprid	135410-20-7	0.1	5
Azoxystrobin	131860-33-8	0.1	40
Bifenazate	149877-41-8	0.1	5
Bifenthrin	82657-04-3	3	0.5
Boscalid	188425-85-6	0.1	10
Captan	133-06-2	0.7	5
Carbaryl	63-25-2	0.5	0.5
Chlorantraniliprole	500008-45-7	10	40
Clofentezine	74115-24-5	0.1	0.5
Cyfluthrin	68359-37-5	2	1
Cypermethrin	52315-07-8	1	1
Diazinon	333-41-5	0.1	0.2
Dimethomorph	110488-70-5	2	20
Etoxazole	153233-91-1	0.1	1.5
Fenhexamid	126833-17-8	0.1	10
Fenpyroximate	111812-58-9	0.1	2
Fonicamid	158062-67-0	0.1	2
Fludioxonil	131341-86-1	0.1	30
Hexythiazox	78587-05-0	0.1	2
Imidacloprid	138261-41-3	5	3
Kresoxim-methyl	143390-89-0	0.1	1

Category II Residual Pesticide	CAS No.	Action Level (µg/g)	
		Inhalable Cannabis Goods	Other Cannabis Goods
Malathion	121-75-5	0.5	5
Metalaxyl	57837-19-1	2	15

Methomyl	16752-77-5	1	0.1
Myclobutanil	88671-89-0	0.1	9
Naled	300-76-5	0.1	0.5
Oxamyl	23135-22-0	0.5	0.2
Pentachloronitrobenzene	82-68-8	0.1	0.2
Permethrin	52645-53-1	0.5	20
Phosmet	732-11-6	0.1	0.2
Piperonylbutoxide	51-03-6	3	8
Prallethrin	23031-36-9	0.1	0.4
Propiconazole	60207-90-1	0.1	20
Pyrethrins	8003-34-7	0.5	1
Pyridaben	96489-71-3	0.1	3
Spinetoram	187166-15-0, 187166-40-1	0.1	3
Spinosad	131929-60-7, 131929-63-0	0.1	3
Spiromesifen	283594-90-1	0.1	12
Spirotetramat	203313-25-1	0.1	13
Tebuconazole	107534-96-3	0.1	2
Thiamethoxam	153719-23-4	5	4.5
Trifloxystrobin	141517-21-7	0.1	30

(e) If the sample fails residual pesticides testing, the batch from which the sample was collected fails residual pesticides testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5720. Microbial Impurities Testing.

(a) The laboratory shall analyze at minimum 1.0 grams of the representative sample of cannabis goods to determine whether microbial impurities are present.

(b) The laboratory shall report the result of the microbial impurities testing by indicating “pass” or “fail” on the COA.

(c) The sample of inhalable cannabis goods shall be deemed to have passed the microbial impurities testing if all of the following conditions are met:

- (1) Shiga toxin-producing *Escherichia coli* is not detected in 1 gram;
- (2) *Salmonella* spp. is not detected in 1 gram; and
- (3) Pathogenic *Aspergillus* species *A. fumigatus*, *A. flavus*, *A. niger*, and *A. terreus* are not detected in 1 gram.

(d) The sample of non-inhalable cannabis goods shall be deemed to have passed the microbial impurities testing if both the following conditions are met:

- (1) Shiga toxin-producing *Escherichia coli* is not detected in 1 gram, and
- (2) *Salmonella* spp. is not detected in 1 gram.

(e) If the sample fails microbial impurities testing, the batch from which the sample was collected fails microbial impurities testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5721. Mycotoxin Testing.

- (a) The laboratory shall analyze at minimum 0.5 grams of the representative sample of cannabis goods to determine whether mycotoxins are present.
- (b) The laboratory shall report the result of the mycotoxins testing in unit micrograms per kilograms ($\mu\text{g}/\text{kg}$) on the COA and indicate “pass” or “fail” on the COA.
- (c) The sample shall be deemed to have passed mycotoxin testing if both the following conditions are met:
 - (1) Total of aflatoxin B1, B2, G1, and G2 does not exceed 20 $\mu\text{g}/\text{kg}$ of substance, and
 - (2) Ochratoxin A does not exceed 20 $\mu\text{g}/\text{kg}$ of substance.
- (d) If the sample fails mycotoxin testing, the batch from which the sample was collected fails mycotoxin testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5722. Foreign Material Testing.

- (a) The laboratory shall analyze the representative sample of cannabis goods to determine whether foreign material is present.
- (b) The laboratory shall report the result of the foreign material test by indicating “pass” or “fail” on the COA.
- (c) The laboratory shall perform foreign material testing on the total representative sample

prior to sample homogenization.

(d) When the laboratory performs foreign material testing, at minimum, the laboratory shall do all of the following:

- (1) Examine both the exterior and interior of the dried flower sample, and
- (2) Examine the exterior of the cannabis product sample.

(e) The sample shall be deemed to have passed the foreign material testing if the presence of foreign material does not exceed:

- (1) 1/4 of the total sample area covered by sand, soil, cinders, or dirt;
- (2) 1/4 of the total sample area covered by mold;
- (3) 1 insect fragment, 1 hair, or 1 count mammalian excreta per 3.0 grams; or
- (4) 1/4 of the total sample area covered by an imbedded foreign material.

(f) If the sample fails foreign material testing, the batch from which the sample was collected fails foreign material testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5723. Heavy Metals Testing.

(a) The laboratory shall analyze at minimum 0.5 grams of the representative sample of cannabis goods to determine whether heavy metals are present.

(b) The laboratory shall report the result of the heavy metals test in unit micrograms per gram ($\mu\text{g/g}$) on the COA and indicate “pass” or “fail” on the COA.

(c) The sample shall be deemed to have passed the heavy metals testing if the presence of heavy metals does not exceed the action levels listed in the following table.

Heavy Metal	Action Level ($\mu\text{g/g}$)	
	Inhalable Cannabis Goods	Other Cannabis Goods
Cadmium	0.2	0.5
Lead	0.5	0.5
Arsenic	0.2	1.5
Mercury	0.1	3.0

(d) If the sample fails heavy metals testing, the batch from which the sample was collected fails heavy metals testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104

and 26110, Business and Professions Code.

§ 5724. Cannabinoid Testing.

(a) The laboratory shall analyze at minimum 0.5 grams of the representative sample of cannabis goods to determine the cannabinoid profile such as THC; THCA; CBD; CBDA; CBG; and CBN.

(b) The laboratory shall establish a limit of quantitation (LOQ) of 1.0 mg/g or lower for all cannabinoids analyzed and reported.

(c) The laboratory shall report the result of the cannabinoid testing on the COA, including, at minimum:

(1) A percentage for THC, THCA, CBD, and CBDA;

(A) When the laboratory reports the result of the cannabinoid testing for harvest batch representative samples on the COA in dry-weight percent, they shall use the following equation:

$$\text{Dry-weight percent cannabinoid} = \text{wet-weight percent cannabinoid} / (1 - \text{percent moisture} / 100)$$

(2) A percentage for Total THC and Total CBD, if applicable;

(3) Milligrams per gram (mg/g) if by dry-weight or milligrams per milliliter (mg/mL) if by volume for THC, THCA, CBD, and CBDA.

(4) Milligrams per gram (mg/g) if by dry-weight or milligrams per milliliter (mg/mL) if by volume for Total THC and Total CBD, if applicable;

(A) The laboratory shall calculate the total cannabinoid concentration as follows:

(i) For concentration expressed in weight:

$$\text{Total cannabinoid concentration (mg/g)} = (\text{cannabinoid acid form concentration (mg/g)} \times 0.877) + \text{cannabinoid concentration (mg/g)}$$

(ii) For concentration expressed in volume:

$$\text{Total cannabinoid concentration (mg/mL)} = (\text{cannabinoid acid form concentration (mg/mL)} \times 0.877) + \text{cannabinoid concentration (mg/mL)}$$

(5) Milligrams per package for THC and CBD;

(6) Milligrams per package for Total THC and Total CBD, if applicable;

(7) Milligrams per serving for THC and CBD, if any;

(8) Milligrams per serving for Total THC and Total CBD, if any and if applicable; and

(9) The laboratory shall report the results of all other cannabinoids analyzed on the COA both as a percentage and in either milligrams per gram (mg/g) if by weight or milligrams per milliliter (mg/mL) if by volume.

(d) The sample shall be deemed to have passed the cannabinoid testing if the following conditions are met:

(1) For all edible cannabis products, the milligrams per serving for THC does not exceed 10 milligrams per serving.

(2) For edible cannabis products that are not orally-dissolving products labeled “FOR MEDICAL USE ONLY”, the milligrams per package for THC does not exceed 100 milligrams per package.

(3) For edible cannabis products that are orally-dissolving products labeled “FOR MEDICAL USE ONLY,” the milligrams per package for THC does not exceed 500 milligrams per package.

(4) For cannabis concentrates and topical cannabis goods not labeled “FOR MEDICAL USE ONLY,” the milligrams per package for THC does not exceed 1000 milligrams per package.

(5) For cannabis concentrates and topical cannabis goods labeled “FOR MEDICAL USE ONLY,” the milligrams per package for THC does not exceed 2000 milligrams per package.

(e) The laboratory shall report the test results and indicate an overall “pass” or “fail” for the cannabinoid testing on the COA.

(f) Any cannabinoids found to be less than the LOQ shall be reported on the COA as “<1 mg/g” if by dry-weight or “<1 mg/mL” if by volume.

(g) If the sample fails cannabinoid testing, the batch from which the sample was collected fails cannabinoid testing and shall not be released for retail sale.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5725. Terpenoid Testing.

(a) If requested, the laboratory shall analyze at minimum 0.5 grams of the representative sample of cannabis goods to determine the terpenoid profile of the sample.

(b) The laboratory shall report the result of the terpenoid testing on the COA both as a percentage and in either milligrams per gram (mg/g) if by weight or milligrams per milliliter (mg/mL) if by volume.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5726. Certificate of Analysis (COA).

(a) The laboratory shall generate a COA for each representative sample that the laboratory analyzes.

(b) The laboratory shall ensure that the COA contains the results of all required analyses performed for the representative sample.

(c) The laboratory shall, within 1 business day of completing all analyses of a sample, both upload the COA into the track and trace system and simultaneously provide a copy of the COA to the Bureau via email at bcc.labs@dca.ca.gov.

- (d) The laboratory shall not release to any person any cumulative or individual test results prior to completing all analyses and providing the COA to the Bureau.
- (e) The COA shall contain, at minimum, the following information:
- (1) The term “Regulatory Compliance Testing” in font no smaller than 14-point, which shall appear in the upper-right corner of each page of the COA. No text or images shall appear above the term “Regulatory Compliance Testing” on any page of the COA.
 - (2) Laboratory’s name, licensed premises address, and license number;
 - (3) Licensed distributor’s or licensed microbusiness authorized to engage in distribution’s name, licensed premises address, and license number;
 - (4) Licensed cultivator’s, licensed manufacturer’s, or licensed microbusiness’ name, licensed premises address, and license number;
 - (5) Batch number of the batch from which the sample was obtained. For cannabis goods that are already packaged at the time of sampling, the labeled batch number on the packaged cannabis goods shall match the batch number on the COA;
 - (6) Sample identifying information, including matrix type and unique sample identifiers;
 - (7) Sample history, including the date collected, the date received by the laboratory, and the date(s) of sample analyses and corresponding testing results;
 - (8) A picture of the sample of cannabis goods. If the sample is pre-packaged, the picture must include an unobstructed image of the packaging;
 - (9) For dried flower samples, the total weight of the batch, in grams or pounds, and the total weight, of the representative sample in grams;
 - (10) For cannabis product or pre-rolls samples, the total unit count of both the representative sample and the total batch size;
 - (11) Measured density of the cannabis goods;
 - (12) The analytical methods, analytical instrumentation used, and corresponding Limits of Detection (LOD) and Limits of Quantitation (LOQ);
 - (13) An attestation on the COA from the laboratory supervisory or management employee that all LQC samples required by section 5730 of this division were performed and met the acceptance criteria; and
 - (14) Analytes detected during the analyses of the sample that are unknown, unidentified, or injurious to human health if consumed, if any.
- (f) The laboratory shall report test results for each representative sample on the COA as follows:
- (1) Indicate an overall “pass” or “fail” for the entire batch;
 - (2) When reporting qualitative results for each analyte, the laboratory shall indicate “pass” or “fail”;

- (3) When reporting quantitative results for each analyte, the laboratory shall use the appropriate units of measurement as required under this chapter;
 - (4) When reporting results for each test method, the laboratory shall indicate “pass” or “fail”;
 - (5) When reporting results for any analytes that were detected below the analytical method LOQ, indicate “<LOQ”, notwithstanding cannabinoid results;
 - (6) When reporting results for any analytes that were not detected or detected below the LOD, indicate “ND”; and
 - (7) Indicate “NT” for any test that the laboratory did not perform.
- (g) The laboratory supervisory or management employee shall validate the accuracy of the information contained on the COA and sign and date the COA.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

Article 6. Post Testing Procedures

§ 5727. Remediation and Retesting.

- (a) A cannabis goods batch that has been additionally processed after failed testing must be retested and successfully pass all the analyses required under this chapter.
- (b) The licensed distributor or licensed microbusiness authorized to engage in distribution shall arrange for remediation of a failed cannabis goods batch. If the batch cannot be remediated, the batch shall be destroyed by the licensed distributor or licensed microbusiness authorized to engage in distribution.
- (c) If a failed batch is not remediated or reprocessed in any way it cannot be retested. Any subsequent COAs produced without remediation or reprocessing of the failed batch will not supersede the initial regulatory compliance testing COA.
- (d) A cannabis goods batch may only be remediated twice. If the batch fails after the second remediation attempt and the second retesting, the entire batch shall be destroyed.
- (e) Within one business day of completing the required analyses of a representative sample obtained from a remediated cannabis goods batch, the laboratory shall upload the COA information into the track and trace system, or if the licensee does not yet have access to the track and trace system, it shall be emailed to the Bureau.
- (f) Nothing in this section shall be interpreted to prevent a cannabis goods batch from being retested when the COA is 12 or more months old.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5728. Post Testing Sample Retention.

- (a) The laboratory shall retain the reserve sample, consisting of any portion of a sample that was not used in the testing process. The reserve sample shall be kept, at minimum, for 45 business days after the analyses, after which time it may be destroyed and denatured to the point

the material is rendered unrecognizable and unusable.

(b) The laboratory shall securely store the reserve sample in a manner that prohibits sample degradation, contamination, and tampering.

(c) The laboratory shall provide the reserve sample to the Bureau upon request.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

Article 7. Laboratory Quality Assurance and Quality Control

§ 5729. Laboratory Quality Assurance (LQA) Program.

(a) The laboratory shall develop and implement a LQA program to assure the reliability and validity of the analytical data produced by the laboratory. The LQA program shall, at minimum, include a written LQA manual that addresses the following:

(1) Quality control procedures;

(2) Laboratory organization and employee training and responsibilities, including good laboratory practice (GLP);

(3) LQA objectives for measurement data;

(4) Traceability of data and analytical results;

(5) Instrument maintenance, calibration procedures, and frequency;

(6) Performance and system audits;

(7) Corrective action procedures;

(8) Steps to change processes when necessary;

(9) Record retention and document control;

(10) Test procedure standardization; and

(11) Method validation.

(b) The supervisory or management laboratory employee shall annually review, amend if necessary, and approve the LQA program and manual both when they are created and when there is a change in methods, laboratory equipment, or the supervisory or management laboratory employee.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5730. Laboratory Quality Control (LQC) Samples.

The laboratory shall use LQC samples and adhere to good laboratory practice (GLP) in the performance of each analysis according to the following specifications.

(a) The laboratory shall analyze LQC samples in the same manner as the laboratory analyzes

cannabis goods samples.

(b) The laboratory shall use at least one negative control, one positive control, and one laboratory replicate sample in each analytical batch for each target organism during microbial testing. If one of the controls produces unexpected results, the samples shall be re-prepped and reanalyzed with a new set of controls.

(c) If the result of the microbial analyses is outside the specified acceptance criteria in the following table, the laboratory shall determine the cause and take steps to remedy the problem until the result is within the specified acceptance criteria.

Laboratory Quality Control Sample	Acceptance Criteria	Corrective Action
Positive control	Produces expected result, positive result	Re-prepare and reanalyze the entire analytical batch, once. If problem persists, locate and remedy the source of unexpected result, then re-prepare samples and reanalyze with a new set of controls.
Negative control	Produces expected result, negative result	Re-prepare and reanalyze the entire analytical batch, once. If problem persists, locate and remedy the source of unexpected result, then re-prepare samples and reanalyze with a new set of controls.
Laboratory replicate sample	Sample results must concur	Reanalyze sample and associated replicate sample once. If problem persists, re-prepare samples and reanalyze.

(d) The laboratory shall prepare and analyze at least one of each of the following LQC samples for each analytical batch:

- (1) Method blank;
- (2) Laboratory control sample (LCS); and
- (3) Laboratory replicate sample or matrix spike sample.

(e) The laboratory shall analyze, at minimum, a continuing calibration verification (CCV) sample at the beginning of each analytical sequence and every 10 samples thereafter.

(f) If the result of the chemical analyses is outside the specified acceptance criteria in the following table, the laboratory shall determine the cause and take steps to remedy the problem until the result is within the specified acceptance criteria.

Laboratory Quality Control Sample	Acceptance Criteria	Corrective Action
Method blank sample	Not to exceed LOQ	Reanalyze entire analytical batch once. If method blank is still greater than the LOQ for any analyte, locate the source of contamination then re-prepare samples and reanalyze.

LCS	Percent recovery 70% to 130%	Reanalyze the entire analytical batch, once. If problem persists, re-prepare samples and reanalyze or re-run the initial calibration curve.
Laboratory replicate sample	RPD \leq 30%	Reanalyze sample and associated replicate sample once. If problem persists, re-prepare samples and reanalyze.
Matrix spike sample	Percent recovery between 70% to 130%	Reanalyze sample and associated matrix spike sample once. If problem persists, re-prepare samples and reanalyze.
CCV	Percent recovery between 70% to 130%	Reanalyze all samples that followed the last CCV that met the acceptance criteria. If CCV still fails, re-run the initial calibration curve and all samples in the analytical sequence.

(g) If any analyte is detected above any action level, as described in this chapter, the sample shall be re-prepped and reanalyzed in replicate within another analytical batch.

(1) For quantitative analyses, the re-prepped sample and its associated replicate must meet the acceptance criteria of RPD \leq 30%.

(2) For qualitative analyses, the re-prepped sample and its associated replicate results must concur.

(h) If any LQC sample produces a result outside of the acceptance criteria, the laboratory cannot report the result and the entire batch cannot be released for retail sale. The laboratory shall determine the cause and take steps to remedy the problem until the result is within the specified acceptance criteria.

(i) If the laboratory determines that the result is a false-positive or a false-negative, the Bureau may ask for the laboratory to re-sample or re-test.

(j) The laboratory shall compile and generate one LQC sample report for each analytical batch that includes LQC acceptance criteria, measurements, analysis date, and matrix.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5731. Limits of Detection (LOD) and Limits of Quantitation (LOQ) for Quantitative Analyses.

(a) The laboratory shall calculate the LOD for chemical method analyses according to any of the following methods:

(1) Signal-to-noise ratio of between 3:1 and 2:1;

(2) Standard deviation of the response and the slope of calibration curve using a minimum of 7 spiked blank samples calculated as follows;

$$\text{LOD} = (3.3 \times \text{standard deviation of the response}) / \text{slope of the calibration curve; or}$$

(3) A method published by the United States Food and Drug Administration (USFDA) or the United States Environmental Protection Agency (USEPA).

(b) The laboratory shall calculate the LOQ for chemical method analyses according to any of the following methods:

(1) Signal-to-noise ratio of 10:1, at minimum;

(2) Standard deviation of the response and the slope using a minimum of 7 spiked blank samples calculated as follows:

LOQ = (10 × standard deviation of the response) / slope of the calibration curve; or

(3) A method published by the USFDA or the USEPA.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104 and 26110, Business and Professions Code.

§ 5732. Data Package.

(a) The laboratory shall compile and generate one data package for each representative sample that the laboratory analyzes.

(b) The laboratory shall create a data package and use the Data Package Cover Page and Checklist Form, BCC-LIC-024, which is incorporated herein by reference. The data package and form BCC-LIC-024 shall be provided to the Bureau immediately upon request.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100, 26104, 26110 and 26160, Business and Professions Code.

§ 5733. Required Proficiency Testing.

(a) The laboratory shall participate in a proficiency testing program provided by an organization that operates in conformance with the requirements of ISO/IEC 17043, at least once every six months.

(b) The laboratory shall annually, successfully participate in a proficiency testing program for each of the following test methods:

(1) Cannabinoids;

(2) Heavy metals;

(3) Microbial impurities;

(4) Mycotoxins;

(5) Residual pesticides;

(6) Residual solvents and processing chemicals; and

(7) If tested, terpenoids.

(c) The laboratory shall report all analytes available by the proficiency testing program provider and for which the licensee is required to test as required under this chapter.

- (d) The laboratory shall participate in the proficiency testing program by following the laboratory's existing SOPs for testing cannabis goods.
- (e) The laboratory shall rotate the proficiency testing program among the laboratory employees who perform the test methods.
- (f) Laboratory employees who participate in a proficiency testing program shall sign the corresponding analytical reports or attestation statements to certify that the proficiency testing program was conducted in the same manner as the laboratory tests of cannabis goods.
- (g) A supervisory or management laboratory employee shall review and verify the accuracy of results reported for all proficiency testing program samples analyzed.
- (h) The laboratory shall request the proficiency testing program provider to send results concurrently to the Bureau, if available, or the laboratory shall provide the proficiency testing program results to the Bureau within 3 business days after the laboratory receives notification of their test results from the proficiency testing program provider. Any results shall be reported by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100 and 26110, Business and Professions Code.

§ 5734. Satisfactory and Unsatisfactory Proficiency Test Performance.

- (a) The laboratory shall be deemed to have successfully participated in a proficiency testing program for an analyte tested in a specific method if the test results demonstrate a “satisfactory” or otherwise proficient performance determination by the proficiency testing program provider.
- (b) The laboratory may not report test results for analytes that are deemed by the proficiency testing program provider as “unacceptable,” “questionable,” “unsatisfactory”, or otherwise deficient.
- (c) The laboratory may resume reporting test results for analytes that were deemed “unacceptable,” “questionable,” “unsatisfactory”, or otherwise deficient, only if both of the following conditions are met:
 - (1) The laboratory satisfactorily remedies the cause of the failure for each analyte; and
 - (2) The laboratory submits, to the Bureau, a written corrective action report demonstrating how the laboratory has fixed the cause of the failure.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100 and 26110, Business and Professions Code.

§ 5735. Laboratory Audits.

- (a) The laboratory shall conduct an internal audit at least once per year or in accordance with the ISO/IEC 17025 accrediting body's requirement, whichever is more frequent.
- (b) The internal audit must include all of the components required by the ISO/IEC 17025 internal-audit standards.

(c) Within 3 business days of completing the internal audit, the laboratory shall submit the results of the internal audit to the Bureau.

(d) Within 3 business days of receiving the accrediting body on-site audit findings, the laboratory shall submit the results to the Bureau.

(e) The laboratory shall submit any audit results to the Bureau, accompanied by the Notification and Request Form, BCC-LIC-027 (New 10/18), which is incorporated herein by reference.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26100 and 26104, Business and Professions Code.

Article 8. Laboratory Employee Qualifications

§ 5736. General Laboratory Employee Qualifications.

(a) The laboratory may only employ persons who are at least 21 years of age.

(b) The laboratory shall develop and implement an employee training program to ensure competency of laboratory employees for their assigned functions.

(c) The laboratory shall ensure and document that each laboratory employee meets the employee qualifications.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26102 and 26104, Business and Professions Code.

§ 5737. Supervisor or Management Responsibilities and Qualifications.

(a) The laboratory shall employ a supervisor or management employee who must be responsible for:

(1) Overseeing and directing the scientific methods of the laboratory;

(2) Ensuring that the laboratory achieves and maintains a laboratory quality assurance program as required by section 5729 of this division; and

(3) Providing ongoing and appropriate training to laboratory employees.

(b) To be considered qualified, the supervisor or management employee must have at minimum:

(1) A doctoral degree in biological, chemical, agricultural, environmental, or related sciences from an accredited college or university;

(2) A master's degree in biological, chemical, agricultural, environmental, or related sciences from an accredited college or university, plus at least 2 years of full-time practical experience;

(3) A bachelor's degree in biological, chemical, agricultural, environmental, or related sciences from an accredited college or university, plus at least 4 years of full-time practical experience; or

(4) A bachelor's degree in any field from an accredited college or university, plus at least 8 years of full-time practical experience, 4 years of which must have been in a supervisory or management position.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26102 and 26104, Business and Professions Code.

§ 5738. Analyst and Sampler Qualifications.

- (a) The laboratory shall employ an analyst who, at minimum, must have either:
 - (1) Earned a master’s degree or a bachelor’s degree in biological, chemical, agricultural, environmental, or related sciences from an accredited college or university;
 - or
 - (2) Completed 2 years of college or university education that included coursework in biological, chemical, agricultural, environmental, or related sciences from an accredited college or university, plus at least 3 years of full-time practical experience.
- (b) The laboratory shall employ a sampler who, at minimum, must have either:
 - (1) Completed 2 years college or university education; or
 - (2) Earned a High School Diploma or passed a General Educational Development or High School Equivalency exam, plus at least 1 year of full-time practical experience.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26102 and 26104, Business and Professions Code.

Article 9. Record Retention

§ 5739. Records.

All laboratory records described in this chapter shall be maintained in accordance with section 5037 of this division.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code.

Chapter 7. ENFORCEMENT

§ 5800. Right of Access.

- (a) The Bureau, and its authorized representatives, shall have full and immediate access to inspect and:
 - (1) Enter onto any premises licensed by the Bureau.
 - (2) Test any vehicle or equipment possessed by, in control of, or used by a licensee or their agents and employees for the purpose of conducting commercial cannabis activity.
 - (3) Test any cannabis goods or cannabis-related materials or products possessed by, in control of, or used by a licensee or their agents and employees for the purpose of conducting commercial cannabis activity.
 - (4) Copy any materials, books, or records of any licensee or their agents and employees.
- (b) Failure to cooperate with and participate in any Bureau investigation pending against the

licensee may result in a licensing violation subject to discipline. This subsection shall not be construed to deprive a licensee of any privilege guaranteed by the Fifth Amendment to the Constitution of the United States, or any other constitutional or statutory privileges. This subsection shall not be construed to require a licensee to cooperate with a request that would require the licensee to waive any constitutional or statutory privilege or to comply with a request for information or other matters within an unreasonable period of time in light of the time constraints of the licensee's business. Any constitutional or statutory privilege exercised by the licensee shall not be used against the licensee in a regulatory or disciplinary proceeding against the licensee.

(c) The Bureau, and its authorized representatives, shall have the rights of full and immediate access under subsection (a) of this section, during any inspection, investigation, review, or audit, or as otherwise allowed by law.

(d) Prior notice of an inspection, investigation, review, or audit is not required.

(e) Any inspection, investigation, review, or audit of a licensed premises shall be conducted anytime the licensee is exercising privileges under the license, or as otherwise agreed to by the Bureau and the licensee or its agents, employees, or representatives.

(f) If the licensed premises is not accessible because access is only available by going through another licensed premises and the licensee occupying the other licensed premises denies the Bureau access, the licensees shall both be held responsible and subject to discipline.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26015 and 26160, Business and Professions Code; and Section 11181, Government Code.

§ 5801. Notice to Comply.

(a) The Bureau may issue a notice to comply to a licensee for violation(s) of the Act or regulations discovered during an investigation or observed during an inspection.

(b) The notice to comply shall be in writing and describe the nature and facts of each violation, including a reference to the statute or regulation violated, and may indicate the manner in which the licensee must correct the violation(s) to achieve compliance.

(c) The Bureau will serve the notice to comply prior to leaving the licensed premises after the inspection on any licensee, employee, agent, or person delegated by any of those listed, to facilitate the inspection or accept such notice, or will mail the notice to comply within 15 calendar days of the discovery of violation or the last date of inspection.

(d) The notice to comply shall inform the licensee that the licensee may, within 20 calendar days from the date of personal service or mailing of the notice to comply, sign and return the notice to comply declaring under penalty of perjury that each violation was corrected and describing how compliance was achieved.

(e) Failure to correct the violation(s) in the notice to comply may result in a disciplinary action.

Authority: Section 26013, Business and Professions Code; Reference: Sections 26012 and 26018, Business and Professions Code.

§ 5802. Citations; Orders of Abatement; Administrative Fines.

- (a) The Bureau may issue citations containing orders of abatement and fines against a licensee, or an unlicensed person, for any acts or omissions which are in violation of any provision of the Act or any regulation adopted pursuant thereto, or for any violation of state law or regulations applicable to cannabis licensees, including, but not limited to, state labor law.
- (b) The Bureau may issue a citation under this section to a licensee for a violation of a term or condition contained in a decision placing that licensee on probation.
- (c) Each citation may contain either order(s) of abatement, monetary fine(s), or both, and shall:
 - (1) Be in writing and describe with particularity the nature of the violation, including a reference to the law or regulation determined to have been violated;
 - (2) Fix a reasonable time for abatement of the violation if the citation contains an order of abatement, or assess an administrative fine of up to \$5,000 if the citation contains a fine;
 - (3) Be served personally or by certified mail; and
 - (4) Inform the licensee or person that they may request an informal conference, or contest the citation, or both, pursuant to section 5803 of this division.
- (d) Failure to pay a fine within 30 calendar days of the date of assessment, unless the citation is being contested, may result in further action being taken by the Bureau including, but not limited to, suspension or revocation of a license. If a citation is not appealed and the fine is not paid, the full amount of the assessed fine shall be added to the fee for renewal of the license. A license shall not be renewed without the payment of the renewal fee and fine.
- (e) The amount of any fine assessed by the Bureau under this section shall take into consideration the factors listed in Business and Professions Code section 125.9(b)(3).
- (f) Nothing in this section shall be deemed to prevent the Bureau from filing an accusation to suspend or revoke a license where grounds for such suspension or revocation exist.

Authority: Sections 125.9 and 26013, Business and Professions Code. Reference: Sections 125.9, 148, 149 and 26012, Business and Professions Code.

§ 5803. Contesting Citations.

- (a) A cited licensee or person may, within 30 calendar days of service of the citation, contest the citation by submitting to the Bureau a written request for a hearing, conducted in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of the Government Code. If a hearing is not requested, it is waived and payment of a fine will not constitute an admission of the violation charged.
- (b) In addition to requesting a hearing provided for in subsection (a) of this section, the cited licensee or person may, within 15 calendar days after service of the citation, submit a written request for an informal conference with the Bureau regarding the acts or omissions charged in the citation.

- (c) The Bureau shall, within 15 calendar days from receipt of the written request, hold an informal conference with the licensee or person cited, and/or his or her legal counsel or authorized representative.
- (d) At the conclusion of the informal conference, the Bureau may affirm, modify, or dismiss the citation, including any fines levied or orders of abatement issued. A written decision stating the reasons for the decision shall be mailed to the cited licensee or person and his or her legal counsel, if any, within 15 calendar days from the date of the informal conference. This decision shall be deemed to be a final order with regard to the citation issued, including the levied fine and the order of abatement, if any.
- (e) If the citation is dismissed, any request for a hearing shall be deemed withdrawn. If the citation is affirmed or modified, the cited licensee or person may, in his or her discretion, withdraw the request for a hearing or proceed with the administrative hearing process.
- (f) If the citation, including any fine levied or order of abatement, is modified, the citation originally issued shall be considered withdrawn and new citation issued. If a hearing is requested for the subsequent citation, it shall be requested within 30 calendar days in accordance with Business and Professions Code section 125.9(b)(4).

Authority: Section 26013, Business and Professions Code. Reference: Sections 125.9, 26012 and 26016, Business and Professions Code.

§ 5804. Citation Compliance.

- (a) The time to abate or correct a violation as provided for in an order of abatement may be extended for good cause. If a cited licensee or person who has been issued an order of abatement is unable to complete the correction within the time set forth in the citation because of conditions beyond his or her control after the exercise of reasonable diligence, the licensee or person cited may request an extension of time from the Bureau in which to complete the correction. Such a request shall be in writing and shall be made within the time set forth for abatement.
- (b) When a citation is not contested, or if it is appealed and the person cited does not prevail, failure to abate the violation within the time allowed or pay a fine that was imposed shall constitute a violation and a failure to comply with the citation or order of abatement.
- (c) Failure to timely comply with an order of abatement or pay a fine that was imposed may result in further action being taken by the Bureau, including, but not limited to, suspension or revocation of a license, or further administrative or civil proceedings.

Authority: Section 26013, Business and Professions Code. Reference: Sections 125.9 and 26012, Business and Professions Code.

§ 5805. Minor Decoys.

- (a) Peace officers may use a person under 21 years of age to attempt to purchase cannabis goods, for the purposes of enforcing the Act, and to apprehend licensees, employees, or agents of licensees who sell cannabis goods to minors. For purposes of this section, a “minor” is a person under 21 years of age.

(b) The following minimum standards shall apply to the use of a minor decoy:

(1) At the time of the operation, the decoy shall be less than 20 years of age.

(2) A decoy shall either carry his or her own identification showing the decoy's correct date of birth, or carry no identification. A decoy who carries identification shall present it upon request to any seller of cannabis goods.

(3) A decoy shall answer truthfully any questions about his or her age.

(4) Following any completed sale, but not later than the time a citation, if any, is issued, the peace officer directing the decoy shall make a reasonable attempt to enter the licensed premises or respond to the location where the licensee is located and have the minor decoy who purchased cannabis goods identify the alleged seller of the cannabis goods.

Authority: Sections 26013 and 26140, Business and Professions Code. Reference: Section 26140, Business and Professions Code.

§ 5806. Attire and Conduct.

No license shall allow the following:

(a) Employment or use of any person in the sale or service of cannabis goods in or upon the licensed premises while such person is unclothed or in such attire, costume, or clothing as to expose to view any portion of the male or female breast below the top of the areola or of any portion of the pubic hair, anus, cleft of the buttocks, vulva, or genitals.

(b) Employment or use of the services of any host or other person to mingle with the patrons while such hostess or other person is unclothed or in such attire, costume, or clothing as described in subsection (a) of this section.

(c) Encouraging or permitting any person on the licensed premises to touch, caress, or fondle the breasts, buttocks, anus, or genitals of any other person.

(d) Permitting any employee or person to wear or use any device or covering, exposed to view, which simulates the breast, genitals, anus, pubic hair, or any portion thereof.

Authority: Section 26013, Business and Professions Code. Reference: 26011.5, Business and Professions Code.

§ 5807. Entertainers and Conduct.

(a) Live entertainment is permitted on a licensed premises, except that no licensee shall permit any person to perform acts of or acts that simulate:

(1) Sexual intercourse, masturbation, sodomy, bestiality, oral copulation, flagellation, or any sexual acts that are prohibited by law.

(2) Touching, caressing, or fondling of the breast, buttocks, anus, or genitals.

(3) Displaying of the buttocks, breasts, pubic hair, anus, vulva, or genitals.

(b) No licensee shall permit any person to use artificial devices or inanimate objects to depict any of the prohibited activities described in this section.

(c) No licensee shall permit any person to remain in or upon the licensed premises who exposes to public view any portion of his or her breast, buttocks, genitals, or anus.

Authority: Section 26013, Business and Professions Code. Reference: 26011.5, Business and Professions Code.

§ 5808. Additional Grounds for Discipline.

The following include, but are not limited to, additional grounds that constitute a basis for disciplinary action:

(a) Failure to pay a fine imposed by the Bureau or agreed to by the licensee.

(b) Failure to take reasonable steps to correct objectionable conditions on the licensed premises, including the immediately adjacent area that is owned, leased, or rented by the licensee, that constitute a nuisance, within a reasonable time after receipt of notice to make those corrections, under Penal Code section 373a.

(c) Failure to take reasonable steps to correct objectionable conditions that occur during operating hours on any public sidewalk abutting a licensed premises and constitute a nuisance, within a reasonable time after receipt of notice to correct those conditions from the Bureau. This subsection shall apply to a licensee only upon written notice to the licensee from the Bureau. The Bureau shall issue this written notice upon its own determination, or upon a request from the local law enforcement agency in whose jurisdiction the licensed premises is located, that is supported by substantial evidence that persistent objectionable conditions are occurring on the public sidewalk abutting the licensed premises. For purposes of this subsection:

(1) “Any public sidewalk abutting a licensed premises” means the publicly owned, pedestrian- traveled way, not more than 20 feet from the licensed premises, that is located between a licensed premises, including any immediately adjacent area that is owned, leased, or rented by the licensee, and a public street

(2) “Objectionable conditions that constitute a nuisance” means disturbance of the peace, public intoxication, drinking alcoholic beverages in public, smoking or ingesting cannabis or cannabis products in public, harassment of passersby, gambling, prostitution, loitering, public urination, lewd conduct, drug trafficking, or excessive loud noise.

(3) “Reasonable steps” means all of the following:

(A) Calling the local law enforcement agency. Timely calls to the local law enforcement agency that are placed by the licensee, or his or her agents or employees, shall not be construed by the Bureau as evidence of objectionable conditions that constitute a nuisance.

(B) Requesting those persons engaging in activities causing objectionable conditions to cease those activities, unless the licensee, or his or her agents or employees, feel that their personal safety would be threatened in making that request.

(C) Making good faith efforts to remove items that facilitate loitering, such as furniture, except

those structures approved or permitted by the local jurisdiction. The licensee shall not be liable for the removal of those items that facilitate loitering.

(4) When determining what constitutes “reasonable steps,” the Bureau shall consider site configuration constraints related to the unique circumstances of the nature of the business.

(d) Notwithstanding that the licensee corrects the objectionable conditions that constitute a nuisance, the licensee has a continuing obligation to meet the requirements of subsections (a) and (b) of this section, and failure to do so shall constitute grounds for disciplinary action.

(e) If a licensee has knowingly permitted the illegal sale, or negotiations for the sales, of controlled substances or dangerous drugs upon his or her licensed premises. Successive sales, or negotiations for sales, over any continuous period of time shall be deemed evidence of permission. As used in this section, “controlled substances” shall have the same meaning as is given that term in Article 1 (commencing with Section 11000) of Chapter 1 of Division 10 of the Health and Safety Code, and “dangerous drugs” shall have the same meaning as is given that term in Article 2 (commencing with Section 4015) of Chapter 9 of Division 2 of the Business and Professions Code.

(f) If the licensee has employed or permitted any persons to solicit or encourage others, directly or indirectly, to buy such persons cannabis goods in the licensed premises under any commission, percentage, salary, or other profit-sharing plan, scheme, or conspiracy.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5, 26012, 26030 and 26031, Business and Professions Code.

§ 5809. Disciplinary Actions.

(a) When an accusation recommending disciplinary action against a licensee has been filed pursuant to Business and Professions Code section 26031, the accusation shall be served on the licensee in accordance with Government Code section 11505.

(b) A hearing shall be conducted in accordance with the provisions of Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code to determine if cause exists to take action against the licensee. At such a hearing, the Bureau shall have all the powers granted therein and by the Business and Professions Code.

(c) If a hearing on an accusation against a licensee results in a finding that the licensee has committed any of the acts or omissions constituting grounds for disciplinary action, the Bureau may order the license revoked, suspended outright for a specified period of time, suspended on probationary restriction for a specified period of time on such terms and conditions of probation as in its judgment are supported by its findings, impose a fine, or any combination thereof. The Bureau may also issue such other lawful orders it considers to be appropriate on the basis of its findings.

(d) An accusation may be terminated by written stipulation at any time prior to the conclusion of the hearing on the accusation. If a licensee submits a proposed stipulation to the Bureau for its consideration and the Bureau subsequently declines to accept the proposed stipulation, the Bureau shall not thereafter be disqualified from hearing evidence on the accusation and taking action thereon as authorized in this section.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26012, 26031 and 26034, Business and Professions Code.

§ 5810. Interim Suspension.

(a) Pursuant to Business and Professions Code section 494, the Bureau may petition for an interim order to suspend any license or impose licensing restrictions upon any licensee, if:

(1) - The licensee has engaged in acts or omissions constituting a violation of the Business and Professions Code or this division, or been convicted of a crime substantially related to the licensed activity, and

(2) Permitting the licensee to continue to engage in the licensed activity would endanger the public health, safety, or welfare.

(b) An interim order for suspension or restrictions may be issued with notice, as follows:

(1) The Bureau shall provide the licensee with at least 15 days' notice of the hearing on the petition for an interim order.

(2) The notice shall include documents submitted in support of the petition.

(c) An interim order for suspension or restrictions may issue without notice to the licensee, as follows:

(1) If it appears from the Bureau's petition and supporting documents that serious injury would result to the public before the matter could be heard on notice.

(2) The Bureau shall provide the licensee with a hearing on the petition within 20 days after issuance of the initial interim order.

(3) Notice of the hearing shall be provided within two days after issuance of the initial interim order.

(d) The Bureau shall file an accusation, pursuant to Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, within 15 calendar days of the issuance of the interim order.

Authority: Section 26013, Business and Professions Code; Reference: Sections 494, 26011.5, 26012 and 26031, Business and Professions Code.

§ 5811. Posting of Notice of Suspension.

(a) A licensee whose license has been suspended shall conspicuously and continuously display a notice on the exterior of the licensee's premises for the duration of the suspension.

(b) The notice shall be two feet in length and 14 inches in width. The notice shall read:

NOTICE OF SUSPENSION
The Bureau of Cannabis Control License(s) Issued For This Premises
Has Been Suspended For Violation of State Law

(c) Advertising or posting signs to the effect that the licensed premises has been closed or that business has been suspended for any reason other than the reason provided in the decision suspending the license, shall be deemed a violation of this section.

(d) Failure to display the notice as required in this section or removal of the notice prior to the expiration of the suspension shall be a violation of this section and may result in additional disciplinary action.

(e) A licensee shall notify the Bureau, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), incorporated herein by reference, within 24 hours of discovering that the notice under subsection (b) of this section has been removed or damaged to an extent that makes the notice illegible.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5 and 26012, Business and Professions Code.

§ 5812. Posting of Notice of Revocation.

(a) A person whose license has been revoked shall conspicuously display a notice on the exterior of the premises indicating that the license has been revoked. The notice shall remain continuously on the premises for at least 15 calendar days.

(b) The notice shall be two feet in length and 14 inches in width. The notice shall read:

NOTICE OF REVOCATION

The Bureau of Cannabis Control License(s) Issued For This Premises
Has Been Revoked For Violation of State Law

(c) Advertising or posting signs to the effect that the premises has been closed or that business has been suspended for any reason other than the reason provided in the decision revoking the license shall be deemed a violation of this section.

(d) If the Bureau revokes a license at a licensed premises that has one or more licenses at the location that will remain active after the revocation, the revocation notice shall remain posted for a period of at least 15 calendar days.

(e) Failure to display the notice for the time required in this section shall be a violation of this section and may result in additional disciplinary action.

(f) A licensee shall notify the Bureau, by submitting the Notification and Request Form, BCC-LIC-027 (New 10/18), incorporated herein by reference, within 24 hours of discovering that the notice under subsection (b) of this section has been removed or damaged to an extent that makes the notice illegible.

Authority: Section 26013, Business and Professions Code. Reference: Sections 26011.5 and 26012, Business and Professions Code.

§ 5813. Enforcement Costs.

(a) In any order in resolution of a disciplinary proceeding for suspension or revocation of a license, the Bureau may request the administrative law judge to direct a licensee found to have committed a violation or violations of the Act, or any regulation adopted pursuant to the Act, to

pay a sum not to exceed the reasonable costs of the investigation and enforcement of the case.

(b) A certified copy of the actual costs, or a good faith estimate of costs where actual costs are not available, signed by the Bureau's designated representative shall be prima facie evidence of reasonable costs of investigation and prosecution of the case. The costs shall include the amount of investigative and enforcement costs up to the date of the hearing, including, but not limited to, charges imposed by the Attorney General.

(c) The administrative law judge shall make a proposed finding of the amount of reasonable costs of investigation and prosecution of the case when requested pursuant to subsection (a). The Bureau may reduce or eliminate the cost award, or remand to the administrative law judge where the proposed decision fails to make a finding on costs requested pursuant to subsection (a).

(d) Where an order for recovery of costs is made and timely payment is not made as directed in the decision, the Bureau may enforce the order for repayment in any appropriate court. This right of enforcement shall be in addition to any other rights the Bureau may have as to any licensee to pay costs.

(e) In any action for recovery of costs, proof of the decision shall be conclusive proof of the validity of the order of payment and the terms for payment.

(f) Except as provided in subsection (g) of this section, the Bureau shall not renew or reinstate any license of any licensee who has failed to pay all of the costs ordered under this division.

(g) Notwithstanding subsection (f) of this section, the Bureau may, in its discretion, conditionally renew or reinstate for a maximum of one year the license of any licensee who demonstrates financial hardship and who enters into a formal agreement with the Bureau for reimbursement within that one-year period for the unpaid costs.

(h) Nothing in this section shall preclude the Bureau from including the recovery of the costs of investigation and enforcement of a case in any stipulated settlement.

Authority: Section 26013, Business and Professions Code; Reference: Sections 125.3, 26012 and 26031, Business and Professions Code

§ 5814. Disciplinary Guidelines.

In reaching a decision on a disciplinary action under the Act and the Administrative Procedure Act (Govt. Code section 11400 et seq.), the Bureau shall consider the disciplinary guidelines entitled "Bureau of Cannabis Control Disciplinary Guidelines October 2018," which are hereby incorporated by reference. Deviation from these guidelines and orders, including the standard terms of probation, is appropriate where the Bureau in its sole discretion determines that the facts of the particular case warrant such a deviation, e.g., the presence of mitigating factors, the age of the case, or evidentiary problems.

Authority: Section 26013, Business and Professions Code; Reference: Sections 26012 and 26031, Business and Professions Code.

§ 5815. Emergency Decision and Order.

(a) The Bureau may issue an emergency decision and order for temporary, interim relief to prevent or avoid immediate danger to the public health, safety, or welfare. Such circumstances include, but are not limited to, the following:

- (1) The Bureau has information that cannabis goods at a licensee's premises have a reasonable probability of causing serious adverse health consequences or death.
- (2) To prevent the sale, transfer, or transport of contaminated or illegal cannabis goods in possession of the licensee.
- (3) The Bureau observes or has information that conditions at the licensee's premises exist that present an immediate risk to worker or public health and safety.
- (4) To prevent illegal diversion of cannabis goods, or other criminal activity at the licensee's premises.
- (5) To prevent the destruction of evidence related to illegal activity or violations of the Act.
- (6) To prevent misrepresentation to the public, such as selling untested cannabis goods, providing inaccurate information about the cannabis goods, or cannabis goods that have been obtained from an unlicensed person.

(b) Temporary, interim relief may include a suspension or administrative hold by one or more of the following:

- (1) The temporary suspension of a license.
- (2) An order to segregate or isolate specific cannabis goods.
- (3) An order prohibiting the movement of cannabis goods to or from the premises.
- (4) (4) An order prohibiting the sale of specific cannabis goods.
- (5) An order prohibiting the destruction of specific cannabis goods.

(c) The emergency decision and order issued by the Bureau shall include a brief explanation of the factual and legal basis of the emergency decision that justify the Bureau's determination that emergency action is necessary, and the specific actions ordered. The emergency decision and order shall be effective when issued or as otherwise provided by the decision and order.

(d) To issue an administrative hold that prohibits activity related to specified cannabis goods, the Bureau shall comply with the following:

- (1) The notice of the administrative hold shall include a description of the cannabis goods subject to the administrative hold.
- (2) Following notice, the Bureau shall identify the cannabis goods subject to the administrative hold in the track and trace system.

(e) A licensee subject to an administrative hold shall comply with the following:

- (1) Within 24 hours of receipt of the notice of administrative hold, physically segregate all designated cannabis goods in a limited-access area of the licensed premises. The licensee shall ensure that all cannabis goods subject to the administrative hold are safeguarded and preserved in

a manner that prevents tampering, degradation, or contamination.

(2) While the administrative hold is in effect, the licensee shall not sell, donate, transfer, transport, gift, or destroy the cannabis goods subject to the hold.

(3) A microbusiness licensee subject to an administrative hold may continue to cultivate any cannabis subject to an administrative hold. If the cannabis subject to the hold must be harvested, the licensee shall place the harvested cannabis into separate batches.

(4) A licensee may voluntarily surrender cannabis goods that are subject to an administrative hold. The licensee shall identify the cannabis goods being voluntarily surrendered in the track and trace system. Voluntary surrender shall not be construed to waive the right to a hearing or any associated rights.

(f) To issue a temporary suspension, the Bureau shall specify in the order that the licensee shall immediately cease conducting all commercial cannabis activities under its license, unless otherwise specified in the order.

(g) A microbusiness licensee subject to a temporary suspension may continue to cultivate cannabis at the licensed premises only as prescribed by the Bureau in the order. If the order permits the cannabis to be harvested, the licensee shall place the harvested cannabis into separate batches.

(h) The emergency decision and order for temporary, interim relief shall be issued in accordance with the following procedures:

(1) The Bureau shall give notice of the emergency decision and order and an opportunity to be heard to the licensee prior to the issuance, or effective date, of the emergency decision and order, if practicable.

(2) Notice and hearing under this section may be oral or written and may be provided by telephone, personal service, mail, facsimile transmission, electronic mail, or other electronic means, as the circumstances permit.

(3) Notice may be given to the licensee, any person meeting the definition of owner for the license, or to the manager or other personnel at the licensed premises.

(4) Upon receipt of the notice, the licensee may request a hearing within three (3) business days by submitting a written request for hearing to the Bureau through electronic mail, facsimile transmission, or other written means. The hearing shall commence within five (5) business days of receipt of the written request for hearing, unless a later time is agreed upon by the Bureau and the licensee.

(5) The hearing may be conducted in the same manner as an informal conference under section 5803 of this division; however, the timeframes provided in section 5803 shall not apply to a hearing under this section. Pre-hearing discovery or cross-examination of witnesses is not required under this section.

(6) The emergency decision and order shall be affirmed, modified, or set aside as determined appropriate by the Bureau within five (5) business days of the hearing.

(i) Within ten (10) calendar days of the issuance or effective date of the emergency decision and order for temporary, interim relief, the Bureau shall commence adjudicative proceedings in

accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code to resolve the underlying issues giving rise to the temporary, interim relief, notwithstanding the pendency of proceedings for judicial review of the emergency decision as provided in subsection (k).

(j) After formal proceedings pursuant to subsection (i) of this section are held, a licensee aggrieved by a final decision of the Bureau may appeal the decision to the Cannabis Control Appeals Panel pursuant to Section 26043 of the Act.

(k) Notwithstanding administrative proceedings commenced pursuant to subsection (i), the licensee may obtain judicial review of the emergency decision and order pursuant to section 1094.5 of the Code of Civil Procedure in the manner provided in Section 11460.80 of the Government Code without exhaustion of administrative remedies.

(l) The Bureau's authority provided by this section may be used in addition to any civil, criminal, or other administrative remedies available to the Bureau.

Authority: Section 26013, Business and Professions Code. Reference: Section 26012, Business and Professions Code; and Sections 11460.10, 11460.20, 11460.30, 11460.40, 11460.50, 11460.60, 11460.70 and 11460.80, Government Code.

Chapter 8. OTHER PROVISIONS

Article 1. Research Funding

§ 5900. Eligibility.

(a) Only public universities in California shall be eligible to be selected to receive funds disbursed pursuant to Revenue and Taxation Code section 34019(b).

(b) Subject to available funding, the amounts to be disbursed to the university or universities will not exceed the sum of ten million dollars (\$10,000,000) for each fiscal year, ending with the 2028-2029 fiscal year.

Authority: Section 26013, Business and Professions Code. Reference: Section 34019, Revenue and Taxation Code.

§ 5901. Request for Proposals.

A Request for Proposal (RFP) is the document issued by the Bureau, which notifies all eligible fund recipients of the following, at a minimum:

(a) The funding available for research related to the Act or regulations adopted pursuant thereto;

(b) Disbursement of funds to eligible applicants through a review and selection process, including the criteria that will be used for review and selection;

(c) The specified timeframes for the proposal review and selection process, including the deadline for submission of proposals;

(d) Proposal requirements, including necessary documentation;

(e) Any priorities or restrictions imposed upon the use of the funds;

(f) (f) The governing statutes and regulations; and

(g) The name, address, and telephone number of a contact person within the Bureau, who can provide further information regarding the process for submission of proposals.

Authority: Section 26013, Business and Professions Code. Reference: Section 34019, Revenue and Taxation Code.

§ 5902. Selection Process and Criteria.

(a) The selection process shall involve eligible proposals timely received by the Bureau, in response to an applicable RFP, or similar notice.

(b) The Bureau will consider only one proposal per applicant for a given research project. Applicants may submit more than one proposal if the proposals are for separate and distinct research projects or activities.

(c) The Bureau will make a selection for funding, based on criteria including, but not limited to:

(1) The extent to which the proposed project is designed to achieve objectives as specified in Revenue and Taxation Code section 34019(b).

(2) The extent to which the proposed project is designed to achieve measurable outcomes, and the clarity of the measures for success, including, for research-based objectives, the scientific and technical merit of the proposed project as evaluated by relevant experts.

(3) The extent to which the proposed project is feasible, demonstrated by:

(A) A timeline for project completion, including readiness; and

(B) Budget detail.

(4) Qualifications of the staff who will be assigned or working on the proposed project.

(5) Any other criteria to determine the proposed project's efficacy in evaluating the implementation and effect of the Act.

(d) Applicants selected for funding will be notified in writing, along with the amount of the proposed funding.

(e) The Bureau's selection decision is final and not subject to appeal.

Authority: Section 26013, Business and Professions Code. Reference: Section 34019, Revenue and Taxation Code.

§ 5903. Release of Funds.

(a) The Bureau shall not cause funds to be disbursed until the Applicant has executed a Grant Agreement, and any other required documents.

(b) Selected recipients shall receive a single disbursement of funds for the duration of the research project.

(c) Funds released to the recipient that will be used for the purchase of any equipment related to the research project shall, at a minimum, meet the following conditions:

- (1) Prior to the purchase of any equipment, the recipient shall obtain written approval from the Bureau.
- (2) Receipts or other documentation for the purchase of any equipment shall be provided to the Bureau immediately upon purchase and request, and retained pursuant to section 5904 of this division.
- (d) Any funds that are not used prior to the completion of the research project shall be forfeited.

Authority: Section 26013, Business and Professions Code. Reference: Section 34019, Revenue and Taxation Code.

§ 5904. Reports to the Bureau.

The recipient of funds shall provide regular performance reports to the Bureau.

(a) Unless otherwise specified in the Grant Agreement, performance reports shall be provided to the Bureau in the following manner:

- (1) At monthly intervals for research projects with an estimated completion time not exceeding one year.
 - (2) At quarterly intervals for research projects with an estimated completion time exceeding one year.
- (b) Performance reports shall include, at a minimum:
- (1) A detailed, estimated time schedule of completion for the research project;
 - (2) Description of any measurable outcomes, results achieved, or other completed objectives of the research project;
 - (3) Description of remaining work to be completed;
 - (4) Summary of the expenditures of the funds, and whether the research project is meeting the proposed budget, and if not, the reasons for any discrepancies and what actions will be taken to ensure the research project will be completed; and
 - (5) Any changes to the information provided in the proposal, including, but not limited to, change in staff.

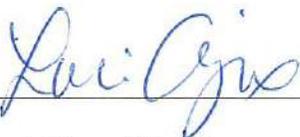
Authority: Section 26013, Business and Professions Code. Reference: Section 34019, Revenue and Taxation Code.

§ 5905. Research Records.

Recipients shall retain all research and financial data necessary to substantiate the purposes for which the funds were spent for the duration of the funding, and for a period of seven years after completion of the research project. Recipients shall provide such documentation to the Bureau upon request.

Authority: Section 26013, Business and Professions Code. Reference: Section 26160, Business and Professions Code; and Section 34019, Revenue and Taxation Code.

I certify that the above text represents a true and correct copy of the regulations; and that I am the Chief of the Bureau of Cannabis Control, and am authorized to make this certification.



Lori Ajax, Chief Bureau of Cannabis Control

Biographies

Oren Bitan

Oren Bitan has an extensive legal background that includes business, real estate, banking, receivership, consumer product, and commercial litigation. Mr. Bitan is known for his ability to solve complex business disputes for his clients in a strong but practical manner. He is a trusted advisor who guides his clients through their day to day legal concerns, and has particular expertise in matters involving real estate, banking and lending, creditors' rights, wine, beer, liquor, cannabis, and intellectual property.

Representative clients include banks and financial institutions, private lenders, state and federal receivers, private investors and investment funds, private equity groups, real property developers, breweries, wineries, distilleries, cannabis businesses, consumer products companies, and corporate entities large and small.

Mr. Bitan is co-chair of Buchalter's Cannabis Industry Law Group and advises cannabis businesses on a wide variety of issues, including regulatory advice, banking, lending, financing, intellectual property, receivership, real property development and leasing, and assembling teams of attorneys to provide corporate and employment advice. Representative clients include vertically integrated companies, brands, retailers, distributors, cultivators, manufacturers, investment funds, secured lenders, factors, equipment lessors, and IP licensors.

His practice experience includes:

- Receivers, Provisional Directors and other Remedies
- Commercial Real Estate Solutions
- Commercial, Corporate and Business Solutions
- Litigation
- Alternatives to Bankruptcy including Assignments for the Benefit of Creditors
- Intellectual Property and Technology Related Issues

Seth Freeman

Seth R. Freeman, CIRA, CTP is a Bankruptcy, Insolvency and Restructuring Consultant, Crisis and Turnaround Manager and Asset Manager with over 30 years of diverse consulting experience including financial advisory, operational and financial restructuring, controlled wind-downs, transaction management, arranging new financing, fiduciary, litigation support; and cross-border due diligence, insolvency and debt resolution, market-entry strategies, compliance, fraud investigation and recovery and complex dispute negotiation. His practice also includes serving as independent advisor to significant investors and directors of companies undergoing change.

Seth has over 20 years' extensive cross-border emerging markets experience involving India, Mainland China, Hong Kong, South East Asia; as well as in Mexico, Central and South America. Seth is an acknowledged expert on cross-border India investment and business practices and provides clients with an extraordinary local market network to assist the firm's U.S. clients in this fast-growing economy.

Over the past several years, Seth has developed expertise in the EB-5 investment immigration program to assist groups of foreign investors and their attorneys in EB-5 related fraud, mismanagement and bankruptcy, as well as assessing "redeployment" of "at-risk" investor funds and compliance required under USCIS regulation.

He has gained experience in all aspects of real estate investment, asset management, development, finance, lending, distressed asset and debt portfolios and investment banking across most property-types with an aggregate value exceeding \$1 Billion, including client projects in the U.S., Mexico, Guatemala and Belize.

Vanita Spalding

Vanita Spaulding is the Valuation Managing Director and Cannabis Group Leader at SingerLewak LLP, a nationally recognized top 100 accounting and consulting firm.

Ms. Spaulding has 35 years of valuation experience providing valuation services to clients in the areas of litigation support, financial reporting, cannabis industry, and estate planning and tax valuation. Vanita has a diverse background in a myriad of valuation projects including federal estate tax and gift tax, allocation of purchase price ASC805 and impairment testing ASC350, common stock valuation and share-based compensation valuation IRC 409A and ASC718, fairness and solvency opinions, intellectual property analyses, pre-acquisition financing, merger and acquisition pricing, ESOP formation and compliance, and various litigation support projects relating to marital and partnership

dissolution, shareholder disputes, breach of contract, lost profits, personal injury losses, and eminent domain. She is qualified as an expert to perform litigation support services and has appeared as an expert witness before the Superior Courts of Los Angeles, Orange, Riverside, and San Bernardino Counties, as well as the American Arbitration Association.



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POST-JUDGMENT RECEIVERSHIPS

How Aggressive Can the Post-Judgment Receiver Be?

A question and answer session with a Judge, a Receiver ,
and Creditor/Receivership Attorney

The Panelists:

The Honorable Edward B. Moreton. Judge Moreton was appointed as a judge to the Los Angeles Superior Court in 2006, and currently oversees Department 44 at the Stanley Mosk Courthouse. Virtually all post-judgment matters are handled in Department 44, making it one of the busiest courtrooms in all of LASC. Judge Moreton started his legal career as a trial attorney for the U.S. Department of Justice. Thereafter, he practiced civil litigation at Riordan and McKinzie, and then spent fifteen years at the U.S. Attorney's Office as an Assistant U.S. Attorney, until his appointment to the judiciary.

Theodore Lanes. Mr. Lanes is the founding member of Lanes Management Services. Mr. Lanes has been appointed as a receiver in both state and federal cases, and specializes in corporate and banking disputes, forensic investigations, and asset identification, recovery and liquidation. Mr. Lanes has over 25 years' experience in various aspects of corporate management, finance, human resources, and technology matters, and has served as the Chief Financial Officer for public and private companies. Mr. Lanes also has experience in assignments for the benefit of creditors, sales of assets, and valuations of business collateral. Mr. Lanes is also an ACAMSC certified anti-money laundering specialist.

Lei Lei Wang Ekvall. Ms. Wang Ekvall is a managing partner of Smiley Wang-Ekvall, a firm located in Orange County that specializes in insolvency, real estate, and business litigation. Ms. Wang Ekvall served a judicial clerkship to the Honorable Alan M. Ahart, William J. Lasarow, Kathleen T. Lax, Kathleen P. March, and Vincent P. Zurzolo, United States Bankruptcy Judges, from October 1992 to September 1993. From September 1993 to September 1994, she served a judicial clerkship to the Honorable Kathleen P. March, United States Bankruptcy Judge. Ms. Wang Ekvall concentrates her practice on insolvency and bankruptcy-related matters including work-outs, business reorganizations, creditors' rights, and trustee, committee, and receiver representation in diverse industries such as hospitality, medical, real estate, technology, entertainment, manufacturing, and retail. She also has substantial experience representing assignees in assignments for benefit of creditors.

Moderator:

Michael J. Muse-Fisher. Mr. Muse-Fisher is Senior Counsel at Buchalter, APC. Mr. Muse-Fisher specializes in receivers, fiduciaries, and provisional directors and has been involved in upwards of one-hundred receivership cases in both State and Federal Court. Mr. Muse-Fisher also specializes in banking litigation, commercial/business litigation, real estate, commercial and residential leasing, alternatives to bankruptcy, and copyright and trademark disputes. Mr. Muse-Fisher is a member of the Executive Committee and former Chair of the Los Angeles County Bar Association, Remedies Section, and is a member of the Board of Directors for the California Receiver's Forum.

KEY STATUTES AND CASES

POST-JUDGMENT RECEIVER:

- **Code Civil Procedure § 708.620**: The court may appoint a receiver to enforce the judgment where the judgment creditor shows that, considering the interests of both the judgment creditor and the judgment debtor, the appointment of a receiver is a reasonable method to obtain the fair and orderly satisfaction of the judgment.

- **Code Civil Procedure § 564**:
 - (a) A receiver may be appointed, in the manner provided in this chapter, by the court in which an action or proceeding is pending in any case in which the court is empowered by law to appoint a receiver.

 - (b) A receiver may be appointed by the court in which an action or proceeding is pending, or by a judge thereof, in the following cases:
 - (1) In an action by a vendor to vacate a fraudulent purchase of property, or by a creditor to subject any property or fund to the creditor's claim, or between partners or others jointly owning or interested in any property or fund, on the application of the plaintiff, or of any party whose right to or interest in the property or fund, or the proceeds thereof, is probable, and where it is shown that the property or fund is in danger of being lost, removed, or materially injured.
 - (2) In an action by a secured lender for the foreclosure of a deed of trust or mortgage and sale of property upon which there is a lien under a deed of trust or mortgage, where it appears that the property is in danger of being lost, removed, or materially injured, or that the condition of the deed of trust or mortgage has not been performed, and that the property is probably insufficient to discharge the deed of trust or mortgage debt.
 - (3) **After judgment, to carry the judgment into effect.**
 - (4) **After judgment, to dispose of the property according to the judgment, or to preserve it during the pendency of an appeal, or pursuant to the Enforcement of Judgments Law (Title 9 (commencing with Section 680.010)), or after sale of real property pursuant to a decree of foreclosure, during the redemption period, to collect, expend, and disburse rents as directed by the court or otherwise provided by law.**
 - (5) Where a corporation has been dissolved, as provided in Section 565.
 - (6) Where a corporation is insolvent, or in imminent danger of insolvency, or has forfeited its corporate rights.
 - (7) In an action of unlawful detainer.
 - (8) At the request of the Public Utilities Commission pursuant to Section 855 or 5259.5 of the Public Utilities Code.
 - (9) In all other cases where necessary to preserve the property or rights of any party.
 - (10) At the request of the Office of Statewide Health Planning and Development, or the Attorney General, pursuant to Section 129173 of the Health and Safety Code.
 - (11) In an action by a secured lender for specific performance of an assignment of rents provision in a deed of trust, mortgage, or separate assignment document. The appointment may be continued after entry of a judgment for specific performance if appropriate to protect, operate, or maintain real property encumbered by a deed of trust or mortgage or to collect rents therefrom while a pending nonjudicial foreclosure under power of sale in a deed of trust or mortgage is being completed.
 - (12) In a case brought by an assignee under an assignment of leases, rents, issues, or profits pursuant to subdivision (g) of Section 2938 of the Civil Code.

(c) A receiver may be appointed, in the manner provided in this chapter, including, but not limited to, Section 566, by the superior court in an action brought by a secured lender to enforce the rights provided in Section 2929.5 of the Civil Code, to enable the secured lender to enter and inspect the real property security for the purpose of determining the existence, location, nature, and magnitude of any past or present release or threatened release of any hazardous substance into, onto, beneath, or from the real property security. The secured lender shall not abuse the right of entry and inspection or use it to harass the borrower or tenant of the property. Except in case of an emergency, when the borrower or tenant of the property has abandoned the premises, or if it is impracticable to do so, the secured lender shall give the borrower or tenant of the property reasonable notice of the secured lender's intent to enter and shall enter only during the borrower's or tenant's normal business hours. Twenty-four hours' notice shall be presumed to be reasonable notice in the absence of evidence to the contrary.

(d) Any action by a secured lender to appoint a receiver pursuant to this section shall not constitute an action within the meaning of subdivision (a) of Section 726.

(e) For purposes of this section:

(1) "Borrower" means the trustor under a deed of trust, or a mortgagor under a mortgage, where the deed of trust or mortgage encumbers real property security and secures the performance of the trustor or mortgagor under a loan, extension of credit, guaranty, or other obligation. The term includes any successor in interest of the trustor or mortgagor to the real property security before the deed of trust or mortgage has been discharged, reconveyed, or foreclosed upon.

(2) "Hazardous substance" means any of the following:

(A) Any "hazardous substance" as defined in subdivision (h) of Section 25281 of the Health and Safety Code.

(B) Any "waste" as defined in subdivision (d) of Section 13050 of the Water Code.

(C) Petroleum including crude oil or any fraction thereof, natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel, or any mixture thereof.

(3) "Real property security" means any real property and improvements, other than a separate interest and any related interest in the common area of a residential common interest development, as the terms "separate interest," "common area," and "common interest development" are defined in Section 4095, 4100, and 4185 of the Civil Code, or real property consisting of one acre or less that contains 1 to 15 dwelling units.

(4) "Release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment, including continuing migration, of hazardous substances into, onto, or through soil, surface water, or groundwater.

(5) "Secured lender" means the beneficiary under a deed of trust against the real property security, or the mortgagee under a mortgage against the real property security, and any successor in interest of the beneficiary or mortgagee to the deed of trust or mortgage.

- **Morand v. Superior Court of the City and County of San Francisco (1974) 38 Cal.App.3d 347, 349**: "The [post-judgment] receiver is not, except in a technical sense, an officer of or instrumentality of the court, but represents and is an agent of the judgment debtor, the judgment creditor at whose instance he was appointed, and such other judgment debtors [sic] as may have caused the receivership to be extended to their claims."

- **Olsan v. Comora (1977) 73 Cal.App.3d 642**: court held that appointment of a “receiver would be the only feasible way to enforce respondent's rights under the judgment.” Key factors included that plaintiff had “done everything possible to satisfy the judgment by levy and execution, and had conducted a diligent search to discovery other assets,” and judgment debtor acknowledged that “no assets other than his business income were available to satisfy the judgment, or if there were, he had or would take such action as necessary to prevent their seizure to satisfy the judgment.”
 - **Crocker National Bank v. O'Donnell (1981) 115 Cal.App.3d 264**: court authorized appointment of post-judgment receiver because debtor: (1) had transferred equity in his home to mother prior to entry of judgment; (2) was paid by his corporation on an as needed basis and when he needed money for personal expenses “he writes a check on the corporate checking account and cashes it”; and, (3) debtor could not identify the directors of his corporation, nor could he locate corporate records, or minutes except those existing prior to entry of judgment.
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Cited

As of: December 13, 2019 2:54 AM Z

[Morand v. Superior Court](#)

Court of Appeal of California, First Appellate District, Division One

April 3, 1974

Civ. Nos. 34304, 34493

Reporter

38 Cal. App. 3d 347 *; 113 Cal. Rptr. 281 **; 1974 Cal. App. LEXIS 1057 ***

WALTER MORAND et al., Petitioners, v. THE SUPERIOR COURT OF THE CITY AND COUNTY OF SAN FRANCISCO, Respondent; MONROE MORRIS, as Receiver, etc., Real Party in Interest. K & E RENTALS, INC., et al., Petitioners, v. THE SUPERIOR COURT OF THE CITY AND COUNTY OF SAN FRANCISCO, Respondent; MONROE MORRIS, as Receiver, etc., Real Party in Interest

Subsequent History: [***1] A petition for a rehearing was denied May 3, 1974, and the petition of the real party in interest for a hearing by the Supreme Court was denied May 29, 1974.

Disposition: The peremptory writs of mandate will issue.

Core Terms

receiver, appointment, judgment debtor, proceedings, aid of execution, receivership, commencement of the action, judgment creditor

Case Summary

Procedural Posture

Petitioner corporations objected, by way of demurrers, to the jurisdiction of a trial court (California) to entertain

respondent receiver's action against them. The demurrers were overruled, and petitioners sought peremptory writs of mandate directing that their demurrers be sustained without leave to amend.

Overview

Respondent receiver was appointed receiver in aid of execution under [Cal. Civ. Proc. Code § 564\(4\)](#) after a money judgment against another party went unsatisfied. Respondent filed suit against petitioner corporations for declaratory relief and petitioners objected by way of demurrers. The trial court overruled the demurrers and petitioners sought peremptory writs of mandate directing that their demurrers be sustained without leave to amend. The court held that the trial court had erred and issued the writs. The court stated that the trial court's order permitting employment of an attorney for the purpose of taking whatever action necessary to obtain possession of the property, which gave questionable authority to sue one defendant, the party against whom the money judgment was entered, fell far short of leave to commence an action against petitioners. The court added that although the trial court's order stated that the attorney could do all things necessary to enable the receiver to effectively carry out the responsibilities of his receivership, it gave no special or express permission to commence an action against petitioners.

Outcome

The court issued the peremptory writs and held that applying the pertinent rules, respondent receiver had no legal authority to commence his action against petitioner

corporations in the mandate proceedings, and that accordingly the trial court was without jurisdiction to entertain the action. The court stated that it was error for the trial court to overrule the demurrers.

LexisNexis® Headnotes

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil
Procedure > ... > Receiverships > Receivers > Appointment of Receivers

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Civil
Procedure > Remedies > Receiverships > General Overview

[HN1](#) [↓] Procedural Matters, State Insolvency Laws

It has been a long standing judicial practice, in proper cases, to appoint receivers in proceedings variously called in aid of execution, supplemental proceedings, creditors' suits, and creditors' bills. The purpose of such proceedings is to reach property of a judgment debtor that may not be reached by the ordinary levy of execution. Unlike receivers generally whose true origin is in equity, receivers in aid of execution are considered creatures of statute. A receivership in proceedings supplementary to execution is a creation of statute and not a remedy in equity. The receiver is not, except in a technical sense, an officer or instrumentality of the court, but represents and is an agent of the judgment debtor, the judgment creditor at whose instance he was appointed, and such other judgment debtors as may have caused the receivership to be extended to their claims.

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil
Procedure > ... > Receiverships > Receivers > Appointment of Receivers

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil
Procedure > Remedies > Receiverships > General Overview

Civil
Procedure > ... > Receiverships > Receivers > General Overview

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

[HN2](#) [↓] Procedural Matters, State Insolvency Laws

The appointment of a receiver rests wholly within the judicial discretion, and upon appointment he is subject to the continued direction and control of the court. The appointment may be made where there are reasonable grounds to believe that the judgment debtor, or third parties, have control of property which rightfully should be subject to execution. Upon his appointment the receiver has no greater rights against others than the judgment creditor would have. And in a proper case, when authorized by the court or by statute, such a receiver may maintain an action to effect the purpose of the receivership. But it must be borne in mind that the power to appoint a receiver is a delicate one which is exercised sparingly and with caution, and only in an extreme case under such circumstances as demand or require summary relief, and never in a doubtful case or where there is no necessity or occasion for the appointment.

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil
Procedure > ... > Receiverships > Receivers > Appointment of Receivers

Civil Procedure > Judgments > Entry of Judgments > General Overview

38 Cal. App. 3d 347, *347; 113 Cal. Rptr. 281, **281; 1974 Cal. App. LEXIS 1057, ***1

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Civil Procedure > Remedies > Receiverships > General Overview

Civil Procedure > ... > Receiverships > Receivers > General Overview

[HN3](#) **Procedural Matters, State Insolvency Laws**

[Cal. Civ. Proc. Code § 564\(4\)](#) authorizes appointment of a receiver, providing, after judgment, in proceedings in aid of execution, when an execution is been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the judgment. [Cal. Code Civ. Proc. § 568](#) provides that the receiver has, under the control of the court, power to bring and defend actions in his own name, as receiver. The power to appoint receivers "in aid of execution" has been recognized by the state's courts, and the right of such a receiver to bring and defend actions has also been judicially recognized.

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil Procedure > ... > Receiverships > Receivers > Appointment of Receivers

Civil Procedure > Remedies > Receiverships > General Overview

Civil Procedure > ... > Receiverships > Receivers > General Overview

[HN4](#) **Procedural Matters, State Insolvency Laws**

California rigidly adheres to the principle that the power to appoint a receiver is a delicate one which is to be exercised sparingly and with caution. It is said by the state's courts that the appointment of a receiver is an extraordinary and harsh, and delicate, and drastic, remedy to be used cautiously and only where less

onerous remedies would be inadequate or unavailable. And a party to an action should not be subjected to the onerous expense of a receiver, unless his appointment is obviously necessary to the protection of the opposite party.

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil Procedure > ... > Receiverships > Receivers > Appointment of Receivers

Civil Procedure > Remedies > Receiverships > General Overview

Civil Procedure > ... > Receiverships > Receivers > General Overview

Civil Procedure > ... > Receiverships > Receivers > Powers of Receivers

[HN5](#) **Procedural Matters, State Insolvency Laws**

The functions and powers of a receiver are controlled by statute, by the order appointing him, and by orders subsequently made by the court. He has no powers beyond those so conferred. This rule is given particular effect with regard to actions sought to be commenced by the receiver. He may commence such an action only by authority of statute or the "special" or "express" permission of the court that appointed him.

Civil Procedure > Parties > Capacity of Parties > General Overview

Real Property Law > Title Quality > Adverse Claim Actions > Quiet Title Actions

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN6](#) **Parties, Capacity of Parties**

See [Cal. Civ. Proc. Code § 720](#).

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court overruled the demurrers of certain defendants in an action brought by a receiver in aid of execution. The receiver sought a declaration that a sublease, in which the demurring defendants and others allegedly claimed an interest, was the sole property of the judgment debtor. The receiver had secured an order authorizing him to employ an attorney for the purpose of taking whatever action might become necessary to obtain possession of property in the possession of another defendant, and to do all other things necessary to enable the receiver to effectively carry out the responsibilities of his receivership.

The Court of Appeal ordered issuance of peremptory writs of mandate, holding that the receiver had no legal authority to commence the action against the demurring defendants and that it was error to overrule the demurrers. The court cited the rule that the functions and powers of a receiver are controlled by statute, by the order appointing him, and by orders subsequently made by the court, and that he has no powers beyond those so conferred. It was further noted that the rule is given particular effect with regard to actions sought to be commenced by a receiver. The court viewed the order authorizing employment of the attorney as falling far short of leave to commence an action against four parties not named therein, and it did not regard the additional "all things necessary" clause as conferring any official or express permission to commence an action against them. (Opinion by Elkington, J., with Molinari, P. J., and Sims, J., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

Classified to McKinney's Digest

[CA\(1\)](#) (1)

Executions § 125—Supplementary Proceedings—Receiver.

--Unlike receivers generally, whose true origin is in equity, a receiver in aid of execution is considered a creature of statute. He is not, except in a technical

sense, an officer or instrumentality of the court, but represents and is an agent of the judgment debtor, the judgment creditor at whose instance he was appointed, and such other judgment creditors as may have caused the receivership to be extended to their claims.

[CA\(2\)](#) (2)

Executions § 125 — Supplementary Proceedings—Receiver.

--The appointment of a receiver in aid of execution rests wholly within the judicial discretion, and upon appointment the receiver is subject to the continued discretion and control of the court, but the power to appoint a receiver is a delicate one which is exercised sparingly and with caution, and only in extreme cases under circumstances as demand or require summary relief, and never in a doubtful case or where there is no necessity or occasion for the appointment.

[CA\(3\)](#) (3)

Receivers § 67—Powers, Duties and Liabilities.

--The rule that the functions and powers of a receiver are controlled by statute, by the order appointing him, and by orders subsequently made by the court, and that he has no powers beyond those so conferred, is given particular effect with regard to actions sought to be commenced by the receiver. He may commence such an action only by authority of statute or the "special" or "express" permission of the court which appointed him.

[CA\(4\)](#) (4)

Executions § 125 — Supplementary Proceedings — Receiver — Authority to Bring Actions.

--The trial court erred in overruling the demurrers of two corporations and two individuals sued by a receiver in aid of execution, where the only conceivable authority of the receiver for the bringing of the action was an order permitting employment of an attorney for the purpose of taking whatever action might become necessary to obtain possession of property in the possession of another corporation. The authority to sue one defendant, for which scant basis appeared, fell far short of leave to commence an action against four parties not named in the order, and additional language of the order

"and to do all things necessary to enable the receiver to effectively carry out the responsibilities of his receivership," gave no "special" or "express" permission to commence an action against them.

Counsel: David A. Norwitt, Harlem, Nevin & Sarraill, Robert A. Harlem, David W. Brennan and John Russell for Petitioners.

No appearance for Respondent.

Robert J. Cort for Real Party in Interest.

Judges: Opinion by Elkington, J., with Molinari, P. J., and Sims, J., concurring.

Opinion by: ELKINGTON

Opinion

ELKINGTON

[*349] [**282] We have consolidated for hearing and decision two closely related applications for relief by way of mandate. They deal with the power of the superior courts to appoint receivers in aid of execution, and the power of such receivers to commence actions in relation to the receivership.

[HN1](#) [↑] It has been a long standing judicial practice, in proper cases, to appoint receivers in proceedings variously called "in aid of execution," "supplemental proceedings," "creditors' suits," and "creditors' bills." The purpose of such proceedings is to [**283] reach property of a judgment debtor which may not be reached by the ordinary levy of execution. [CA\(1\)](#) [↑] (1)

Unlike receivers generally whose [***2] true origin is in equity (see 42 Cal.Jur.2d, Receivers, § 3; [65 Am.Jur.2d, Receivers, § 1](#)), receivers in aid of execution are considered creatures of statute. Their nature is pointed up from a wide collection of authority, q.v., by Corpus

Juris Secundum, Volume 33, in its [*350] article on Executions, section 385, as follows: "A receivership in proceedings supplementary to execution is a creation of statute and not a remedy in equity. The receiver is not, except in a technical sense, an officer or instrumentality of the court, but represents and is an agent of the judgment debtor, the judgment creditor at whose instance he was appointed, and such other judgment debtors [sic] as may have caused the receivership to be extended to their claims."

[CA\(2\)](#) [↑] (2) [HN2](#) [↑] The appointment of such a receiver rests wholly within the judicial discretion, and upon appointment he is subject to the continued direction and control of the court. The appointment may be made where there are reasonable grounds to believe that the judgment debtor, or third parties, have control of property which rightfully should be subject to execution. Upon his appointment the receiver has no greater rights against others [***3] than the judgment creditor would have. And in a proper case, when authorized by the court or by statute, such a receiver may maintain an action to effect the purpose of the receivership. (See generally: 33 C.J.S., Executions, §§ 384-393; 21 C.J.S., Creditors' Suits, § 63; 30 Am.Jur.2d, Executions, §§ 851-858; and see authority in these works collected.)

But it must be borne in mind that "[the] power to appoint a receiver is a delicate one which is exercised sparingly and with caution, and only in an extreme case under such circumstances as demand or require summary relief, and never in a doubtful case or where there is no necessity or occasion for the appointment." (75 C.J.S., Receivers, § 15; see also 33 C.J.S., Executions, § 386, subd. d; 30 Am.Jur.2d, Executions, §§ 851-853; and see authority in these works collected.)

California follows the general rules we have discussed. [HN3](#) [↑] [Code of Civil Procedure section 564, subdivision 4](#), has since 1933 authorized appointment of a receiver: "After judgment, . . . in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the judgment; [***4] . . ." [Section 568](#) of the same code provides that: "The receiver has, under the control of the court, power to bring and defend actions in his own name, as receiver; . . ." The power to appoint receivers "in aid of execution" had been recognized by the state's courts. (See [Bruton v. Tearle, 7 Cal.2d 48, 56 \[59 P.2d 953, 106 A.L.R. 580\]](#); [In re Ferguson, 123 Cal.App.2d 799, 804 \[268 P.2d 71\]](#); [Tucker v. Fontes, 70 Cal.App.2d 768 \[161 P.2d 697\]](#); [Elson v. Nyhan, 45 Cal.App.2d 1, 4-5 \[113 P.2d 474\]](#);

[Medical F. Assn. v. Short, 36 Cal.App.2d Supp. 745 \[92 P.2d 961\]](#); 19 Cal.Jur.2d, Rev., Executions, § 233.) And the right of such a receiver to bring and defend actions has also been judicially recognized. ([Tucker v. Fontes, supra, p. 773.](#))

[*351] But we find it important to note that [HN4](#) California rigidly adheres to the principle that the power to appoint a receiver is a delicate one which is to be exercised sparingly and with caution. It is said by the state's courts that the appointment of a receiver is "an extraordinary and harsh," and "delicate," and "drastic," remedy to be used "cautiously and only where less onerous remedies would [***5] be inadequate or unavailable. . . ." (See [Cohen v. Herbert, 186 Cal.App.2d 488, 495 \[8 Cal.Rptr. 922\]](#); [Alhambra etc. Mines v. Alhambra G. Mine, 116 Cal.App.2d 869, 873 \[254 P.2d 599\]](#); [Dabney Oil Co. v. Providence Oil Co., 22 Cal.App. 233, 238, 239 \[133 P. 1155\]](#); 42 Cal.Jur.2d, Receivers, § 9.) And a party to an action should not be "subjected [**284] to the onerous expense of a receiver, unless . . . his appointment is obviously necessary to the protection of the opposite party. . . ." ([De Leonis v. Walsh, 148 Cal. 254, 255 \[82 P. 1047\]](#).)

[CA\(3\)](#) (3) It is the rule that: [HN5](#) The functions and powers of a receiver are controlled by statute, by the order appointing him, and by orders subsequently made by the court. He has no powers beyond those so conferred." (42 Cal.Jur.2d, Receivers, § 73; and see authority there collected.) This rule is given particular effect with regard to actions sought to be commenced by the receiver. He may commence such an action only by authority of statute or the "special" or "express" permission of the court which appointed him. (See [Code Civ. Proc., § 568](#); [Scott v. Hollingsworth, 215 Cal. 314, 316 \[9 P.2d 836, \[***6\] 82 A.L.R. 995\]](#); [Bishop v. McKillican, 124 Cal. 321, 325-326 \[57 P. 76\]](#); [Tibbets v. Cohn & Co., 116 Cal. 365, 367 \[48 P. 372\]](#); 3 Witkin, Cal. Procedure (2d ed. 1971) Pleading, § 116; 42 Cal.Jur.2d, Receivers, §§ 89, 90.)

We end this dissertation and proceed with our analysis of the problems presented to us.

Scott Electric Company had obtained a money judgment against a corporation named Far East Exports. The judgment was unsatisfied, after return of execution and summary proceedings.

Thereafter, upon notice and hearing, one Monroe Morris was in the same action, appointed receiver in aid of execution under [Code of Civil Procedure section 564,](#)

[subdivision 4.](#) His authority, spelled out in the order and as relevant here, was (1) to "take over any and all assets of the judgment debtor herein and to take all necessary action to reduce the same to possession," and (2) to "collect any rents due and hereafter to become due from tenants or sublessees of said judgment debtor."

Thereafter Monroe Morris as such receiver represented to the court that Western Tri-Pack Corporation and Surgical Plastic Products, Inc., [*352] had possession of or were claiming certain [***7] "assets, to wit, rental to be paid the judgment debtor." On application therefor the court authorized the receiver to employ a designated attorney "as his attorney for the purpose of taking whatever action may become necessary to obtain possession of the property now in the possession of Western Tri-Pack Corporation, and to do all other things necessary to enable [the receiver] to effectively carry out the responsibilities of his receivership."

The receiver thereupon commenced an action for "Declaratory Relief" against the judgment debtor, Far East Exports, Western Tri-Pack Corporation, and, among others, the previously unmentioned four petitioners in the mandate proceedings before us, Walter Morand, Surgical Plastic Products, Inc., K. L. Kleinen and K & E Rentals, Inc.

The action sought a judicial declaration that a certain sublease in which the defendants allegedly claimed an interest was the property solely of the judgment debtor Far East Exports; and further, that certain of the defendants were "each the alter-ego of the other." Although compensatory damages were not sought, punitive damages of \$ 25,000 were.

The defendants below and petitioners here, Walter Morand, Surgical [***8] Plastic Products, Inc., K. L. Kleinen and K & E Rentals, Inc., objected, by way of demurrers, to the jurisdiction of the superior court to entertain the receiver's action against them. The demurrers having been overruled, they sought from this court peremptory writs of mandate directing that their demurrers be sustained without leave to amend. We issued alternative writs of mandate directed to the superior court.

We first observe that [HN6](#) [Code of Civil Procedure section 720](#) provides that when "it appears that a person or corporation, alleged to have property of the judgment debtor, or to be indebted to him, claims an interest in the property adverse to him, or denies the debt, the judgment creditor may maintain an action against such

person or corporation for the recovery of such interest or debt; . . ." And certainly, in **[**285]** such an action, the judgment creditor himself could establish that third parties claiming interest in the property, or denying the debt, were but the *alter egos* of the judgment debtor. For these reasons there would seem to have been scant reason for the court in the exercise of its judicial discretion, to authorize the receiver to commence the action; **[***9]** no reason was shown why it should not have been brought by the judgment creditor under [Code of Civil Procedure section 720](#).

[CA\(4\)](#)**[↑]** **(4)** But the central question before us is whether the receiver was, in any event, authorized to bring the action against the several petitioners in the proceedings now before this court.

[*353] As pointed out, the only conceivable authority of the receiver for the *bringing of the action* was the court's order permitting employment of an attorney "for the purpose of taking whatever action may become necessary to obtain possession of the property now in the possession of Western Tri-Pack Corporation." This questionable authority to sue one defendant falls far short of leave to commence an action against the there unnamed four parties who are the petitioners before us. The order's additional language, "and to do all things necessary to enable the receiver to effectively carry out the responsibilities of his receivership," gave no "special" or "express" permission to commence an action against them. Indeed, if one were to assume that it did, then the court would have improperly relinquished to the receiver the discretion whether an action might be commenced, **[***10]** and if so, against whom.

Applying the pertinent rules we hold that the receiver had no legal authority to commence his action against the petitioners in these mandate proceedings; and that accordingly the superior court was without jurisdiction to entertain the action. It was error to overrule the demurrers.

The peremptory writs of mandate will issue.



Caution

As of: December 13, 2019 3:01 AM Z

Olsan v. Comora

Court of Appeal of California, Second Appellate District, Division Five

September 23, 1977

Civ. No. 49897

Reporter

73 Cal. App. 3d 642 *; 140 Cal. Rptr. 835 **; 1977 Cal. App. LEXIS 1878 ***

BARBARA R. OLSAN, Plaintiff and Respondent, v.
EMANUEL M. COMORA et al., Defendants and
Appellants

Subsequent History: [***1] Appellant's petition for a hearing by the Supreme Court was denied November 17, 1977.

Prior History: Superior Court of Los Angeles County, Nos. C 982996 and C 983022, Norman R. Dowds, Judge.

Disposition: The order appointing the receiver is affirmed.

Core Terms

receiver, appointed, appointment of a receiver, declaration, satisfaction of a judgment, supplementary proceeding, simple money judgment, circumstances, earnings, exempt, return unsatisfied, aid of execution, superior court, proceedings, subdivision, sections

Case Summary

Procedural Posture

Appellant, judgment debtor, challenged the decision from the Superior Court of Los Angeles County (California), which appointed a receiver in order for respondent, judgment creditor, to satisfy the money judgment she had against appellant.

Overview

Respondent, judgment creditor, obtained a money judgment against appellant, judgment debtor, but was unable to collect the debt. Respondent then initiated a receivership proceeding in order to collect the judgment, and the trial court appointed a receiver. The trial court denied appellant's motion to reconsider. On review, appellant argued that a receiver could not be appointed to collect a simple money judgment. However, the court rejected that argument because it found that the statute did not exclude appointment of a receiver to collect a simple money judgment; only that it limited the circumstances under which a court could use the remedy. Furthermore, the court rejected appellant's argument that the appointment of a receiver could only be made in connection with a [Cal. Civ. Proc. Code §§ 714](#) or [715](#) proceeding because the cases and the statute did not exclude the direct appointment of a receiver by a court without supplementary proceedings. Therefore, the order appointing the receiver was affirmed.

Outcome

Trial court's decision to appoint a receiver in order for

respondent, judgment creditor, to satisfy the money judgment she had against appellant was affirmed. Even though receivership was a drastic measure for a money judgment, respondent was left with no other remedy because appellant refused to satisfy the judgment.

Bankruptcy Law > Procedural Matters > State Insolvency Laws

Civil
Procedure > Remedies > Receiverships > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

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Civil
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Civil Procedure > Judgments > Entry of Judgments > General Overview

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Civil
Procedure > Remedies > Receiverships > General Overview

Civil
Procedure > ... > Receiverships > Receivers > General Overview

[HN1](#) Procedural Matters, State Insolvency Laws

[Cal. Civ. Proc. Code § 564 \(4\)](#) provides in part that a receiver may be appointed by the court in which an action or proceeding is pending after judgment to dispose of the property according to the judgment, or to preserve it during the pendency of an appeal, or in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the judgment.

[HN2](#) Procedural Matters, State Insolvency Laws

Generally, because of its drastic nature, receivership should not be resorted to unless other remedies are inadequate. Receivership may not ordinarily be used for the enforcement of a simple money judgment, but under proper circumstances a receiver may be appointed in aid of execution.

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

Plaintiff recovered a money judgment against defendant and a corporation for the sum of \$ 382,886 plus costs, and the judgment became final after being affirmed on appeal. By means of an execution and garnishment, plaintiff collected \$ 36,560 from defendant out of a pending escrow. A receivership proceeding was then instigated by the issuance of an order ex parte to show cause why a receiver should not be appointed to marshal and disburse defendant's assets to satisfy the judgment. The trial court appointed a receiver to take possession and collect all earnings, cash, bank deposits and checks representing amounts received by defendant for services performed by him as a dentist. (Superior Court of Los Angeles County, Nos. C 982996 and C 983022, Norman R. Dowds, Judge.)

The Court of Appeal affirmed. The court held, contrary to defendant's contention, that under certain circumstances a receiver may be appointed to collect a simple money judgment, and pointed out that Civ. Code, § 564, subd. 4, under which the receiver was appointed, providing that a receiver may be appointed "in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the

judgment . . . ," does not exclude appointment of a receiver to collect a simple money judgment, but only limits the circumstances under which the court may use that remedy. The court further held that a trial court may directly appoint a receiver under [Code Civ. Proc., § 564, subd. 4](#), without first bringing supplementary proceedings under [Code Civ. Proc., §§ 714 or 715](#), and that the trial court had jurisdiction to directly appoint the receiver and did not abuse its discretion in doing so. (Opinion by Hastings, J., with Kaus, P. J., and Stephens, J., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

Classified to California Digest of Official Reports, 3d Series

[CA\(1\)](#) (1)

Receivers § 4—When Receiver May Be Appointed— Collection of Simple Money Judgment.

--It is proper under certain circumstances to appoint a receiver to collect a simple money judgment, and the provision of [Code Civ. Proc., § 564, subd. 4](#), that a receiver may be appointed "in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply its property in satisfaction of the judgment . . . ," does not exclude appointment of a receiver to collect a simple money judgment, but only limits the circumstances under which the court may use that remedy.

[CA\(2\)](#) (2)

Receivers § 6—Appointment and Qualification— Without Supplementary Proceedings.

--The trial court had jurisdiction to directly appoint a receiver pursuant to [Code Civ. Proc., § 564, subd. 4](#), without prior supplementary proceedings pursuant to [Code Civ. Proc., §§ 714, or 715](#), and did not abuse its discretion in doing so, where the declarations in support of the motion for appointment of a receiver sufficiently showed that a receiver was necessary in aid of a partially satisfied execution on a judgment. There is no provision in [Code Civ. Proc., § 564, subd. 4](#), requiring supplementary proceedings before the remedies of the statute can be invoked, nor is there any such requirement in [Code Civ. Proc., §§ 714, or 715](#), and the

trial court therefore was not required to order a supplementary proceeding that would only establish anew the need for a receiver.

[CA\(3\)](#) (3)

Receivers § 13—Title to and Possession of Property— Scope of Order.

--An order appointing a receiver that ordered the receiver to take possession of all earnings of defendant was proper and not too broad where the order also specifically stated that the receiver was authorized to release to defendant so much of his earnings as would be exempt under [Code Civ. Proc., § 690 et seq.](#)

Counsel: Kenneth D. Sanborn and Christopher M. Gilman for Defendant and Appellant.

Loeb & Loeb and Morry Langer for Plaintiff and Respondent.

Judges: Opinion by Hastings, J., with Kaus, P. J., and Stephens, J., concurring.

Opinion by: HASTINGS

Opinion

[*644] [836]** The presiding judge in Department 85 of the Superior Court of Los Angeles County appointed a receiver to take possession and collect all earnings, cash, bank deposits and checks representing amounts received by defendant-appellant Emanuel Comora for services performed by him as a dentist. He appeals from the order appointing such receiver primarily on the ground that a receiver cannot be appointed to collect a simple money judgment.

On July 31, 1972, a money judgment was obtained by Barbara R. Olsan, plaintiff and respondent, against

appellant Comora and Cybertronics-Nevada, Inc.,¹ a corporation, in Los Angeles Superior Court, for the sum of \$ 382,886 plus costs. The judgment became final [***2] after being affirmed on appeal. By means of an execution and garnishment, respondent collected \$ 36,560 from appellant Comora out of a pending escrow.

A receivership proceeding was then instigated entitled "Barbara R. Olsan, assigned to Metropolitan Adjustment Bureau L.A., Inc., a corporation, plaintiff, vs. Emanuel Comora, defendant."² This proceeding was initiated by the issuance of an order ex parte to show cause why a receiver should not be appointed to marshal and disburse Comora's assets to satisfy the judgment. Hearing was set for February 6, 1976. Two documents were filed in support of the motion. The first was a declaration of Sherman Shelton, president of Metropolitan Adjustment Bureau, which in substance states that he is president of Metropolitan, the assignee, and that after judgment was entered against Comora, Olsan made demand upon Comora to pay the judgment, but he refused; that Olsan, as the judgment creditor, is unable to levy execution upon [***3] [*645] Comora's earnings, and that the only process available to enforce payment is by the appointment of a receiver who would collect Comora's earnings and disburse the funds to the judgment creditor toward the satisfaction of the judgment in accordance with [section 690.6 of the Code of Civil Procedure](#) (exempting certain earnings for personal services).

The second document was a declaration by Andrew S. Garb, an attorney at law and member of the firm of Loeb & Loeb, the firm that successfully tried the action resulting in the money judgment for Olsan. It stated that the only amount which Olsan had been able to collect from Comora was \$ 36,560 which had been held in Comora's name at a pending escrow. Although Comora had an apartment building in his own name, when garnishment on the rents was sought it was met by a claim by Comora's mother-in-law that she had a trust deed promissory note on the property with an assignment of rents [***4] clause. Comora, at the time, was in default on the note; therefore, she had a prior claim to the rents. This issue was litigated in the Los Angeles Municipal Court. Olsan was unable to prove collusion between Comora and his mother-in-law, and therefore could not establish a right to the rents. Garb's

declaration also stated that, although Comora is a practicing dentist, he was personally advised by Comora that his accounts receivable were subject to a factoring arrangement and that a judgment creditor of his would have great difficulty in collecting a judgment. He was further advised by Comora that Miss Olsan would have great difficulty locating any of his assets that were subject to levy. Because of these difficulties in locating assets [**837] subject to levy, Olsan decided to assign the judgment for collection. The declaration concluded that under these circumstances a receiver would be the only feasible way to enforce respondent's rights under the judgment.

There was no affidavit or declaration showing that the motion for appointment of a receiver was ever served on Comora or his attorney. The file, however, reflects that on February 4, 1976, Donald R. Colvin, attorney [***5] for Comora, filed a "Motion In Abatement Of, To Quash, And In Response To Order To Show Cause Why Receiver Should Not Be Appointed." The heading of this document also noted that it was filed in department 85 for a February 6, 1976, hearing. This motion, seven pages in length, set forth reasons why Comora objected to the appointment of a receiver.

On February 6, 1976, the court made its minute order appointing Gilbert Robinson as receiver. Neither Comora nor his attorney Donald [*646] R. Colvin were present in court. On February 9, 1976, Colvin filed a motion for a stay order to allow the filing of a motion for reconsideration. Colvin's declaration in support of the motion for reconsideration stated that he had an unexpected attack of influenza on the morning of February 6th and was unable to appear in court and his home telephone was inoperative until that afternoon so that he was unable to advise the court of his inability to be present. This motion was denied.

[CA\(1\)](#)^[↑] (1) Comora's first argument is that a receiver cannot be appointed to collect a simple money judgment. The law, both statutory and decisional, does not support this contention. The receiver in this case was appointed [***6] pursuant to section [HN1](#)^[↑] 564, subdivision 4 of the Code of Civil Procedure, which provides in pertinent part as follows: "A receiver may be appointed . . . by the court in which an action or proceeding is pending . . . 4. After judgment, to dispose of the property according to the judgment, or to preserve it during the pendency of an appeal, or in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the judgment; . . ."

¹ The receivership applied only to Comora.

² To simplify this opinion we refer to Olsan, the assignor as respondent.

In *Jackson v. Jackson*, 253 Cal.App.2d 1026, 1040-1041 [62 Cal.Rptr. 121], the court said: "*HN2*[↑] Generally, because of its drastic nature, receivership should not be resorted to unless other remedies are inadequate. [Citation.] Receivership may not ordinarily be used for the enforcement of a simple money judgment³ [citations], *but under proper circumstances a receiver may be appointed in aid of execution.* (*Bruton v. Tearle* (1936) 7 Cal.2d 48, 53 [59 P.2d 953, 106 A.L.R. 580]; *In re Ferguson* (1954) 123 Cal.App.2d 799, 804 [268 P.2d 71]; *Medical Finance Assn. v. Short* (1939) 36 Cal.App.2d Supp. 745, 747 [92 P.2d 961]; and see [***7] *Code Civ. Proc.*, 564, subd. 4; and §§ 714-723.)" (Italics added.) And in *Tucker v. Fontes*, 70 Cal.App.2d 768 [161 P.2d 697], the defendant appeared in court in response to an order under *Code of Civil Procedure* section 714. At that hearing it was established that he had certain accounts receivable from his machinery and parts business that were not exempt from execution and an interest in an apartment house. At the conclusion of the supplementary hearing, the court appointed a receiver. The court stated on page 773: "In view of the foregoing factual showing and under the law laid down in the cases above cited, it was entirely within the discretionary power of the trial court to appoint a receiver to take over any property, not exempt from execution, of which defendant was found [***647] to be the owner, and to collect all accounts receivable, and subject the same to the satisfaction of the judgment; and for such purpose to have access to all of the books and accounts pertaining to defendant's business."

[***8] The provision of *section 564, subdivision 4* pertinent to this appeal states that a receiver *may* be appointed "in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment [***838] debtor refuses to apply his property in satisfaction of the judgment" These words, clear and unambiguous, do not exclude appointment of a receiver to collect a simple money judgment. The wording only limits the circumstances under which the court *may* use this somewhat harsh remedy. *Jackson* and *Tucker* confirm that it is proper under certain circumstances; therefore, Comora's first argument that a receiver cannot be appointed under any circumstances to collect a simple money judgment is incorrect.

³ Comora heavily relied on this portion of the *Jackson* opinion; however, the emphasized portion of the paragraph was not referred to in his argument.

CA(2)[↑] (2) Comora's second argument assumes arguendo that a receiver may be appointed to collect a simple money judgment, but that the appointment can only be made in connection with a *section 714* or *715* proceeding (see fn. 4, *post.*). It is true that most, if not all, cases to date affirming the appointment of a receiver in a money judgment situation have done so in conjunction with a supplementary proceeding under one of the two sections. Based [***9] upon these cases, Witkin, in 5 California Procedure (2d ed. 1971) Enforcement of Judgment, section 182, page 3539, states: "*C.C.P. 564* [subdivision] (4) authorizes a receiver 'in proceedings in aid of execution, when an execution has been returned unsatisfied, or when the judgment debtor refuses to apply his property in satisfaction of the judgment.' This provision recognizes the equitable jurisdiction to appoint a receiver . . . in connection with statutory *supplemental proceedings* (supra, § 123)⁴ . . . (See *Tucker v. Fontes* [***648] [*supra*] (1945) 70 C.A.2d 768, 771, 161 P.2d 697; *McCutcheon v. Superior Court* (1933) 134 C.A. 5, 9, 24 P.2d 911 [pleading held insufficient]; *Bruton v. Tearle* (1936) 7 C.2d 48, 53, 59 P.2d 953; *In re Ferguson* (1954) 123 C.A.2d 799, 804, 268 P.2d 71; *Tobin v. Tobin* (1960) 181 C.A.2d 789, 791, 5 C.R. 712 [to

⁴ Witkin, California Procedure, sections 123 and 125, comment on the supplementary proceedings as follows: Section 123 states in pertinent part: "(1) *Nature of Remedies.* The chapter of the Code of Civil Procedure commencing with *C.C.P. 714* establishes certain 'Proceedings Supplemental to Execution' for the purpose of discovering assets of the judgment debtor and applying them to satisfaction of the judgment. These proceedings are (1) *ancillary*, or incidental to the main action, in *aid of execution*; (2) *summary*, giving a speedy and inexpensive remedy. [para.] The ancillary and summary proceeding is intended as a substitute for the old 'creditor's suit' or 'creditor's bill in equity,' wherein the judgment creditor, after return of execution unsatisfied, sought to compel discovery of assets and apply them to the judgment. The creditor's suit was a slow and cumbersome independent action, and the statutory proceeding supersedes it except in unusual situations. [Citations.]" (Italics in original.)

The pertinent comment on section 125 states: "[It] gives a right to an order of examination after execution has issued, without the necessity of its return unsatisfied. The creditor must make proof, by *affidavit or otherwise*, that the debtor has property which he unjustly refuses to apply to satisfaction of the judgment. . . . [para.] The basic difference between the procedure under *C.C.P. 714* and *C.C.P. 715* is that, where execution has been returned unsatisfied this is itself sufficient proof of fruitless search for property; otherwise a showing of such facts must be made. . . ."

enforce integrated property settlement agreement]; *Jackson v. Jackson* [*supra*] (1967) 253 C.A.2d 1026, 1040, 62 C.R. 121; 7 Cal. Practice 445 et seq.; 9 Am.Jur. P.P. Forms (Rev. ed.) 860 et seq.; 3 *Summary Husband and Wife*, Supp., § 146; cf. *Elson v. Nyhan* (1941) 45 [***10] C.A.2d 1, 4, 113 P.2d 474 [discretion to deny where doubt as to whether property could be subjected to creditor's claim]; *Conaway v. Conaway* (1963) 218 C.A.2d 427, 428, 32 C.R. 890 [receiver should not be appointed where fund sought is exempt from execution and there is consequently nothing to receive].)"

[***11] The cases and the statute do not, however, exclude the direct appointment of a receiver by a court sans supplementary proceedings. There is no provision in section 564, subdivision 4 requiring supplementary proceedings before the remedies of the section can be invoked, nor is there any such provisional language in sections 714 or 715. The current practice of superior courts in numerous counties is that a petitioning party has procedural alternatives, i.e., a proceeding under sections 714 or 715 or a direct proceeding by motion to the court under section 564, subdivision 4. (See Witkin, Cal. Evidence (2d ed. 1966) Judicial Notice, [**839] § 175, subd. (b), p. 162; *Denham v. Superior Court*, 2 Cal.3d 557, 564-565 [86 Cal.Rptr. 65, 468 P.2d 193].) The latter procedure was used by Olsan. There is a logical and expeditious reason for such pragmatic procedure, and our present case is a good example. The declaration supporting Olsan's motion for appointment of a receiver disclosed that she had, on her own volition, done everything possible to satisfy the judgment by levy of execution, and had conducted a diligent search to discover other assets. Statements by Comora to [***12] Olsan's attorney made after the first execution support a conclusion that no assets other than his business income were available to satisfy the judgment or, if there were, he had, or would, take such action as necessary to prevent their seizure to satisfy the judgment. Here, the declarations in support of the motion for appointment of a receiver obviously convinced the court that a receiver was necessary in aid of the partially satisfied execution. Under such [**649] circumstances, the judge was not required to order a supplementary proceeding that would only establish anew the need for a receiver. We are satisfied that the court had jurisdiction to appoint the receiver under the facts and procedures used in this case, and it did not abuse its discretion in doing so.

CA(3) [↑] (3) Comora's other contentions on appeal can quickly be answered. First, he claims the order was

too broad in ordering the receiver to take possession of all earnings of Comora because some are exempt under section 690 et seq. of the Code of Civil Procedure. The order, however, specifically states that the receiver is authorized to release to Comora so much of his earnings as would be exempt under said sections. [***13] There was no error. Second, Comora claims the court abused its discretion because it disregarded his "Memorandum of Points and Authorities in Support of Motion in Abatement etc." ⁵ We have no reasons, under the record before us, to believe the court disregarded the memorandum. For reasons stated earlier, there was more than sufficient evidence to justify the appointment of the receiver. Comora's objection did not mandate a different result. The trial court's action on appeal is presumed to be correct. Any claim of error must be affirmatively shown. (*Walling v. Kimball*, 17 Cal.2d 364, 373 [110 P.2d 58].) Third, and finally, Comora argues the court abused its discretion in summarily denying his ex parte motion for a stay of execution of the order appointing the receiver. Again, Comora has not shown how the court abused its discretion in this regard. Comora's reasons for opposing the appointment of the receiver were before the court. These reasons were not sufficient to change the court's ruling as a matter of law, and Comora has not indicated any new facts that would require us to reverse the order.

[***14] The order appointing the receiver is affirmed.

End of Document

⁵ In this memorandum reference was made to other actions and appeals by Comora that relate to his continuing litigation with Olsan. They do not affect the court's ruling appointing the receiver or this appeal.



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Crocker National Bank v. O'Donnell

Court of Appeal of California, Second Appellate District, Division Five

January 26, 1981

Civ. No. 58460

Reporter

115 Cal. App. 3d 264 *; 171 Cal. Rptr. 225 **; 1981 Cal. App. LEXIS 1315 ***

CROCKER NATIONAL BANK, Plaintiff and
Respondent, v. EUGENE P. O'DONNELL, Defendant
and Appellant

Prior History: [***1] Superior Court of Los Angeles
County, No. C 207036, Vernon G. Foster and Robert I.
Weil, Judges.

Disposition: The order appointing a receiver is
affirmed.

Core Terms

receiver, earnings, attorneys, records, appointment of a
receiver, substitution

Case Summary

Procedural Posture

Appellant doctor sought review of an order of the
Superior Court of Los Angeles County (California) that
appointed a receiver to aid respondent bank in the
execution of a money judgment obtained by respondent
against appellant on a promissory note. The receiver
was appointed on respondent's motion. Appellant had a
closely held medical corporation, which apparently was
his only asset.

Overview

Respondent bank obtained a money judgment, and
appellant doctor was the judgment debtor. Respondent
moved for the appointment of a receiver after trying to
execute the judgment. The trial court appointed a
receiver, and appellant sought review. The appointment
authorized, inter alia, the receiver to demand, collect,
and receive all earnings of appellant and the medical
corporation in which he was the sole shareholder. It also
authorized the taking of possession of all books and
records and entry into the business premises and
receipt, review, and reconciliation of the books to
determine earnings. The court rejected the argument
that the power of the receiver was too broad. The court
found that the receiver was not authorized to manage
the entire business or to take any assets. The court also
rejected the argument that the motion for a receiver was
defective because it did not name the corporation as a
party and was not served on the corporation. The court
found that appellant was the sole shareholder and used
the corporation's funds as his own and that his use of
the corporate checking account for personal expenses
defrauded respondent by preventing collection. The
court affirmed.

Outcome

The court affirmed the trial court's order appointing a
receiver in favor of respondent bank. The court rejected,
inter alia, appellant doctor's contention that the order
was an abuse of discretion because it was too broad.
The order empowered the receiver to collect and
receive all earnings of appellant and his corporation and

to enter on the premises and to receive, review, and reconcile the books and records.

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

After a bank attempted unsuccessfully to collect or execute on a judgment obtained against a doctor, it moved for appointment of a receiver in aid of execution under [Code Civ. Proc., § 564](#). In support of the motion, the bank showed that the only asset which could be used to enforce the judgment was defendant's earnings, but that defendant was using his wholly owned medical corporation as a device to hinder, delay and defraud his creditors. The trial court granted the motion. (Superior Court of Los Angeles County, No. C 207036, Vernon G. Foster and Robert I. Weil, Judges.)

The Court of Appeal affirmed. The court rejected defendant's contention that the order was invalid insofar as it applied to the records of the corporation, as the corporation was not named in the motion and not served as a separate entity. The court held that because the order authorized the receiver to act for the limited purpose of collecting the earnings of defendant for application to the judgment, it did not give overly broad powers to the receiver. The court also held defendant failed to show he was misled or prejudiced by the lack of a formal substitution of attorneys after the firm originally representing the bank had split and the trial court did not abuse its discretion in recognizing the new firm. (Opinion by Ashby, J., with Kaus, P. J., and Hastings, J., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

Classified to California Digest of Official Reports, 3d Series

[CA\(1\)](#) [↓] (1)

Receivers § 5—Appointment and Qualification—Motion and Service.

--An order appointing a receiver in aid of execution of a judgment to prevent a doctor from taking his earnings

out of his medical corporation for his own benefit without applying the earnings to the judgment was not rendered invalid by the fact the motion for appointment did not name the corporation as a defendant and was not served on the corporation as a separate entity, where the declarations and deposition introduced in support of the motion showed that the doctor was the sole shareholder in the corporation, that he used the corporation funds as his own, and that his use of the corporate checking account for his personal expenses operated to defraud creditors by preventing them from reaching his earnings. Under these circumstances service of the motion on the doctor was also service on the corporation, and the trial court's order appointing a receiver properly was directed to the corporation as well as the doctor.

[CA\(2\)](#) [↓] (2)

Receivers § 17—Powers and Duties.

--An order appointing a receiver in aid of execution of a judgment against a doctor and a medical corporation of which the doctor was the sole shareholder did not give overly broad powers to the receiver by permitting him to take possession of all records of the corporation, where the receivership was not to take assets of the corporation and apply them to the doctor's debt, but rather was simply to prevent the doctor from effectively withdrawing his earnings from the corporation without applying them to the judgment.

[CA\(3\)](#) [↓] (3)

Attorneys at Law § 16—Attorney-client Relationship—Substitution of Attorneys and Termination of Relationship.

--At a hearing on a motion to appoint a receiver in aid of an execution of a judgment, the trial court did not abuse its discretion in recognizing the attorney representing the creditor, even though between the time the original judgment was obtained and the motion for appointment there was a change in the name of the law firm representing the creditor, and no formal substitution of attorneys had been filed by the time of the hearing on the motion ([Code Civ. Proc., §§ 284, 285](#)), where the law firm originally representing the creditor had since split, and where the debtor failed to show he was misled or prejudiced by the lack of a formal substitution. Moreover, by appearing at the hearing in response to

the attorney's notice, and proceeding to argue the merits, the debtor could be held to have waived the technical objection.

Counsel: Theodore A. Cohen for Defendant and Appellant.

No appearance for Plaintiff and Respondent.

Judges: Opinion by Ashby, J., with Kaus, P. J., and Hastings, J., concurring.

Opinion by: ASHBY

Opinion

[*266] [**226] In February 1978 respondent Crocker National Bank obtained a money judgment against appellant Eugene P. O'Donnell, M.D., based on a promissory note. Respondent unsuccessfully attempted to collect or execute upon the judgment. In January 1979 respondent moved for appointment of a receiver in aid of execution (see [Code Civ. Proc., § 564](#); [Olsan v. Comora \(1977\) 73 Cal.App.3d 642 \[140 Cal.Rptr. 835\]](#)), which the court granted when the matter came on for hearing. Appellant appeals from the order appointing the receiver.

The motion for appointment of a receiver in aid of execution was supported by the declarations of John Graham and Dennis Lombardi, who were attorneys for respondent, and the deposition of appellant taken on August 3, 1978, pursuant to court order. (See [Code Civ. Proc., §§ 714, 715](#).) Respondent alleged [***2] that the only asset which could be used to enforce the judgment was appellant's considerable earnings as a physician, but that appellant was using his wholly owned medical corporation as a device to hinder, delay, and defraud his creditors, and that appellant's conduct had made it impossible for respondent to reach this asset

without the aid of a court-appointed receiver.¹ Appellant practices medicine as a professional corporation, Eugene P. O'Donnell, M.D., Inc. He is the sole shareholder. He does not know how to locate his corporate records, there are no corporate minutes since 1977, and he does not know who the directors are. Appellant is paid by the corporation on a sporadic basis when the corporation has the money and appellant needs it. When appellant needs money for personal expenses, he writes a check on the corporate checking account and cashes it. Appellant does not have a personal checking account. Furthermore, according to the declaration of Lombardi, appellant at his further examination in September [*267] 1978 admitted that "he receives his salary by drawing [**227] money out of the corporation's checking account on an as-needed basis" and that "he uses [***3] the medical corporation's bank account as if it were his own."

As explained by counsel for respondent at the hearing on the motion, a receivership was necessary to prevent appellant from taking his earnings out of the corporation for his own benefit without applying the earnings to the judgment. (See [Olsan v. Comora, supra, 73 Cal.App.3d at p. 648](#).)

The order appointing the receiver authorizes the receiver to demand, collect, and receive all "earnings" by Eugene P. O'Donnell, M.D., from any and all sources, including but not limited to Eugene P. O'Donnell, M.D., Inc.; to enter upon the business premises; to receive, review and reconcile the books and records of Eugene P. O'Donnell, M.D., Inc., and Eugene P. O'Donnell, M.D., for the purpose of determining the earnings [***4] of Eugene P. O'Donnell, M.D.; and to take possession of all books and records of Eugene P. O'Donnell, M.D., and/or Eugene P. O'Donnell, M.D., Inc., to enable the receiver to collect the earnings of Eugene P. O'Donnell, provided said records be available to Eugene P. O'Donnell, M.D., and/or Eugene P. O'Donnell, M.D., Inc., at reasonable times for use in its business.

[CA\(1\)](#)[↑] (1) Appellant contends that the motion for appointment of a receiver did not name the corporation as a defendant nor was it served on the corporation as a separate entity. He argues from this that the order appointing the receiver is invalid insofar as it applies to

¹ Appellant's other asset, his home, had been quitclaimed to his mother in 1975. At his examination appellant claimed this was in consideration for cancellation of past debts, which, however, he was unable to corroborate or even estimate.

the records of the corporation. This argument is wholly without merit. The declarations and the deposition introduced in support of the motion showed that appellant was the sole shareholder, that he used the corporation funds as his own, and that appellant's use of the corporate checking account for his personal expenses operated to defraud creditors by preventing respondent as a practical matter from reaching appellant's earnings. Under the circumstances service of the motion on appellant was also service on the corporation, and the court's order properly [***5] was directed to the corporation as well as appellant. (See [Sunset Farms, Inc. v. Superior Court \(1935\) 9 Cal.App.2d 389, 401-402 \[50 P.2d 106\]](#); see also [Shea v. Leonis \(1939\) 14 Cal.2d 666, 669 \[96 P.2d 332\]](#); [Campbell v. Birch \(1942\) 53 Cal.App.2d 399, 404 \[128 P.2d 120\]](#).)

[CA\(2\)](#)^[↑] (2) Appellant next contends that the order was an abuse of discretion because it gives overly broad powers to the receiver. In particular, [*268] he contends it should not be necessary for the receiver to take possession of all records of the corporation, and that this constitutes an unwarranted interference in the business of the corporation. However, as pointed out by respondent's counsel at the hearing, the receivership is not to take assets of the corporation and apply them to the debt of appellant, but rather simply to prevent appellant from effectively withdrawing his earnings from the corporation without applying them to the judgment. The order authorizes the receiver to act for the limited purpose of collecting the earnings of appellant. The receiver was not being authorized to manage the entire business.

[CA\(3\)](#)^[↑] (3) Finally, appellant contends the order should be reversed because [***6] between the obtaining of the original judgment in February 1978 and the motion for appointment of a receiver in January 1979 there was a change in the name of the law firm representing respondent, and no formal substitution of attorneys had been filed by the time of the hearing on the motion. (See [Code Civ. Proc., §§ 284, 285](#).) There is also no merit to this argument. The original complaint on the promissory note was filed by Foonberg and Frandzel, a law corporation, by Richard Hudson Share. The motion for appointment of a receiver was filed by Frandzel and Share, attorneys at law, Richard Hudson Share and John A. Graham, by John A. Graham. In the declaration in support of the motion, Graham mentioned that he was an attorney at law and a former member of Foonberg and Frandzel, a law corporation.

At the hearing on the motion, Mr. Graham, in response to appellant's objection that there had been no substitution of attorneys, explained that the law firm had [**228] recently split, that his firm represented 25 banks and had 6,000 cases pending, and for that reason might not yet have filed the many necessary substitutions of attorneys, but that all the attorneys working on this [***7] file were involved in the change; that he did not think a technicality like that should be determinative; and that if the court desired he could provide a substitution of attorneys within 24 hours. The court impliedly overruled appellant's objection and then heard arguments on the merits.

Appellant fails to show he was misled or prejudiced by the lack of a formal substitution. Considering all the circumstances, the court did not abuse its discretion in recognizing Mr. Graham. (See [In re Marriage of Warner \(1974\) 38 Cal.App.3d 714, 720 \[113 Cal.Rptr. 556\]](#).) Furthermore, by appearing at the hearing in response to Mr. Graham's notice, and proceeding to argue the merits, appellant may be held to have [*269] waived this technical objection. ([Ross v. Ross \(1953\) 120 Cal.App.2d 70, 74 \[260 P.2d 652\]](#); [Carrara v. Carrara \(1953\) 121 Cal.App.2d 59, 62-63 \[262 P.2d 591\]](#).)

The order appointing a receiver is affirmed.

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Caution

As of: December 13, 2019 2:26 AM Z

[Office Depot, Inc. v. Zuccarini](#)

United States Court of Appeals for the Ninth Circuit

July 17, 2009, Argued and Submitted, San Francisco, California; February 26, 2010, Filed

No. 07-16788

Reporter

596 F.3d 696 *; 2010 U.S. App. LEXIS 4052 **

OFFICE DEPOT INC., Plaintiff-Appellee, DS HOLDINGS, LLC, Assignee-Appellee, v. JOHN ZUCCARINI, doing business as Country Walk, Defendant-Appellant.

Subsequent History: Stay denied by, Motion denied by [Office Depot Inc. v. Zuccarini, 2010 U.S. Dist. LEXIS 54943 \(N.D. Cal., May 12, 2010\)](#)

Prior History: **[**1]** Appeal from the United States District Court for the Northern District of California Susan Yvonne Illston, District Judge, Presiding. D.C. No. CV-06-80356-SI.

[Office Depot, Inc. v. Zuccarini, 2008 U.S. Dist. LEXIS 23110 \(N.D. Cal., Mar. 13, 2008\)](#)

Disposition: AFFIRMED.

Core Terms

domain name, registry, district court, registered, appointment of a receiver, receiver, levy, intangible property, registrant, appointed, writ of execution, purposes, situs, quasi in rem, state law, ownership, money judgment

Case Summary

Procedural Posture

Appellee was the assignee of a judgment against appellant judgment debtor. The U.S. District Court for the Northern District of California appointed a receiver to take control of and auction off some of the judgment debtor's domain names in order to satisfy the judgment. The judgment debtor appealed, contending that the Northern District of California was not a proper place to levy upon his domain names.

Overview

Appellee argued that the district court had jurisdiction over the judgment debtor's intangible property that was located, for purposes of attachment, in the Northern District. Because [Fed. R. Civ. P. 66](#) did not provide a rule governing the proper location for appointment of a receiver in aid of execution of a judgment, the court looked to state law. Under California law, domain names were intangible property subject to a writ of execution. Given the persuasive but not controlling language of the Anticybersquatting Consumer Protection Act, and the practicalities involved in bringing suit to execute judgments against owners of domain names, the court concluded that under California law, domain names were located where the registry was located for the purpose of asserting quasi in rem jurisdiction. Because the registry for the domain names had its headquarters in the Northern District of California, the district court had quasi in rem jurisdiction over the domain names registered with the registry for purposes of appointing a receiver to assist in executing a judgment against the judgment debtor.

Outcome

The judgment of the district court was affirmed.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

Civil Procedure > ... > Receiverships > Receivers > Appointment of Receivers

[HN1](#) Standards of Review, Abuse of Discretion

Appellate courts review for abuse of discretion a district court order appointing a receiver.

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

[HN2](#) Standards of Review, De Novo Review

Appellate courts review de novo a district court's interpretation of law, including state law.

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > Quasi in Rem Actions

[HN3](#) In Rem Actions, Quasi in Rem Actions

Type two quasi in rem jurisdiction is used to establish the ownership of property in a dispute unrelated to the property. Type two quasi-in rem jurisdiction is sometimes called "attachment jurisdiction."

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > Quasi in Rem Actions

[HN4](#) In Rem Actions, Quasi in Rem Actions

A district court can obtain quasi in rem jurisdiction over property situated within its geographical borders. [Fed. R. Civ. P. 4\(n\)\(2\)](#).

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > Quasi in Rem Actions

[HN5](#) In Rem Actions, Quasi in Rem Actions

See [Fed. R. Civ. P. 4\(n\)\(2\)](#).

Civil Procedure > ... > Jurisdiction > In Rem & Personal Jurisdiction > Constitutional Limits

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > Quasi in Rem Actions

[HN6](#) In Rem & Personal Jurisdiction, Constitutional Limits

Though the situs of intangibles is often a matter of controversy, quasi in rem jurisdiction can be asserted over intangible property. Due process requires a constitutionally sufficient relationship among the defendant, the forum, and the litigation. In an action to execute on a judgment, due process concerns are satisfied, assuming proper notice, by the previous rendering of a judgment by a court of competent jurisdiction. Once it has been determined by a court of competent jurisdiction that the defendant is a debtor of the plaintiff, there would seem to be no unfairness in allowing an action to realize on that debt in a State where the defendant has property, whether or not that State would have jurisdiction to determine the existence of the debt as an original matter.

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > General Overview

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN7](#) [↓] **In Rem & Personal Jurisdiction, In Rem Actions**

State law has been applied under [Fed. R. Civ. P. 69\(a\)](#) to garnishment, mandamus, arrest, contempt of a party, and appointment of receivers, when such actions are undertaken in aid of executing on a judgment.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN8](#) [↓] **Judgments, Enforcement & Execution**

[Fed. R. Civ. P. 69](#) governs procedures on execution of a judgment and, for the most part, directs the district court to look to state rules.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN9](#) [↓] **Judgments, Enforcement & Execution**

See [Fed. R. Civ. P. 69](#).

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN10](#) [↓] **Judgments, Enforcement & Execution**

[Fed. R. Civ. P. 69](#) provides that state law applies generally, but a federal statute governs to the extent it applies.

Civil Procedure > ... > Receiverships > Receivers > Appointment of Receivers

[HN11](#) [↓] **Receivers, Appointment of Receivers**

See [Fed. R. Civ. P. 66](#).

Civil Procedure > ... > Receiverships > Receivers > Appo

intment of Receivers

[HN12](#) [↓] **Receivers, Appointment of Receivers**

The federal rules, including [Fed. R. Civ. P. 66](#), qualify as federal statutes under [fed. R. Civ. P. 69\(a\)](#). Therefore, [Fed. R. Civ. P. 66](#) prevails over any state law to the extent it applies. However, [Fed. R. Civ. P. 66](#) does not provide a rule governing the proper location for appointment of a receiver in aid of execution of a judgment. Because [Fed. R. Civ. P. 66](#) does not provide a governing rule, courts look to state law.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN13](#) [↓] **Judgments, Enforcement & Execution**

See [Cal. Code Civ. Proc. § 695.010\(a\)](#).

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN14](#) [↓] **Judgments, Enforcement & Execution**

See [Cal. Code Civ. Proc. § 699.710](#).

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN15](#) [↓] **Judgments, Enforcement & Execution**

In California, all property of a judgment debtor can be used to satisfy a writ of execution.

Civil Procedure > ... > Receiverships > Receivers > Appointment of Receivers

[HN16](#) [↓] **Receivers, Appointment of Receivers**

[Cal. Code Civ. Proc. § 708.620](#) governs the appointment of a receiver in aid of the execution of a judgment in California state courts.

Civil

Procedure > ... > Receiverships > Receivers > Appointment of Receivers

[HN17](#) **Receivers, Appointment of Receivers**

See [Cal. Code Civ. Proc. § 708.620](#).

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

[HN18](#) **Enforcement & Execution, Writs of Execution**

See [Cal. Code Civ. Proc. § 699.510\(a\)](#).

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Computer & Internet Law > Civil Actions > General Overview

[HN19](#) **Judgments, Enforcement & Execution**

Domain names are intangible property under California law. Domain names do not constitute property subject to a turnover order because they cannot be taken into custody. [Cal. Code Civ. Proc. § 699.040](#) provides that, with respect to a turnover order, property must be levied upon by taking it into custody.

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Computer & Internet Law > Civil Actions > General Overview

[HN20](#) **Enforcement & Execution, Writs of Execution**

Domain names are intangible property subject to a writ of execution.

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

[HN21](#) **Enforcement & Execution, Writs of Execution**

Attaching a situs to intangible property is necessarily a legal fiction; therefore, the selection of a situs for intangibles must be context-specific, embodying a common sense appraisal of the requirements of justice and convenience in particular conditions. That is, the location of intangible property varies depending on the purpose to be served: the situs may be in one place for ad valorem tax purposes; it may be in another place for venue purposes, i.e., garnishment; it may be in more than one place for tax purposes in certain circumstances; it may be in still a different place when the need for establishing its true situs is to determine whether an overriding national concern, like the application of the Act of State Doctrine is involved. A single piece of intangible property may be located in multiple places for some purposes.

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > General Overview

Computer & Internet Law > ... > Trademark Protection > Protection of Rights > Internet Domain Names

[HN22](#) **In Rem & Personal Jurisdiction, In Rem Actions**

Under the Anticybersquatting Consumer Protection Act (ACPA), a trademark owner in a civil cybersquatting action can proceed in personam against the cybersquatter. If there is no in personam jurisdiction in any judicial district of the United States, the owner may proceed in rem against the allegedly infringing domain name. [15 U.S.C.S. § 1125\(d\)\(2\)\(A\) \(ii\)\(I\)](#). The ACPA provides that in rem jurisdiction over these domain names shall be in the judicial district in which the domain name registrar, domain name registry, or other domain name authority that registered or assigned the domain name is located. [15 U.S.C.S. § 1125\(d\)\(2\)\(A\)](#). The ACPA also provides for the legal situs of the domain name once a lawsuit has been filed.

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > General Overview

Computer & Internet Law > ... > Trademark Protection > Protection of Rights > Internet Domain Names

[HN23](#) **In Rem & Personal Jurisdiction, In Rem**

Actions

See [15 U.S.C.S. § 1125\(d\)\(2\)\(C\)\(i\)](#).

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Rem Actions > General Overview

Computer & Internet Law > Civil Actions > General Overview

[HN24](#) In Rem & Personal Jurisdiction, In Rem Actions

Under California law that domain names are located where the registry is located for the purpose of asserting quasi in rem jurisdiction.

Counsel: John Zuccarini, Pro se, Stuart, Florida, defendant-appellant.

Michael Woodrow De Vries, Latham & Watkins LLP, Costa Mesa, California, for the plaintiff-appellee.

Henry M. Burgoyne III, Karl S. Kronenberger, Kronenberger Burgoyne LLP, San Francisco, California, for the assignee-appellee.

Judges: Before: Cynthia Holcomb Hall, William A. Fletcher and Richard A. Paez, Circuit Judges. Opinion by Judge William A. Fletcher.

Opinion by: William A. Fletcher

Opinion

[*698] W. FLETCHER, Circuit Judge:

John Zuccarini is a judgment debtor who owns the rights to many Internet domain names. DS Holdings ("DSH") is the assignee of the judgment against Zuccarini. DSH

attempted to levy upon Zuccarini's domain name holdings in the Northern District of California where VeriSign, the official registry for all ".com" and ".net" domain names, has its headquarters. The district court appointed a receiver to take control of and auction off some of Zuccarini's domain names in order to satisfy the judgment.

Zuccarini appeals, contending that the Northern District of California is not a **[**2]** proper place to levy upon his domain names and that the appointment of the receiver was therefore improper.

We affirm.

I. Background

In December 2000, Office Depot obtained a judgment against Zuccarini under the Anticybersquatting Consumer Protection Act of 1999 ("ACPA"), [15 U.S.C. § 1125\(d\)](#), arising out of Zuccarini's registration of the domain name "offic-depot.com." Office Depot was unable to collect on the judgment and eventually assigned the judgment to DSH.

DSH sought to levy upon some of the other domain names owned by Zuccarini. DSH registered the judgment in the district court for the Northern District of California. DSH then obtained a preservation order from the district court and engaged in discovery. It learned that Zuccarini owned more than 248 domain names registered with VeriSign, of which more than 190 were ".com" domain names. DSH targeted the ".com" domain names in its levy.

Some background information on the structure of the domain name system will be helpful to the reader:

Every computer connected to the Internet has a unique Internet Protocol ("IP") address. IP addresses are long strings of numbers, such as 64.233.161.147. The Internet [domain name system] provides **[**3]** an alphanumeric shorthand for IP addresses. The hierarchy of each domain name is divided by periods. Thus, reading a domain name from right to left, the portion of the domain name to the right of the first period is the top-level domain ("TLD"). TLDs include .com, .gov, .net., and .biz. Each TLD is divided into second-level domains identified by the designation to the left of the first period, such as "example" in "example.com" or "example.net." . . . Each domain name is unique and thus can only be registered to one entity . . .

A domain name is created when it is registered with

the appropriate registry operator. A registry operator maintains the definitive database, or registry, that associates the registered domain names with the proper IP numbers for the respective domain name servers. The domain name servers direct Internet queries to the related web resources. A registrant can register a domain name only through companies that serve as [*699] registrars for second level domain names. Registrars accept registrations for new or expiring domain names, connect to the appropriate registry operator's TLD servers to determine whether the name is available, and register available domain names [**4] on behalf of registrants

The majority of domain name registrations for commercial purposes utilize the .com TLD.

[Coalition for ICANN Transparency, Inc. v. VeriSign, Inc., 464 F. Supp. 2d 948, 951-53 \(N.D. Cal. 2006\), reversed by 567 F.3d 1084 \(9th Cir. 2009\).](#)

As explained in *Coalition for ICANN Transparency*, there are three primary actors in the domain name system. First, companies called "registries" operate a database (or "registry") for all domain names within the scope of their authority. Second, companies called "registrars" register domain names with registries on behalf of those who own the names. Registrars maintain an ownership record for each domain name they have registered with a registry. Action by a registrar is needed to transfer ownership of a domain name from one registrant to another. Third, individuals and companies called "registrants" own the domain names. Registrants interact with the registrars, who in turn interact with the registries.

VeriSign is the registry for the domain names ".com" and ".net". *Id. at 953*. Its headquarters are located in Mountain View, California, in the Northern District of California. During discovery, DSH learned that the registrars [**5] for Zuccarini's ".com" and ".net" domain names were located in the United States, Germany, and Israel. DSH filed a request in the district court for a turnover order to compel the registrars of certain ".com" domain names owned by Zuccarini to transfer ownership to DSH. The district court denied the request, holding that, under [California Civil Procedure Code § 699.040](#), it could not order third parties to turn over property. DSH then moved for the appointment of a receiver who would obtain and sell the ".com" domain names in question and would use the proceeds to satisfy the judgment. The district court granted the motion to appoint a receiver.

Zuccarini appealed. We have jurisdiction under [28 U.S.C. § 1292\(a\)\(2\)](#) to entertain an appeal from an interlocutory order appointing a receiver.

II. Standard of Review

[HN1](#) [↑] We review for abuse of discretion a district court order appointing a receiver. *Canada Life Assurance Co. v. LaPeter*, 563 F.3d 837, 844 (9th Cir. 2009). [HN2](#) [↑] We review de novo a district court's interpretation of law, including state law. [Capital Dev. Co. v. Port of Astoria](#), 109 F.3d 516, 518 (9th Cir. 1997).

III. Discussion

DSH does not argue that the district court in the Northern District [**6] of California has *in personam* jurisdiction over Zuccarini. Rather, it argues that the court has jurisdiction over Zuccarini's intangible property that is located, for purposes of attachment, in the Northern District.

The type of jurisdiction at issue is "type two *quasi in rem*." See *Restatement (First) of Judgments* § 32 (1942). [HN3](#) [↑] Type two *quasi in rem* jurisdiction is used to establish the ownership of property in a dispute unrelated to the property. Type two *quasi-in rem* jurisdiction is sometimes called "attachment jurisdiction." See *Restatement (Second) of Judgments* § 8 (1982). So far as the record in this case shows, the domain names upon which DSH seeks to levy were not involved in the [**700] underlying litigation that led to the judgment against Zuccarini.

[HN4](#) [↑] A district court can obtain *quasi in rem* jurisdiction over property situated within its geographical borders. See [Pennington v. Fourth Nat'l Bank](#), 243 U.S. 269, 272, 37 S. Ct. 282, 61 L. Ed. 713 (1917); [Fed. R. Civ. P. 4\(n\)\(2\)](#) ([HN5](#) [↑]) "[T]he court may assert jurisdiction over the defendant's assets found in the district. Jurisdiction is acquired by seizing the assets under the circumstances and in the manner provided by state law in that district." [HN6](#) [↑] Though "the situs of intangibles [**7] is often a matter of controversy," [Hanson v. Denckla](#), 357 U.S. 235, 246-47, 78 S. Ct. 1228, 2 L. Ed. 2d 1283 (1958), *quasi in rem* jurisdiction can be asserted over intangible property. [Harris v. Balk](#), 198 U.S. 215, 25 S. Ct. 625, 49 L. Ed. 1023 (1905). Due process requires a constitutionally sufficient relationship among the defendant, the forum, and the litigation. [Shaffer v. Heitner](#), 433 U.S. 186, 204, 97 S. Ct. 2569, 53 L. Ed. 2d 683 (1977). In an action to execute on a judgment, due process concerns are satisfied, assuming proper notice, by the previous rendering of a judgment

by a court of competent jurisdiction. *Id.* at 210 n.36 ("Once it has been determined by a court of competent jurisdiction that the defendant is a debtor of the plaintiff, there would seem to be no unfairness in allowing an action to realize on that debt in a State where the defendant has property, whether or not that State would have jurisdiction to determine the existence of the debt as an original matter."); *Glencore Grain Rotterdam B.V. v. Shivnath Rai Harnarain Co.*, 284 F.3d 1114, 1127 (9th Cir. 2002) (quoting *Shaffer*).

We have previously noted that *HN7* "[s]tate law has been applied under *Rule 69(a)* to garnishment, mandamus, arrest, contempt of a party, and appointment of receivers," when such actions are ***8* undertaken in aid of executing on a judgment. *In re Merrill Lynch Relocation Mgmt., Inc.*, 812 F.2d 1116, 1120 (9th Cir. 1987); see also *Edmonston v. Sisk*, 156 F.2d 300, 301 (10th Cir. 1946) (applying *Rule 69(a)*, and state law, to appointment of receiver in aid of an action for execution); 12 Wright & Miller, Federal Practice and Procedure § 3012 at 148-49. We now take the opportunity to explain why this is so.

HN8 Federal Rule of Civil Procedure 69 governs procedures on execution of a judgment and, for the most part, directs the district court to look to state rules. The version of *Rule 69(a)* relied upon by the district court provided as follows:

HN9 Process to enforce a judgment for the payment of money shall be a writ of execution, unless the court directs otherwise. The procedure on execution, in proceedings supplementary to and in aid of a judgment, and in proceedings on and in aid of execution shall be in accordance with the practice and procedure of the state in which the district court is held, existing at the time the remedy is sought, except that any statute of the United States governs to the extent that it is applicable. . .

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¹The rule was amended as of December 1, 2008. The updated text of the rule is as follows:

A money judgment is enforced by a writ of execution, unless the court directs otherwise. The procedure on execution--and in proceedings supplementary to and in aid of judgment or execution-- must accord with the procedure of the state where the court is located, but a federal statute governs to the extent it applies.

Fed. R. Civ. P. 69(a)(1) (2009). The advisory committee notes indicate that these amendments were merely stylistic.

***701* To paraphrase, *HN10* *Rule 69* provides that state law applies ***9* generally, but a federal statute governs to the extent it applies.

Rule 66 governs the appointment of a receiver in federal court. It provides:

HN11 These rules govern an action in which the appointment of a receiver is sought or a receiver sues or is sued. But the practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule. An action in which a receiver has been appointed may be dismissed only by court order.

HN12 The federal rules, including *Rule 66*, qualify as federal statutes under *Rule 69(a)*. *Bair v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 112 F.2d 247, 249-50 (9th Cir. 1940) ***10* (applying federal rule to *Rule 69* action); see also *Schneider v. Nat'l R.R. Passenger Corp.*, 72 F.3d 17, 19 (2d Cir. 1995) ("This term includes the Federal Rules of Civil Procedure, since they have the force and effect of federal statutes."); *Okla. Radio Assoc. v. FDIC*, 969 F.2d 940, 942 (10th Cir. 1992). Therefore, *Rule 66* prevails over any state law to the extent it applies. However, *Rule 66* does not provide a rule governing the proper location for appointment of a receiver in aid of execution of a judgment. Because *Rule 66* does not provide a governing rule, we look to state law.

California Civil Procedure Code § 695.010(a) provides, *HN13* "Except as otherwise provided by law, all property of the judgment debtor is subject to enforcement of a money judgment." *Section 699.710* provides, *inter alia*, *HN14* "[A]ll property that is subject to enforcement of a money judgment . . . is subject to levy under a writ of execution to satisfy a money judgment." Under these provisions, *HN15* all property of a judgment debtor can be used to satisfy a writ of execution.

HN16 *California Civil Procedure Code § 708.620* governs the appointment of a receiver in aid of the execution of a judgment in California state courts. It ***11* provides:

HN17 The court may appoint a receiver to enforce the judgment where the judgment creditor shows that, considering the interests of both the judgment creditor and the judgment debtor, the

Advisory Committee Note (2007).

appointment of a receiver is a reasonable method to obtain the fair and orderly satisfaction of the judgment.

This rule does not indicate where a receiver over property should be appointed. However, § 699.510(a) provides that the appropriate place to direct a writ of execution is the county where the levy is to be made:

HN18 [↑] [A]fter entry of a money judgment, a writ of execution shall be issued by the clerk of the court upon application of the judgment creditor and shall be directed to the levying officer in the county where the levy is to be made and to any registered process server.

The combined effect of these provisions is to provide that if the domain names are property subject to execution, and if they are located in the Northern District of California, that district is an appropriate location to execute judgment on them through the appointment of a receiver. There are thus two questions before us. First, are domain names property that is subject to execution? Second, if so, where are the domain ****12** names located for purposes of execution? We address these questions in turn.

First, we have already held that **HN19** [↑] domain names are intangible property under California law. *Kremen v. Cohen*, 337 F.3d 1024, 1030 (9th Cir. 2003). In *Palacio Del Mar Homeowners Ass'n, Inc. v. McMahon*, 174 Cal. App. 4th 1386, 1391, 95 Cal. Rptr. 3d 445 (2009), a California ***702** Court of Appeal held that domain names do not constitute property subject to a turnover order because they cannot be taken into custody. The court in *Palacio Del Mar* based its holding on a reading of *California Civil Procedure Code* § 699.040, which provides that, with respect to a turnover order, property must "be levied upon by taking it into custody." However, the court left open the question whether domain names constitute intangible property generally, and it cited *Kremen* with approval. Moreover, the "taking it into custody" language in § 699.040 does not appear in § 708.620, which governs the appointment of receivers. We conclude that *Kremen* is still an accurate statement of California law, and that **HN20** [↑] domain names are intangible property subject to a writ of execution.

Second, we note that **HN21** [↑] "attaching a situs to intangible property is necessarily a legal fiction; ****13** therefore, the selection of a situs for intangibles must be context-specific, embodying a 'common sense appraisal of the requirements of justice and

convenience in particular conditions.'" *Af-Cap Inc. v. Republic of Congo*, 383 F.3d 361, 371 (5th Cir. 2004) (quoting *U.S. Indus., Inc. v. Gregg*, 540 F.2d 142, 151 n.5 (3rd Cir. 1976)). That is, the location of intangible property varies depending on the purpose to be served:

The situs may be in one place for ad valorem tax purposes; it may be in another place for venue purposes, i.e., garnishment; it may be in more than one place for tax purposes in certain circumstances; it may be in still a different place when the need for establishing its true situs is to determine whether an overriding national concern, like the application of the Act of State Doctrine is involved.

Tabacalera Severiano Jorge, S. A. v. Standard Cigar Co., 392 F.2d 706, 714-15 (5th Cir. 1968) (citations omitted). A single piece of intangible property may be located in multiple places for some purposes. *Curry v. McCannless*, 307 U.S. 357, 367-68, 59 S. Ct. 900, 83 L. Ed. 1339 (1939).

California law says nothing specific about the location of domain names. However, in the Anticybersquatting Consumer Protection ****14** Act Congress has addressed the question. **HN22** [↑] Under the ACPA, a trademark owner in a civil cybersquatting action can proceed *in personam* against the cybersquatter. If there is no *in personam* jurisdiction in any judicial district of the United States, the owner may proceed *in rem* against the allegedly infringing domain name. 15 U.S.C. § 1125(d)(2)(A) (iii)(I). The ACPA provides that *in rem* jurisdiction over these domain names shall be "in the judicial district in which the domain name registrar, domain name registry, or other domain name authority that registered or assigned the domain name is located . . ." 15 U.S.C. § 1125(d)(2)(A). The ACPA also provides for the legal situs of the domain name once a lawsuit has been filed:

HN23 [↑] In an *in rem* action under this paragraph, a domain name shall be deemed to have its situs in the judicial district in which . . . the domain name registrar, registry, or other domain name authority that registered or assigned the domain name is located

Id. § 1125(d)(2)(C)(i); see also *Mattel, Inc. v. Barbie-Club.com*, 310 F.3d 293, 302 (2d Cir. 2002) (interpreting these provisions). Although the current proceeding is not an action under the ACPA, the statute is ****15** authority for the proposition that domain names

are personal property located wherever the registry or the registrar are located.

Both parties make practical arguments relevant to an appraisal of the interests of "justice and convenience." [Af-Cap Inc., 383 F.3d at 371](#). Zuccarini argues that since registrars tell the registries who owns domain names, any attachment **[*703]** should be directed to registrars. Zuccarini also argues that if the domain names under VeriSign's control are located in the district where VeriSign has its headquarters, every ".net" and ".com" domain name is located in that district.

DSH admits that instructions concerning the transfer of ownership of domain names must go through registrars. But it points out that the registrars are essentially intermediaries, that the registry controls the database of all domain names, and that any change in ownership is ultimately reflected in the registry. Additionally, DSH points out that it would greatly impede the ability of judgment creditors to levy upon domain names if they were required to bring suits in the many different places where registrars of the domain names are located.

Given the persuasive but not controlling language of **[**16]** the ACPA, and the practicalities involved in bringing suit to execute judgments against owners of domain names, we conclude [HN24](#) under California law that domain names are located where the registry is located for the purpose of asserting *quasi in rem* jurisdiction. Although the question is not directly before us, we add that we see no reason why for that purpose domain names are not also located where the relevant registrar is located.

Conclusion

Because VeriSign has its headquarters in the Northern District of California, the district court had *quasi in rem* jurisdiction over the domain names registered with VeriSign for purposes of appointing a receiver to assist in executing a judgment against the owner of the names.

AFFIRMED.



As of: December 13, 2019 2:32 AM Z

Palacio Del Mar Homeowners Assn., Inc. v. McMahon

Court of Appeal of California, Fourth Appellate District, Division Three

June 16, 2009, Filed

G040349, ; G040412

Reporter

174 Cal. App. 4th 1386 *; 95 Cal. Rptr. 3d 445 **; 2009 Cal. App. LEXIS 955 ***

PALACIO DEL MAR HOMEOWNERS ASSOCIATION,
INC., Plaintiff and Respondent, v. ARNOLD A.
MCMAHON, Defendant and Appellant.

Prior History: [***1] Appeal from a postjudgment order of the Superior Court of Orange County, No. 01CC14684, Jane D. Myers, Temporary Judge. (Pursuant to [Cal. Const., art. VI, § 21.](#)).

Disposition: Reversed and remanded with directions.

Core Terms

domain name, turnover order, judgment debtor, judgment creditor, turnover, AHRC, authorizes, directing, levying officer, custody

Case Summary

Procedural Posture

Pursuant to [Code Civ. Proc., § 708.205](#), the Orange County Superior Court, California, entered a postjudgment order directing defendant judgment debtor to turn over a domain name to plaintiff judgment creditor to aid the execution of its money judgment against the judgment debtor. The judgment debtor appealed.

Overview

The court concluded that the judgment creditor could not obtain an order directing the turnover of intangible property directly to it. [Section 708.205](#) did not allow the turnover of the domain name, which was intangible property, directly to the judgment creditor. Rather, it authorized the judgment debtor's interest in property to be applied toward the satisfaction of the money judgment. The judgment creditor could not rely upon the general turnover statute, [Code Civ. Proc., § 699.040](#), because that statute did not allow a turnover to the judgment creditor. Moreover, [§ 699.040](#) limited itself to tangible property. Finally, the turnover order was wrongly directed at the judgment debtor because the judgment creditor did not show the domain name was in the judgment debtor's possession. The judgment debtor's testimony he operated the associated Web site did not show he was in possession of the underlying domain name.

Outcome

The postjudgment order was reversed, and the case was remanded with directions to vacate the order.

LexisNexis® Headnotes

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN1](#) Judgments, Enforcement & Execution

[Code Civ. Proc., § 708.205, subd. \(a\)](#), authorizes the court to order a judgment debtor's interest in property in the possession or under the control of the judgment debtor to be applied toward the satisfaction of the money judgment.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN2](#) Judgments, Enforcement & Execution

Cash is easily applied toward satisfying a judgment. Nonmonetary property is not so easily applied. It must be valued and sold. [Code Civ. Proc., § 708.205](#), does not authorize the judgment debtor to value property unilaterally or put it up for public sale.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN3](#) Judgments, Enforcement & Execution

A turnover order may direct the examinee to deliver (1) property to a levying officer, and (2) funds directly to the judgment creditor - but not property directly to the judgment creditor.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

[HN4](#) Judgments, Enforcement & Execution

[Code Civ. Proc., § 699.040, subd. \(a\)](#), allows a judgment creditor to seek an order directing the judgment debtor to transfer to the levying officer either or both of the following: (1) possession of the property sought to be levied upon if the property is sought to be levied upon by taking it into custody; (2) possession of documentary evidence of title to property of or a debt owed to the judgment debtor that is sought to be levied upon. It does not allow a turnover to the judgment creditor. [Section 699.040](#) limits itself to tangible property

that can be levied upon by taking it into custody. Domain name registration supplies the intangible contractual right to use a unique domain name for a specified period of time. Even if this right constitutes property, it cannot be taken into custody.

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

Pursuant to [Code Civ. Proc., § 708.205](#), the trial court entered a postjudgment order directing a judgment debtor to turn over a domain name to a judgment creditor to aid the execution of its money judgment against the judgment debtor. (Superior Court of Orange County, No. 01CC14684, Jane D. Myers, Temporary Judge.)

The Court of Appeal reversed the postjudgment order and remanded the matter with directions to vacate the order. The court concluded that the judgment creditor could not obtain an order directing the turnover of the domain name, which was intangible property, directly to it. [Code Civ. Proc., § 708.205](#), does not allow a turnover of intangible property directly to the judgment creditor. Rather, it authorizes a judgment debtor's interest in property to be applied toward the satisfaction of the money judgment. The judgment creditor could not rely upon the general turnover statute ([Code Civ. Proc., § 699.040](#)) because that statute does not allow a turnover to a judgment creditor. Moreover, [§ 699.040](#) limits itself to tangible property. Finally, the turnover order was erroneously directed at the judgment debtor because the judgment creditor did not show the domain name was in the judgment debtor's possession. The judgment debtor's testimony he operated the associated Web site did not show he was in possession of the underlying domain name. (Opinion by Ikola, J., with Bedsworth, Acting P. J., and O'Leary, J., concurring.) **[*1387]**

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

* Pursuant to [California Constitution, article VI, section 21](#).

[CA\(1\)](#) [↓] (1)**Judgments § 100—Enforcement—Turnover Order—Satisfaction.**

[Code Civ. Proc., § 708.205, subd. \(a\)](#), authorizes the court to order a judgment debtor's interest in property in the possession or under the control of the judgment debtor to be applied toward the satisfaction of the money judgment.

[CA\(2\)](#) [↓] (2)**Judgments § 100—Enforcement—Turnover Order—Intangible Property—Domain Name.**

A postjudgment order directing a judgment debtor to turn over a domain name to a judgment creditor to aid the execution of its money judgment against the judgment debtor was subject to reversal because [Code Civ. Proc., § 708.205](#), did not allow a turnover of intangible property directly to the judgment creditor.

[[Cal. Forms of Pleading and Practice \(2009\) ch. 254, Executions and Enforcement of Judgments, § 254.64](#); 8 Witkin, Cal. Procedure (5th ed. 2008) Enforcement of Judgment, § 101.]

[CA\(3\)](#) [↓] (3)**Judgments § 100—Enforcement—Satisfaction—Cash—Nonmonetary Property.**

Cash is easily applied toward satisfying a judgment. Nonmonetary property is not so easily applied. It must be valued and sold. [Code Civ. Proc., § 708.205](#), does not authorize the judgment debtor to value property unilaterally or put it up for public sale.

[CA\(4\)](#) [↓] (4)**Judgments § 100—Enforcement—Turnover Order.**

A turnover order may direct the examinee to deliver (1) property to a levying officer, and (2) funds directly to the judgment creditor—but not property directly to the judgment creditor.

[CA\(5\)](#) [↓] (5)**Judgments § 100—Enforcement—Turnover Order—Tangible Property—Domain Name Registration.**

[Code Civ. Proc., § 699.040, subd. \(a\)](#), allows a judgment creditor to seek an order directing the judgment debtor to transfer to the levying officer either or both of the following: (1) possession of the property sought to be levied upon if the property is sought to be levied upon by taking it into custody; (2) possession of documentary evidence of title to property of, or a debt owed to, the judgment debtor that is sought to be levied upon. It does not allow a turnover to the judgment creditor. [Section 699.040](#) limits itself to tangible property that can be levied upon by taking it into custody. Domain name registration supplies the intangible contractual right to use a unique domain name for a specified period of time. Even if this right constitutes property, it cannot be taken into custody.

[*1388]

Counsel: Arnold A. McMahon, in pro. per., for Defendant and Appellant.

Peters & Freedman, Michael G. Kim and Simon J. Freedman for Plaintiff and Respondent.

Judges: Opinion by Ikola, J., with Bedsworth, Acting P. J., and O'Leary, J., concurring.

Opinion by: Ikola

Opinion

[**446] **IKOLA, J.**—Defendant Arnold A. McMahon (McMahon) appeals from a postjudgment order directing him to turn over a domain name to plaintiff Palacio Del Mar Homeowners Association, Inc. (Palacio), to aid the execution of its judgment against McMahon. But Palacio cannot obtain an order directing the turnover of intangible property directly to it. And Palacio failed to show McMahon is in possession of the domain name. We reverse.

FACTS

As protracted litigation¹ snowballed, Palacio obtained a \$ 40,000 judgment against McMahon for attorney fees incurred defending against McMahon's frivolous anti-SLAPP motion. (*Palacio IV, supra, G038622* [affirming attorney fee award].) Palacio obtained a writ of execution. (*Palacio V, supra, G039245* [dismissing appeal from order granting [***2] writ]; see *Code Civ. Proc., § 699.510*.)² The levying officer received two employer returns, but ultimately [**447] returned the writ unsatisfied to the court on the date it expired: February 27, 2008. (*Palacio V, supra, G039245*; see §§ *699.530, subd. (b), 699.560, subd. (a)(4)*.)

[*1389]

In the meantime, Palacio conducted a judgment debtor examination of McMahon on February 2, 2008. (§ *708.110, subd. (a)*.) McMahon conceded he had represented to the California Supreme Court that he “has been a provider of interactive computer service, www.[.]ahrc.com, for approximately ten years” He testified the statement was true, though he thought the

¹This appeal is *Palacio VII*. It follows the following nonpublished opinions: *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (Mar. 17, 2004, G028742) (*Palacio I*) affirming judgment awarding injunctive relief, declaratory relief, and \$ 134,000 in attorney fees and costs to Palacio; *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (May 31, 2005, G034741) (*Palacio II*) issuing writ reversing contempt judgment against McMahon; *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (Aug. 24, 2006, G036287) (*Palacio III*) affirming denial of McMahon's anti-SLAPP (strategic lawsuit against public participation) motion and sanctioning him for taking a frivolous appeal; *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (May 23, 2008, G038622) (*Palacio IV*) affirming Palacio's award of attorney fees incurred on McMahon's anti-SLAPP motion; *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (Aug. 25, 2008, G039245) (*Palacio V*) dismissing the McMahaons' moot appeal from order issuing [***3] writ of execution to Palacio and sanctioning them and counsel; and *Palacio Del Mar Homeowners Assn., Inc. v. McMahon* (Dec. 1, 2008, G039731) (*Palacio VI*) reversing fraudulent transfer judgment against McMahon. Other related nonpublished opinions include: *Peters & Freedman v. McMahon* (Feb. 14, 2008, G037871) affirming denial of McMahaons' anti-SLAPP motion to strike Palacio's counsel's libel complaint; *Pratt v. McMahon* (Feb. 14, 2008, G038236) same; and *Vithlani v. McMahon* (July 24, 2008, G038909) affirming judgment for McMahon's former counsel on his complaint to recover on unpaid legal bills in this action.

²All further statutory references are to the Code of Civil Procedure.

domain name was registered in his wife's name.

Palacio moved for an order directing McMahon to turn over possession and control of the ahrc.com domain name. [***4] It supported its motion with the transcript pages from the judgment debtor examination, a printout from the Orange County Clerk-Recorder's Web site showing McMahon's wife had registered the fictitious business name “AHRC NEWS SERVICES” in 2001, and a printout from the Network Solutions' Web site showing AHRC News had registered the domain name in 1997.

The court granted the motion in April 2008. Its order provided, “It appears [McMahon] has an interest in the property in possession or under the custody and control of his wife.” It directed McMahon and his wife (doing business as AHRC News or AHRC News Services) to “transfer [within 30 days] any and all rights of ownership, access, administration, and control over the domain name known as ‘ahrc.com,’ but not the speech content of the host computer to which the ‘ahrc.com’ domain name currently connects, to [Palacio].” It provided the “domain name shall be offered for sale by public auction [upon transfer], and the proceeds from said sale shall be applied towards the satisfaction of the money judgment dated April 18, 2007. ...”

McMahon appealed and petitioned for a writ of supersedeas to stay the turnover order. We granted the petition, [***5] issued the writ of supersedeas, and consolidated the two matters.

DISCUSSION

The parties devoted much of their briefing to discussing the nature of a domain name. We asked for additional briefing on more basic issues concerning the turnover order.³ We conclude the order must be reversed.

[CA\(1\)](#)^[↑] (1) The turnover order was sought and issued pursuant to [section 708.205](#). That statute is part of an article governing judgment debtor examinations. (§ [708.110 et seq.](#)) [HN1](#)^[↑] It authorizes the court to order “the judgment debtor's interest in the property in the possession or under the control of the judgment debtor ... to be applied toward the satisfaction of the money judgment” (§ [708.205, subd. \(a\)](#).)

[*1390]

[CA\(2\)](#)^[↑] (2) [Section 708.205](#) does not allow the turnover of the domain name directly to Palacio. It

³We deny as irrelevant Palacio's requests to take judicial notice.

authorizes the judgment debtor's interest in property "to be applied toward the satisfaction of the money judgment." (§ 708.205, subd. (a).) [HN2](#) [CA\(3\)](#) (3) Cash is easily applied toward satisfying the judgment. Nonmonetary property is not so easily applied. It must be valued and sold. And [section 708.205](#) does not authorize the judgment debtor to value property unilaterally [***6] or put it up for public sale.

[CA\(4\)](#) (4) Palacio unpersuasively contends otherwise. Its primary case holds the judgment debtor's interest in turned-over property is applied to the judgment by "order[ing] the person examined ... to deliver property or funds to a levying officer [**448] or directly to the judgment creditor." (*Imperial Bank v. Pim Electric, Inc.* (1995) 33 Cal.App.4th 540, 547 [39 Cal. Rptr. 2d 432] (*Imperial*)). We parse the disjunctive clauses thusly: [HN3](#) A turnover order may direct the examinee to deliver (1) property to a levying officer, and (2) funds directly to the judgment creditor—but not property directly to the judgment creditor. This limitation follows from the authorities upon which *Imperial* relies. In *Lewis v. Neblett* (1961) 188 Cal.App.2d 290 [10 Cal. Rptr. 441] (*Lewis*), the court affirmed a turnover order directing the judgment debtor to deliver cash to the sheriff as levying officer. (*Id.* at pp. 295, 298.) The Law Revision Commission comment to [section 708.205](#) states the property may be ordered turned over to the levying officer or a receiver. (Cal. Law Revision Com. com., 17 West's Ann. Code Civ. Proc. (1987 ed.) foll. § 708.205, p. 455.) It further asserts "[t]he person examined may also be ordered to [***7] pay the judgment creditor directly" (*ibid.*), but it relies upon a case in which the court reversed (on other grounds) an order directing the judgment debtor's sublessee to pay rent directly to the judgment creditor. (*Hustead v. Superior Court* (1969) 2 Cal.App.3d 780, 783, 793 [83 Cal. Rptr. 26] (*Hustead*)).⁴ If *Hustead* authorizes any

⁴ *Lewis* and *Hustead* construed former section 719, the predecessor of [section 708.205](#). (See *Lewis, supra*, 188 Cal.App.2d at p. 295; *Hustead, supra*, 2 Cal.App.3d at p. 785, fn. 3; Cal. Law Revision Com. com., 17 West's Ann. Code Civ. Proc., *supra*, foll. § 708.205, p. 455.) Former section 719 provided, "The judge or referee may order any property of the judgment debtor, not exempt from execution, in the hands of such debtor, or any other person, or due to the judgment debtor, to be applied toward the satisfaction of the judgment; but no such order can be made as to money or property in the hands of any other person or claimed to be due from him to the judgment debtor, if such person claims an interest in the property adverse to the judgment debtor or denies the debt." (*Hustead, at p. 785, fn. 3.*)

turnover order, at most it supports the turnover of cash to the judgment debtor. At one point, *Imperial* cites a commentator for the proposition that "a turnover order issued in connection with an examination proceeding ... may require delivery of property directly to the judgment creditor" (*Imperial, supra*, 33 Cal.App.4th at p. 550.) But the cited commentator misreads *Hustead* and the comment to [section 708.205](#) as supporting the turnover of nonmonetary property directly to the judgment creditor. (Ahart, Cal. Practice Guide: Enforcing Judgments and Debts (The [*1391] Rutter Group 2009) ¶ 6:1341.) *Jogani v. Jogani* (2006) 141 Cal.App.4th 158, 173 [45 Cal. Rptr. 3d 792], and *In re Burns* (Bankr. 9th Cir. 2003) 291 B.R. 846, 855, uncritically repeat *Imperial's* reference to the commentator's unsupported conclusion. In sum, no persuasive authority directs the examinee to turn over nonmonetary property [***8] directly to the judgment creditor.

[CA\(5\)](#) (5) Palacio did not invoke and cannot rely upon the general turnover statute, [section 699.040](#). [HN4](#) The statute allows a judgment creditor to seek an order "directing the judgment debtor to transfer to the levying officer either or both of the following: [¶] (1) Possession of the property sought to be levied upon if the property is sought to be levied upon by taking it into custody. [¶] (2) Possession [***9] of documentary evidence of title to property of or a debt owed to the judgment debtor that is sought to be levied upon." (§ 699.040, subd. (a), italics added.) It does not allow a turnover to the judgment creditor.⁵

And [section 699.040](#) limits itself to tangible property that can be "levied [***449] upon by taking it into custody" (or tangible, "documentary evidence of title" to property or a debt). (*ibid.*) Domain name registration supplies the intangible "contractual right to use a unique domain name for a specified period of time." (*Network Solutions, Inc. v. Umbro International, Inc.* (2000) 259 Va. 759 [529 S.E.2d 80, 86]).⁶ Even if this right constitutes property,

⁵ The statute also authorizes a turnover order only when "a writ of execution is issued." (§ 699.040, subd. (a).) Palacio's writ of execution expired in February 2008, well before the court issued the turnover order in April 2008.

⁶ (Accord, *Kremen v. Cohen* (9th Cir. 2003) 325 F.3d 1035, 1047–1048 [***10] (dis. opn. of Kozinski, J.) [the plaintiff's "intangible property is ... the right to have people who type 'www.sex.com' into their web browsers sent to his website. It is, in standard Geek, the right to have the second-level .com domain 'sex' associated with his IP address in NSI's .com

it cannot be taken "into custody." (§ 699.040, subd. (a); accord, *Pacific Decision Sciences Corp. v. Superior Court* (2004) 121 Cal.App.4th 1100, 1109 [18 Cal. Rptr. 3d 104] [no turnover order in aid of writ of attachment for "intangible assets incapable of being taken into physical custody"].)

Finally, the turnover order is wrongly directed at McMahon because Palacio has not shown the domain name is in his possession. (§§ 699.040, subd. (a) [authorizing turnover by "the judgment debtor"], 708.205 [authorizing turnover by third party only when it is examined].) Palacio's evidence showed the domain name is registered to McMahon's wife and serviced by Network Solutions. (See *Office Depot, Inc. v. Zuccarini* (N.D.Cal. 2007) 488 F.Supp.2d 920, 921 [§ 699.040 does not authorize turnover order directed at third party "domain name 'registrars'"].) McMahon's testimony he "operates" the associated Web site does not show he is in possession of the underlying domain name.

[*1392]

DISPOSITION

The order is reversed. The matter is remanded to the trial court with directions to vacate the order. McMahon shall recover his costs on appeal.

Bedsworth, Acting P. J., and O'Leary, J., concurred.

End of Document

registry"].)

Yufa v. TSI Inc.

United States District Court for the Northern District of California

August 17, 2018, Decided; August 17, 2018, Filed

Case No. 4:09-cv-01315-KAW

Reporter

2018 U.S. Dist. LEXIS 140115 *; 2018 WL 3956489

ALEKSANDR L. YUFA, Plaintiff, v. TSI
INCORPORATED, Defendant.

Judges: KANDIS A. WESTMORE, United States
Magistrate Judge.

Subsequent History: Appeal filed, 08/28/2018

Opinion by: KANDIS A. WESTMORE

Prior History: [Yufa v. TSI Inc., 2012 U.S. Dist. LEXIS 129403 \(N.D. Cal., Sept. 11, 2012\)](#)

Opinion

Core Terms

patents, receiver, appointed, assign, Receivership, valuation, legal representative, renew a motion, declaration, reply, provides, execute, argues

Counsel: [*1] Aleksandr L. Yufa, Plaintiff, Pro se, Colton, CA.

For TSI Incorporated, Defendant, Counter-claimant:
Michael D. Kanach, LEAD ATTORNEY, Gordon Rees Scully Mansukhani LLP, San Francisco, CA; Courtland Merrill, Anthony Ostlund Baer Louwagie P.A., Minneapolis, MN; Peter Joseph McElligott, Anthony Ostlund Baer and Louwagie P.A., Minneapolis, MN; Richard Ostlund, PRO HAC VICE, Minneapolis, MN.

Aleksandr L. Yufa, Counter-defendant, Pro se, Colton, CA.

ORDER GRANTING DEFENDANT'S SECOND RENEWED MOTION TO COMPEL ASSIGNMENTS OF PATENTS TO RECEIVER

Re: Dkt. No. 289

On April 18, 2018, Defendant TSI Incorporated filed a second renewed motion to compel the assignment of Dr. Yufa's patents to a receiver.

Upon review of the moving papers, the Court finds this matter suitable for resolution without oral argument pursuant to Civil *Local Rule 7-1(b)*, and, for the reasons set forth below, GRANTS TSI's second renewed motion to compel the assignment of Dr. Yufa's patents to Receiver Greyhound IP.

I. BACKGROUND

Plaintiff Aleksandr L. Yufa is an inventor, who has applied for and acquired multiple U.S. patents. Filed on January 29, 1998, and entitled "Methods and Wireless [*2] Communicating Particle Counting and Measuring Apparatus," U.S. Patent No. 6,346,983 ("the '983 Patent"), which was at the center of this lawsuit, concerns the methods and devices for determining the existence, size, and quantity of airborne particles by

utilizing a light beam. '983 Patent col. 1 l.5-10. As originally issued, the '983 Patent contained eight claims in total.

Plaintiff filed this action on March 25, 2009, alleging that Defendant TSI Incorporated's predecessor-in-interest, Adams Instruments, infringed on Plaintiff's '983 Patent by manufacturing and selling wireless communication products believed to be utilizing technologies covered by the '983 Patent. The case was stayed pending the reexamination of the '983 Patent by the U.S. Patent and Trademark Office ("PTO"). Ultimately, only claims 6-8 survived the PTO's reexamination process with amendment. One such amendment was the addition of the words "without using a reference voltage" in claim 6. ('983 Patent Reexamination Certificate col. 2 l. 1-2 (issued Aug. 14, 2012)).

On May 21, 2015, the Court granted Defendant's motion for summary judgment, and, on September 3, 2014, TSI obtained a monetary judgment in the amount of \$166,364.88 against Dr. Yufa. (Dkt. Nos. 176-177, 205.)

On February 18, 2016, the Court granted TSI's motion to appoint [*3] a receiver and to compel the assignment of Dr. Yufa's patents to satisfy its monetary judgment in part by appointing Greyhound IP as receiver, but declined to compel the assignment of the patents until after Greyhound IP provided a valuation. (2/18/16 Order, Dkt. No. 240.) The Court instructed TSI that any future motion for assignment should be accompanied by a declaration from the receiver setting forth the value of each patent and a plan for selling the patents. *Id.* at 5. Dr. Yufa appealed, and the Federal Circuit affirmed. (Dkt. No. 250.)

On June 22, 2017, the Court denied Dr. Yufa's *ex parte* application requesting an order directing TSI to file its forthcoming motion to compel the assignment of patents to the appointed receiver by a certain deadline (Dkt. No. 253). (6/22/17 Order, Dkt. No. 262.) In the same order, the Court granted TSI's motion to approve the instructions for the administration of the court-appointed receiver Greyhound IP LLC (Dkt. No. 256). (6/22/17 Order at 1-2.) Therein, the Court ordered that:

1. Greyhound, or its acquirer, Houlihan Lokey, with offices at One Sansome Street, Suite 1700, San Francisco, CA 94104 shall swear to perform the duties of receiver faithfully [*4] pursuant to [California Code of Civil Procedure § 567](#).

2. Greyhound shall have all of the powers and authority usually held by receivers and reasonably necessary to value the Receivership Property

unless otherwise stated, without further order of the Court.

3. Greyhound shall have the right to apply to this Court for further instructions or directions.

4. Greyhound shall be entitled to be paid without prior Court approval, at the rate of \$400.00 per hour, not to exceed \$40,000.00. Greyhound's compensation for valuing the Receivership Property shall be paid directly by the Defendant. Upon approval of the Court, any sums paid by Defendant to Greyhound shall be added to the judgment after Greyhound has provided its final declaration or report to the Court regarding the value of the Receivership Property.

5. Plaintiff, as well as his agents or representatives, shall cooperate with all requests of Greyhound and are enjoined from interfering with Greyhound's performance of its duties hereunder.

6. Greyhound shall faithfully perform and discharge its duties and obey the Court's orders.

Id. at 2-3. In sum, Greyhound's fees may not exceed \$40,000, which "shall be added to the judgment after Greyhound has provided [*5] its final declaration or report to the Court regarding the value of the Receivership Property." *Id.* at 2. Therefore, the maximum final judgment, absent further court order, is \$206,464.88. *See id.*

On July 7, 2017, Dr. Yufa filed a notice of appeal to the Federal Circuit appealing the denial of his *ex parte* application and Order Nos. 4 and 5, above. (Dkt. No. 263.)

On September 5, 2017, while the appeal was pending, TSI filed a renewed motion to compel assignment of patents to the receiver, in which it represented that Greyhound appraised the aggregate value of all of the patents to be between \$129,000 and \$198,000. (Dkt. No. 267 at 3; Decl. of Mitchell Rosenfeld, Dkt. No. 268 ¶¶ 3-7, Ex. A.)

On October 2, 2017, the Federal Circuit lifted the stay of the proceedings, and set a briefing schedule for the parties to address whether the court had jurisdiction or whether the appeal should be dismissed for lack of jurisdiction. (Dkt. No. 272 at 1-2.)

On December 11, 2017, in an abundance of caution, the undersigned denied the renewed motion to compel the assignment of patents to the receiver without prejudice to permit the Federal Circuit to rule on the jurisdictional issue, and to potentially determine [*6] whether the inclusion of the sums approved to be paid to Greyhound

were proper. (Dkt. No. 273 at 2.) The Court invited TSI to file a second renewed motion once the appeal was resolved. *Id.* at 3.

On April 13, 2018, the Federal Circuit dismissed Dr. Yufa's appeal for lack of jurisdiction. (Dkt. No. 288-1.) Therein, the Federal Circuit opined that "[i]t is time for Dr. Yufa to pay the just debts he owes to TSI." *Id.* at 7.

On April 18, 2018, Defendant TSI Incorporated filed a second renewed motion to compel the assignment of Dr. Yufa's patents to a receiver, in which it incorporated its renewed motion and accompanying declarations. (Notice of Mot., Dkt. No. 289; Def.'s Mot., Dkt. No. 267; Dkt. Nos. 268-269.) On April 26, 2018, Plaintiff filed an opposition. (Pl.'s Opp'n, Dkt. No. 290.) On May 9, 2018, Defendant filed a reply. (Def.'s Reply, Dkt. No. 291.) On May 14, 2018, Plaintiff filed objections to Defendant's reply, in which he objected to two assertions that Plaintiff's respective arguments were wrong. (Pl.'s Obj., Dkt. No. 292 at 1.)¹

II. LEGAL STANDARD

[Federal Rule of Civil Procedure 69\(a\)](#) provides that a money judgment obtained in federal court is enforced by a writ of execution and the procedure on execution must generally accord with [*7] the procedure of the state where the court is located, but federal statutes govern to the extent they apply. Under [Federal Rule of Civil Procedure 66](#), a receiver may be appointed by the court. [Rule 66](#) does not provide the specifics for appointing a receiver to assign and sell patents in satisfaction of a money judgment. See [Office Depot Inc. v. Zuccarini](#), 596 F.3d 696, 701 (9th Cir. 2010). Since no federal statute applies to the appointment of a receiver, [Rule 69\(a\)](#) dictates that state law be followed. See [In re Levander](#), 180 F.3d 1114, 1121 (9th Cir. 1999) ([Rule 69\(a\)](#) allows judgment-creditors to use state law to collect on their debts).

[California Code of Civil Procedure § 708.610](#) provides that the provisions of Chapter 5, commencing with Code of Civil Procedure [§ 564](#), governs the appointment, qualifications, powers, rights and duties of a receiver. [Wells Fargo Fin. Leasing, Inc. v. D & M Cabinets, et al.](#), 177 Cal. App. 4th 59, 70, 99 Cal. Rptr. 3d 97 (2009). [Section 564\(b\)\(3\)](#) provides that a receiver may be appointed by the court after judgment, to carry the

judgment into effect. The receiver has, under the control of the court, the power to take and keep possession of the property, to make transfers, and generally to do such acts respecting the property as the court may authorize. [Cal. Civ. Proc. Code § 568](#). "A receiver may, pursuant to an order of the court, sell real or personal property in the receiver's possession upon the notice and in the manner prescribed by Article 6 (commencing with [Section 701.510](#)) of Chapter 3 of Division [*8] 2 of Title 9." [Cal. Civ. Proc. Code § 568.5](#). The sale is not final until confirmed by the court. *Id.* [Section 701.810](#) provides for the order of distribution of the proceeds of sale.

[California Code of Civil Procedure § 708.620](#) provides:

The court may appoint a receiver to enforce the judgment where the judgment creditor shows that, considering the interests of both the judgment creditor and the judgment debtor, the appointment of a receiver is a reasonable method to obtain the fair and orderly satisfaction of the judgment.

[Cal. Civ. Proc. Code § 708.620](#). Under [Section 708.620](#), a receiver may be appointed where a writ of execution would not reach certain property and other remedies appear inadequate. Comment to [Cal. Civ. Proc. Code § 708.620](#). A patent owner may be compelled to assign all of his rights in a patent to an appointed receiver to dispose of it in satisfaction of a judgment. [Finnegan v. Finnegan](#), 64 Cal. App. 2d 109, 112-13, 148 P.2d 37 (1944); [Peterson v. Sheriff of City & Cnty. of San Francisco](#), 115 Cal. 211, 213, 46 P. 1060 (1896) (writs of execution do not reach patents); [Ager v. Murray](#), 105 U.S. 126, 131, 26 L. Ed. 942, 1882 Dec. Comm'r Pat. 188 (1881) (patents are subject to assignment).

III. DISCUSSION

On February 18, 2016, the Court appointed Greyhound IP as the receiver. The Court, while recognizing that Dr. Yufa's patents may be assigned to the appointed receiver for the purposes of satisfying the judgment, declined to compel the assignment of the patents without a valuation. (2/18/16 Order at 4-5.) In making the second renewed motion, [*9] TSI has provided a formal valuation in support of its motion to compel the assignment of Plaintiff's U.S. Patent Nos. 7,573,573; 7,439,855; 6,346,983; 6,034,769; 5,969,665; 5,946,091; and 5,767,967 to a receiver in order to satisfy the judgment entered in this case. (Def.'s Mot. at 1.)

¹ Plaintiff's objections, which are not based on any analysis or legal authority, are overruled.

A. Assignment of the Patents

i. Valuation

The undersigned previously declined to assign the patents in 2016, due to a concern that the value could far exceed the amount of the judgment, and Dr. Yufa would be unjustly divested of his intellectual property. (See 2/18/16 Order at 4-5.) As a result, the Court stated that it would "entertain a second motion for assignment once the proposed receiver conducts a proper valuation of each patent, both individually and in the aggregate" and that the "future motion for assignment should be accompanied by a declaration from the receiver setting forth the value of each patent and a plan for selling the patents." *Id.* at 5.

In its second renewed motion, TSI provides valuation information regarding the seven patents at issue, which was completed by Receiver Greyhound IP. (Def.'s Mot. at 3.) In performing the valuation, "Greyhound IP researched comparable transactions, completed a detailed analysis of the patents, including a litigation history, to determine [*10] how the market would likely view the patents, and estimated a value range for the patents based upon comparable transactions and an assessment of the analytical characteristics of each patent." (Def.'s Mot. at 3 (citing Decl. of Mitchell Rosenfeld, "Rosenfeld Decl.," Dkt. No. 268 ¶ 3, Ex. A at 2).)

Greyhound IP concluded that U.S. Patent Nos. 7,573,573, 7,439,855, and 6,346,983 were each valued between \$35,000 and \$50,000. (Rosenfeld Decl. ¶ 4, Ex. A at 3.) Greyhound IP concluded U.S. Patent No. 5,969,665 was valued between \$24,000 and \$48,000. (Rosenfeld Decl. ¶ 5, Ex. A at 3.) Finally, Greyhound IP concluded that U.S. Patent Nos. 6,034,769, 5,946,091, and 5,767,967 had a *de minimis* value because they had expired. (Rosenfeld Decl. ¶ 6, Ex. A at 3.) Greyhound IP concluded the aggregate value of all the patents is between \$129,000 and \$198,000. (Rosenfeld Decl. ¶ 7, Ex. A at 3.) The current outstanding amount of the judgment is \$166,364.88, which does not include any of the receiver's costs. (See Dkt. Nos. 205, 262.) The Court notes that, should Greyhound IP incur the total \$40,000.00 in fees it is entitled to be paid without further court approval, the maximum expected sale amount of \$198,000 would not satisfy the final judgment. (See Dkt. No. 262 at 2.)

Greyhound IP's plan for selling the patents [*11] is to:

- (a) prepare a sales deck; (b) prepare a data room for prospective buyers (patents, file histories, encumbrance information, relevant courts orders and filings, etc.); (c) research and prepare a list of prospective buyers for a marketing campaign; (d) conduct outreach to and communicate with prospective buyers through email and telephone; (e) prepare and place an advertisement or listing in a relevant trade publication if reasonably helpful; (f) negotiate with and secure a stalking horse bidder if possible; and (g) conduct an auction for qualified bidders approximately thirty (30) days after the initial notice to prospective buyers.

(Def.'s Mot. at 3-4; Rosenfeld Decl. ¶ 8.) Greyhound expects that this auction process will maximize the return on the sale of the patents. (Rosenfeld Decl. ¶ 8.)

In opposition, Plaintiff argues that the patent valuation material is insufficient and does not reflect the true value of the receivership property, because it is "not based upon any of the known concrete and generally used principles and methods for patent valuation" and it does not take into account the four pending patent infringement cases involving the '983 Patent. (Pl.'s Opp'n at 1.) To the extent [*12] that Plaintiff argues that the valuation does not consider the value of four pending lawsuits involving a patent at issue, Mr. Rosenfeld expressly considered the history of litigation involving Dr. Yufa's patents. (Rosenfeld Decl., Ex. A at 2, 11-12, 14, 19.)

In its reply, TSI argues that the patent valuation is sufficient given that Receiver Mitchell Rosenfeld is a registered patent attorney with over 20 years of experience as an intellectual property professional that specializes in the monetization of intellectual property portfolios. (Def.'s Reply at 1; Rosenfeld Decl. ¶ 2.) Furthermore, Mr. Rosenfeld used a market-based approach based upon comparable transactions, and compared market trends, in reaching his conclusions. (Def.'s Reply at 1; Rosenfeld Decl., Ex. A at 6, 9-10.) The Court notes that Plaintiff does not offer any explanation as to why the market-based approach employed by Mr. Rosenfeld is not a valid patent valuation method. To the contrary, the Court is satisfied with Mr. Rosenfeld's valuation, and Greyhound IP's plan for maximizing the return on the sale of the patents via auction. (Rosenfeld Decl. ¶ 8.)

ii. Proposed Patent Assignment Form

Greyhound IP has prepared a [*13] form to assign the patents that it believes is acceptable to the United States Patent and Trademark Office ("PTO"). (Rosenfeld Decl. ¶ 9, Ex. B.) Pursuant to [35 U.S.C. § 261](#), patents "shall be assignable in law by an instrument in writing. The applicant, patentee, or his assigns or legal representative may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States."

In opposition, Dr. Yufa argues that the proposed assignment form is not an official PTO form, and requests that the Court not approve the form for that reason. (Pl.'s Opp'n at 1.) In reply, TSI explains that there is no requirement that an assignment of patents be made on a form by the PTO. Indeed, [§ 261](#) only requires that the assignment be made in writing. While the Court appreciates TSI's willingness to consider a different form, so long as it sufficiently conveys ownership of the patents to the Receiver, the undersigned finds that the form submitted by Greyhound IP is appropriate for the purposes of the assignment of Dr. Yufa's patents.

Accordingly, the Court grants TSI's motion to assign Dr. Yufa's patents, using the form attached as Exhibit B to Mr. Rosenfeld's [*14] declaration, to Greyhound IP for sale and to use the funds to satisfy the judgment.

B. Whether Greyhound IP should be appointed Dr. Yufa's legal representative in the event that he refuses to assign the patents.

Additionally, Defendant requests that the Court appoint Greyhound IP as Dr. Yufa's legal representative for the limited purpose of assigning the patents should Dr. Yufa refuse to comply with the Court's order. (Def.'s Mot. at 5.) TSI argues that Dr. Yufa's repeated resistance to TSI's efforts at collection indicates that he may also resist in assigning the patents. *See id.*

Pursuant to [35 U.S.C. § 261](#), "patents shall have the attributes of personal property." If a patent owner refuses to execute the assignment, the district court may appoint a legal representative to assign the patents on the patent owner's behalf. *See McClaskey v. Harbison-Walker Refractories Co.*, [138 F.2d 493, 499 \(3d Cir. 1943\)](#) (in validating a sheriff's sale, and labeling the sheriff the "legal representative" of the judgment-debtor, the court considered the sheriff's bill of sale as the necessary assignment required under [35 U.S.C. §](#)

[261](#)).

Thus, if Dr. Yufa refuses to assign the patents to the Greyhound IP, the Court may appoint Greyhound IP as Dr. Yufa's "legal representative" under [§ 261](#) for purposes of taking possession [*15] of, and causing the patents to be assigned, to the receivership for a sale. TSI asks that the Court "order Dr. Yufa to execute the proposed assignment in the form prescribed by Greyhound IP within ten days" and, in the event that Dr. Yufa fails to do so, "appoint Greyhound IP as Dr. Yufa's legal representative for the sole purpose of executing an assignment of the patents on his behalf to the receivership." (Def.'s Mot. at 5-6.)

In opposition, Dr. Yufa objects to the 10-day period proposed by TSI, because it would deprive him of his ability to appeal to the Federal Circuit and the United States Supreme Court. (Pl.'s Opp'n at 1-2.) The Federal Circuit has at least twice articulated that Dr. Yufa should pay his debts, and intimated the futility of future appeals based on the assignability of patents to satisfy the judgment in this case. (Dkt. No. 288-1 at 3, 7.) Notwithstanding, the undersigned will not deprive Plaintiff of his right to appeal this order.

Accordingly, the Court orders Dr. Yufa to execute the proposed assignment, and, should he refuse to do so within 45 days, appoints Mitchell Rosenfeld at Greyhound IP as his legal representative for the sole purpose of executing an assignment [*16] of the patents on his behalf to the receivership. If Dr. Yufa timely appeals this order to the Federal Circuit, Mr. Rosenfeld will be immediately appointed the legal representative in the event that Dr. Yufa has exhausted his rights to appeal.

IV. CONCLUSION

In light of the foregoing, TSI's second renewed motion to compel the assignment of Plaintiff Aleksandr L. Yufa's patents to satisfy its monetary judgment is GRANTED, and the Court enters the following orders:

1. "Receivership Property" means and includes the following United States Patents: 7,573,573; 7,439,855; 6,346,983; 6,034,769; 5,969,665; 5,946,091; 5,767,967, and any continuation, continuation-in-part, or divisional applications(s) related to, and/or that derive priority from, the foregoing patents, and any foreign counterparts thereof, including the rights to all past damages as well as all income derived from these patents.

2. Plaintiff Aleksandr L. Yufa is directed to immediately, using the form attached as Exhibit B to the Declaration of Mitchell Rosenfeld, assign all rights, title, and interest in the Receivership Property to Greyhound IP LLC as receiver.

3. In the event that Plaintiff fails to assign the Receivership Property [*17] within 45 days, the Court appoints Mitchell Rosenfeld, as legal representative for Plaintiff, for the sole purpose of assigning the Receivership Property to Greyhound IP LLC as receiver. Should Dr. Yufa appeal this order to the Federal Circuit, Mr. Rosenfeld will be immediately appointed Plaintiff's legal representative in the event that Dr. Yufa has exhausted his rights to appeal.

4. After the patents have been assigned, Greyhound IP LLC is authorized to direct and take immediate possession and full control of the Receivership Property, to execute the plan outlined in the Declaration of Mitchell Rosenfeld to sell the Receivership Property, and to take such other actions as Greyhound IP LLC deems reasonable and appropriate.

5. After the Receivership Property has been sold, Greyhound IP LLC will file a declaration or report with the Court finalizing its costs paid by Defendant which, upon Court approval, will be added to the judgment.

6. After the judgment has been finalized, Greyhound IP LLC will distribute funds from the sale of the Receivership Property to the judgment creditor, Defendant, to satisfy the judgment. To the extent any funds remain, Greyhound IP LLC will distribute the [*18] remaining funds to Plaintiff.

IT IS SO ORDERED.

Dated: August 17, 2018

/s/ Kandis A. Westmore

KANDIS A. WESTMORE

United States Magistrate Judge



Caution

As of: December 13, 2019 2:48 AM Z

[Ager v. Murray](#)

Supreme Court of the United States

March 6, 1882, Decided; OCTOBER, 1881 Term

No Number in Original

Reporter

105 U.S. 126 *; 26 L. Ed. 942 **; 1881 U.S. LEXIS 2099 ***; 15 Otto 126

AGER v. MURRAY.

Prior History: [***1] APPEAL from the Supreme Court of the District of Columbia.

The case is stated in the opinion of the court.

Core Terms

patent-rights, patent, purchaser, bankrupt, patentee, execute, decree, rights, vest, assignee

holder, being intangible and resting altogether in grant, was not the subject of seizure or sale at common law but could be reached by a creditor's bill, the same as stock of the debtor. The Court pointed out that the bill was filed by a judgment creditor of the patentee in a court of the United States of appropriate jurisdiction, against the patentee, holding the entire legal title and two-thirds of the equitable interest in the patent-rights, and against the owner of an equitable interest in the remaining third who was properly made a party to the bill. The Court noted that both defendants were before the trial court and had filed answers. The court stated that the patentee's interest in the patent-rights was property, assignable by him, and which could not be taken on execution at law and that the case was thus brought directly within the earlier opinion.

Case Summary

Procedural Posture

Appellants, a patentee and his assignee, citing Rev. Stat., §§ 4884, 4898, 4952, 4955, 5046, 5062-5064, sought review of a decree of the Supreme Court of the District of Columbia in favor of appellee judgment creditor in a suit by the judgment creditor seeking to have patent rights held by the patentee and assigned to the assignee sold in order to pay a judgment at law obtained against the patentee.

Outcome

The Court affirmed the decree of the trial court in favor of the judgment creditor in his suit against the patentee and assignee to obtain the sale of patent-rights in execution of a judgment.

LexisNexis® Headnotes

Overview

The patentee and assignee contended that a patent-right could not be ordered by a court of equity to be sold and the proceeds applied to the payment of a judgment debt of the patentee. The Court affirmed the decree. The Court observed that it had been held that the incorporeal right secured by statute to a copyright

Business & Corporate

Compliance > ... > Ownership > Conveyances > Assignments

Civil Procedure > Judgments > Enforcement &

Execution > Exemptions From Execution

Copyright Law > Scope of Copyright
Protection > Publication > General Overview

Copyright Law > Scope of Copyright
Protection > Assignments & Transfers > General
Overview

Patent Law > Ownership > General Overview

Patent Law > Ownership > Conveyances > General
Overview

[HN1](#) **Conveyances, Assignments**

A patent or a copyright, which vests the sole and exclusive right of making, using, and vending the invention, or of publishing and selling the book, in the person to whom it has been granted by the government, as against all persons not deriving title through him, is property, capable of being assigned by him at his pleasure, although his assignment, unless recorded in the proper office, is void against subsequent purchasers or mortgagees for a valuable consideration without notice. Rev. Stat., §§ 4884, 4898, 4952, 4955. And the provisions of the patent and copyright acts, securing a sole and exclusive right to the patentee, do not exonerate the right and property thereby acquired by him, of which he receives the profits, and has the absolute title and power of disposal, from liability to be subjected by suitable judicial proceedings to the payment of his debts.

Bankruptcy Law > ... > Bankruptcy > Estate
Property > Contents of Estate

Business & Corporate
Compliance > ... > Ownership > Conveyances > Ass
ignments

Patent Law > Ownership > Patents as Property

Patent Law > Ownership > General Overview

Patent Law > Ownership > Conveyances > General
Overview

[HN2](#) **Estate Property, Contents of Estate**

In England it has long been held that a patent-right would pass by an assignment in bankruptcy, even

without express words to that effect in the Bankrupt Act. The right to the patent is made assignable; why then may it not be assigned under a commission of bankrupt? It is true that the schemes which a man may have in his own head before he obtains his certificate, or the fruits which he may make of such schemes, do not pass, nor could the assignee require him to assign them over, provided he does not carry his schemes into effect until after he has obtained his certificate. But if he avail himself of his knowledge and skill, and thereby acquire a beneficial interest, which may be the subject of assignment, an argument cannot be framed why that interest should not pass in the same manner as any other property acquired by his personal industry.

Bankruptcy Law > ... > Bankruptcy > Estate
Property > Contents of Estate

Contracts Law > Personal Property > Choses in
Action

Copyright Law > Scope of Copyright
Protection > Assignments & Transfers > General
Overview

Business & Corporate
Compliance > ... > Ownership > Conveyances > Ass
ignments

[HN3](#) **Estate Property, Contents of Estate**

The recent Bankrupt Act of the United States, in defining what property should vest in the assignee in bankruptcy, expressly enumerates all rights in equity, choses in action, patent-rights, and copyrights, and requires the assignee to sell all the property of the bankrupt for the benefit of his creditors. Rev. Stat., §§ 5046, 5062-5064. The only difference is, that in England all such rights pass that become vested in the bankrupt before he obtains a certificate of discharge, whereas here only those rights pass which belong to him at the time of the assignment.

Business & Corporate
Compliance > ... > Default > Foreclosure &
Repossession > Enforcement

Civil Procedure > ... > Jurisdiction > Subject Matter
Jurisdiction > General Overview

Contracts Law > Personal Property > Choses in Action

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Jurisdiction

Civil Procedure > Preliminary Considerations > Equity > General Overview

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Exemptions From Execution

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Contracts Law > ... > Default > Foreclosure & Repossession > General Overview

Business & Corporate Compliance > ... > Ownership > Conveyances > Assignments

[HN4](#) **Foreclosure & Repossession, Enforcement**

It has been said that a patent-right may be seized and sold in execution by the sheriff under a fieri facias, being in the nature of a personal chattel. The Supreme Court of the United States is not aware of any instance in which such a course has been judicially approved. But it is within the general jurisdiction of a court of chancery to assist a judgment creditor to reach and apply to the payment of his debt any property of the judgment debtor, which by reason of its nature only, and not by reason of any positive rule exempting it from liability for debt, cannot be taken on execution at law; as in the case of trust property in which the judgment debtor has the entire beneficial interest, of shares in a corporation, or of choses in action.

Contracts Law > Personal Property

Copyright Law > ... > Ownership Rights > Distribution > General Overview

Civil Procedure > Preliminary Considerations > Equity > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Copyright Law > Scope of Copyright Protection > Assignments & Transfers > General Overview

Copyright Law > ... > Ownership Rights > Reproductions > General Overview

[HN5](#) **Contracts Law, Personal Property**

By a sale of the copperplate engraving of a map on execution from a State court against the owner of the copyright, the purchaser acquires no right to strike off and sell copies of the map. The copperplate engraving, like any other tangible personal property, is the subject of seizure and sale on execution, and the title passes to the purchaser the same as if made at a private sale. But the incorporeal right, secured by the statute to the author, to multiply copies of the map by the use of the plate, being intangible, and resting altogether in grant, is not the subject of seizure or sale by means of this process, -- certainly not at common law. No doubt the property may be reached by a creditor's bill, and be applied to the payment of the debts of the author, the same as stock of the debtor is reached and applied, the court compelling a transfer and sale of the stock for the benefit of creditors. But in case of such remedy, it would be necessary for the court to compel a transfer to the purchaser, in conformity with the requirements of the copyright act, in order to vest him with a complete title to the property.

Civil Procedure > Preliminary Considerations > Equity > General Overview

Copyright Law > Scope of Copyright Protection > Assignments & Transfers > General Overview

Governments > Local Governments > Finance

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Business & Corporate Compliance > ... > Ownership > Conveyances > Assignments

[HN6](#) Preliminary Considerations, Equity

There would certainly be great difficulty in assenting to the proposition that patent and copyright, held under the laws of the United States, are subject to seizure and sale on execution. These incorporeal rights do not exist in any particular State or district; they are coextensive with the United States. There is nothing in any act of Congress, or in the nature of the rights themselves, to give them locality anywhere, so as to subject them to the process of courts having jurisdiction limited by the lines of States and districts. That an execution out of the Court of Common Pleas for the County of Bristol, in the State of Massachusetts, can be levied on an incorporeal right subsisting in Rhode Island or New York, will hardly be pretended. That by the levy of such an execution the entire right could be divided, and so much of it as might be exercised within the county of Bristol sold, would be a position subject to much difficulty. The difficulties are of seizing and selling a patent or copyright upon an execution at law, which is ordinarily levied only upon property, or the rents and profits of property, that has itself a visible and tangible existence within the jurisdiction of the court and the precinct of the officer; and do not attend decrees of a court of equity, which are in personam, and may be enforced in all cases where the person is within its jurisdiction.

[Bankruptcy Law > Procedural Matters > State Insolvency Laws](#)

[Governments > Courts > Judicial Precedent > Dicta](#)

[Patent Law > Ownership > General Overview](#)

[Civil Procedure > Preliminary Considerations > Equity > General Overview](#)

[Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution](#)

[Business & Corporate Compliance > ... > Ownership > Conveyances > Assignments](#)

[HN7](#) Procedural Matters, State Insolvency Laws

There are, indeed, decisions in the circuit courts that an assignee in insolvency, or a receiver, of all the property of a debtor, appointed under the laws of a State, does not, by virtue of the general assignment or appointment merely, without any conveyance made by the debtor or

specifically ordered by the court, acquire a title in patent-rights. But it has clearly been intimated that the courts of the State might have compelled the debtor to execute such a conveyance. And the highest courts of New York and California, have affirmed the power, upon a creditor's bill, to order the assignment and sale of a patent-right for the payment of the patentee's judgment debts. One court has reserved the expression of any opinion upon that question, because unnecessary to the decision. And the assumption in a decision by another court that an author could not be deprived, against his will, and in favor of any of his creditors, of any of the rights secured to him by the copyright acts, is merely obiter dictum, unsupported by reasoning or authority.

Lawyers' Edition Display

Headnotes

Patent-right. --

Headnote:

* Head note by Mr. Justice Gray.

A patent-right may be subjected by bill in equity to the payment of a judgment debt of the patentee.

Syllabus

A patent-right may be subjected by bill in equity to the payment of a judgment debt of the patentee.

Counsel: Submitted on printed briefs by Mr. Thomas T. Crittenden and Mr. Warwick Martin for the appellants, and by Mr. Lemon G. Hine and Mr. S. T. Thomas for the appellee.

Opinion by: GRAY

Opinion

[*126] [**942] MR. JUSTICE GRAY delivered the opinion of the court.

This is a bill in equity by a judgment creditor to subject to the payment of his debt the interest of his debtor in patent-rights. The case was heard in the Supreme Court of the District of Columbia upon bill and answers, by which it appears to be as follows: --

[*127] On the 10th of April, 1876, Talbot C. Murray, in an action at law upon a promissory note, recovered judgment against Wilson Ager for the sum of \$2,164.66, with interest and costs. Upon that judgment a writ of fieri facias was issued, and returned nulla bona. Wilson Ager had no real or personal property in the District subject to execution at law, but was the owner of sundry letters-patent issued to him by the United States for useful inventions, [***2] which, if sold, would produce more than enough money to satisfy that judgment. On the 26th of September, 1876, he conveyed all his right and interest in these letters-patent to the other defendant, Elisha C. Ager, who owned an equitable interest of one-third therein, and who, on the 8th of October, 1877, recoveyed the patent-rights to Wilson by an assignment which was not recorded in the Patent Office. Wilson Ager resides in the District of Columbia, and the other defendant resides in the State of California, and both have appeared in the cause and answered to the merits of the bill.

The bill prays for an injunction against further assignment pending the suit, and that the patents be sold under the direction of the court, and the proceeds of the sale applied to the payment of the judgment debt, and the defendant, Wilson Ager, be required to execute such assignment as may be necessary to vest title in the purchaser or purchasers, in conformity with the patent laws, and for further relief. The decree is, that in default of his paying by a certain day the judgment mentioned in the bill, with interest and costs, and the costs of this suit, the patent-rights be sold and an assignment [***3] thereof executed by him as prayed for, and that, in default of his executing such assignment, some suitable person be appointed trustee to execute the same.

From that decree the original defendants have appealed to this court; and the single question argued before us is

whether a patent-right may be ordered by a court of equity to be sold and the proceeds applied to the payment of a judgment debt of the patentee.

HN1^[↑] A patent or a copyright, which vests the sole and exclusive right of making, using, and vending the invention, or of publishing and selling the book, in the person to whom it has been [*128] granted by the government, as against all persons not deriving title through him, is property, capable of being assigned by him at his pleasure, although his assignment, unless recorded in the proper office, is void against subsequent purchasers or mortgagees for a valuable consideration without notice. Rev. Stat., sects. 4884, 4898, 4952, 4955. And the provisions of the patent and copyright acts, securing a sole and exclusive right to the patentee, do not exonerate the right and property thereby acquired by him, of which he receives the profits, and has the absolute title and [***4] power of disposal, from liability to be subjected by suitable judicial proceedings to the payment of his debts.

HN2^[↑] In England it has long been held that a patent-right would pass by an assignment in bankruptcy, [**943] even without express words to that effect in the Bankrupt Act. *Hesse v. Stevenson*, 3 Bos. & Pul. 565; s.c. *Davies*, Pat. Cas. 263; *Longman v. Tripp*, 2 New Rep. 67; *Bloxam v. Elsee*, 1 Car. & P. 558; s.c. *Ry. & M.* 187; 6 Barn. & Cress. 169; 9 D. & R. 215; *Mawman v. Tegg*, 2 Russ. 385; *Edelsten v. Vick*, 11 Hare, 78; *Hudson v. Osborne*, 39 L.J.N.S. Ch. 79. In *Hesse v. Stevenson*, Mr. Justice Chambre, in the course of the argument, said: "The right to the patent is made assignable; why then may it not be assigned under a commission of bankrupt?" 3 Bos. & Pul. 571. And Lord Alvanley, delivering the unanimous judgment of the court, after observing that it was contended "that the nature of the property in this patent was such that it did not pass under the assignment," and "that although by the assignment every right and interest, and every right of action, as well as right of possession and possibility of interest, is taken out of the bankrupt and vested in the assignee, yet [***5] that the fruits of a man's own invention do not pass," said: "It is true that the schemes which a man may have in his own head before he obtains his certificate, or the fruits which he may make of such schemes, do not pass, nor could the assignee require him to assign them over, provided he does not carry his schemes into effect until after he has obtained his certificate. But if he avail himself of his knowledge and skill, and thereby acquire a beneficial interest, which may be the subject of assignment, I cannot frame to myself an [*129] argument why that interest should

not pass in the same manner as any other property acquired by his personal industry." 3 Bos. & Pul. 577, 578. [HN3](#) [↑] The recent Bankrupt Act of the United States, in defining what property should vest in the assignee in bankruptcy, expressly enumerated "all rights in equity, choses in action, patent-rights, and copyrights," and required the assignee to sell all the property of the bankrupt for the benefit of his creditors. Rev. Stat; sects. 5046, 5062-5064. The only difference is, that in England all such rights pass that become vested in the bankrupt before he obtains a certificate of discharge, whereas here only [***6] those rights pass which belong to him at the time of the assignment.

[HN4](#) [↑] It has been said by an English text-writer that "a patent-right may be seized and sold in execution by the sheriff under a fieri facias, being in the nature of a personal chattel." Webster on Patents, 23. We are not aware of any instance in which such a course has been judicially approved. But it is within the general jurisdiction of a court of chancery to assist a judgment creditor to reach and apply to the payment of his debt any property of the judgment debtor, which by reason of its nature only, and not by reason of any positive rule exempting it from liability for debt, cannot be taken on execution at law; as in the case of trust property in which the judgment debtor has the entire beneficial interest, of shares in a corporation, or of choses in action. M'Dermutt v. Strong, 4 Johns. (N.Y.) Ch. 687; Spader v. Hadden, 5 id. 280; and [20 Johns. \(N.Y.\) 554](#); Edmeston v. Lyde, 1 Paige (N.Y.), 637; [Wiggin v. Heywood, 118 Mass. 514](#); Sparhawk v. Cloon, 125 id. 263; Daniels v. Eldredge, id. 356; Drake v. Rice, 130 id. 410.

In [Stephens v. Cady \(14 How. 528\)](#), and again in *Stevens v. Gladding* (17 id. 447), the point [***7] decided was that, [HN5](#) [↑] by a sale of the copperplate engraving of a map on execution from a State court against the owner of the copyright, the purchaser acquired no right to strike off and sell copies of the map.

Mr. Justice Nelson, in delivering judgment in *Stephens v. Cady*, said: "The copperplate engraving, like any other tangible personal property, is the subject of seizure and sale on execution, and the title passes to the purchaser the same as if made at a private sale. But the incorporeal right, secured [*130] by the statute to the author, to multiply copies of the map by the use of the plate, being intangible, and resting altogether in grant, is not the subject of seizure or sale by means of this process, -- certainly not at common law. No doubt the property may be reached by a creditor's bill, and be

applied to the payment of the debts of the author, the same as stock of the debtor is reached and applied, the court compelling a transfer and sale of the stock for the benefit of creditors." He then cited the cases in Johnson's and Paige's Reports, above referred to, and added: "But in case of such remedy, we suppose, it would be necessary for the court to compel a transfer [***8] to the purchaser, in conformity with the requirements of the copyright act, in order to vest him with a complete title to the property." [14 How. 531](#).

In *Stevens v. Gladding*, Mr. Justice Curtis said: [HN6](#) [↑] "There would certainly be great difficulty in assenting to the proposition that patent and copyright, held under the laws of the United States, are subject to seizure and sale on execution. Not to repeat what is said on this subject in [14 How. 531](#), it may be added, that these incorporeal rights do not exist in any particular State or district; they are coextensive with the United States. There is nothing in any act of Congress, or in the nature of the rights themselves, to give them locality anywhere, so as to subject them to the process of courts having jurisdiction limited by the lines of States and districts. That an execution out of the Court of Common Pleas for the County of Bristol, in the State of Massachusetts, can be levied on an incorporeal right subsisting in Rhode Island or New York, will hardly be pretended. That by the levy of such an execution the entire right could be divided, and so much of it as might be exercised within the county of Bristol sold, would be a position [***9] subject to much difficulty. These are important questions, on which we do not find it necessary to express an opinion, because in this case neither the copyright, as such, nor any part of it, was attempted to be sold." [17 How. 451](#). The difficulties of which the learned justice here speaks are of seizing and selling a patent or copyright upon an execution at law, which is ordinarily levied only upon property, or the rents and profits of property, that has itself a visible and tangible [*131] existence within the jurisdiction of the court and the precinct of the officer; and do not attend decrees of a court of equity, which are in personam, and may be enforced in all cases where the person is within its jurisdiction. *Massie v. Watts*, 6 Cranch, 148. And the terms in which he refers to the statement of Mr. Justice Nelson show that there was no intention to criticise or qualify that statement.

[**944] [HN7](#) [↑] There are, indeed, decisions in the Circuit Courts that an assignee in insolvency, or a receiver, of all the property of a debtor, appointed under the laws of a State, does not, by virtue of the general assignment or appointment merely, without any

conveyance made by the debtor [***10] or specifically ordered by the court, acquire a title in patent-rights. *Ashcroft v. Walworth*, 1 Holmes, 152; *Gordon v. Anthony*, 16 Blatchf. 234. But in *Ashcroft v. Walworth* Judge Shepley clearly intimated that the courts of the State might have compelled the debtor to execute such a conveyance. And the highest courts of New York and California, have affirmed the power, upon a creditor's bill, to order the assignment and sale of a patent-right for the payment of the patentee's judgment debts. *Gillette v. Bate*, 86 N.Y. 87; *Pacific Bank v. Robinson*, 57 Cal. 520.

In *Carver v. Peck* (131 Mass. 291), the court reserved the expression of any opinion upon that question, because unnecessary to the decision. And the assumption in *Cooper v. Gunn, &c.* (4 B. Mon. (Ky.) 594), that an author could not be deprived, against his will, and in favor of any of his creditors, of any of the rights secured to him by the copyright acts, was merely obiter dictum, unsupported by reasoning or authority.

In the case at bar, the bill is filed by a judgment creditor of the patentee, in a court of the United States of appropriate jurisdiction, against the patentee, residing within the District and holding [***11] the entire legal title and two-thirds of the equitable interest in the patent-rights, and against the owner of an equitable interest in the remaining third, who is properly made a party to the bill. Both defendants are before the court and have filed answers. The debtor's interest in the patent-rights is property, assignable by him, and which cannot be taken on execution at law. The case is thus brought directly within the [*132] opinion delivered by Mr. Justice Nelson in *Stephens v. Cady*, of the soundness of which we entertain no doubt.

The clause of the decree below, appointing a trustee to execute an assignment if the patentee should not himself execute one as directed by the decree, has not been objected to in argument, and was clearly within the chancery powers of the court as defined in the statute of Maryland of 1785, which is in force in the District of Columbia. Maryland Stat., 1785, c. 72, sects. 7, 13, 25; 2 Kilty's Laws; Laws of District of Columbia (ed. 1868), pp. 326, 328, 333, 336.

Decree affirmed.

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CODE OF CIVIL PROCEDURE - CCP

PART 2. OF CIVIL ACTIONS [307 - 1062.20] (Part 2 enacted 1872.)

TITLE 9. ENFORCEMENT OF JUDGMENTS [680.010 - 724.260] (Title 9 repealed and added by Stats. 1982, Ch. 1364, Sec. 2.)

DIVISION 2. ENFORCEMENT OF MONEY JUDGMENTS [695.010 - 709.030] (Division 2 added by Stats. 1982, Ch. 1364, Sec. 2.)

CHAPTER 6. Miscellaneous Creditors' Remedies [708.010 - 709.030] (Chapter 6 added by Stats. 1982, Ch. 1364, Sec. 2.)

ARTICLE 7. Receiver to Enforce Judgment [708.610 - 708.630] (Article 7 added by Stats. 1982, Ch. 1364, Sec. 2.)

[708.610.](#) The provisions of Chapter 5 (commencing with Section 564) and Chapter 5a (commencing with Section 571) of Title 7 govern the appointment, qualifications, powers, rights, and duties of a receiver appointed under this article.

(Added by Stats. 1982, Ch. 1364, Sec. 2. Operative July 1, 1983, by Sec. 3 of Ch. 1364.)

[708.620.](#) The court may appoint a receiver to enforce the judgment where the judgment creditor shows that, considering the interests of both the judgment creditor and the judgment debtor, the appointment of a receiver is a reasonable method to obtain the fair and orderly satisfaction of the judgment.

(Added by Stats. 1982, Ch. 1364, Sec. 2. Operative July 1, 1983, by Sec. 3 of Ch. 1364.)

[708.630.](#) (a) The judgment debtor's interest in an alcoholic beverage license may be applied to the satisfaction of a money judgment only as provided in this section.

(b) The court may appoint a receiver for the purpose of transferring the judgment debtor's interest in an alcoholic beverage license that is transferable under Article 5 (commencing with Section 24070) of Chapter 6 of Division 9 of the Business and Professions Code, unless the judgment debtor shows in the proceeding to appoint a receiver that the amount of delinquent taxes described in Section 24049 of the Business and Professions Code and claims of creditors with priority over the judgment creditor pursuant to Section 24074 of the Business and Professions Code exceed the probable sale price of the license.

(c) The receiver may exercise the powers of the licensee as necessary and in exercising such powers shall comply with the applicable provisions of Division 9 (commencing with Section 23000) of the Business and Professions Code and applicable regulations of the Department of Alcoholic Beverage Control. An application shall be filed to transfer the license to the receiver and a temporary retail permit shall be obtained during the pendency of the transfer.

(Added by Stats. 1982, Ch. 1364, Sec. 2. Operative July 1, 1983, by Sec. 3 of Ch. 1364.)


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CODE OF CIVIL PROCEDURE - CCP

PART 2. OF CIVIL ACTIONS [307 - 1062.20] (Part 2 enacted 1872.)

TITLE 7. OTHER PROVISIONAL REMEDIES IN CIVIL ACTIONS [501 - 574] (Heading of Title 7 added by Stats. 1974, Ch. 1516.)

CHAPTER 5. Receivers [564 - 570] (Chapter 5 enacted 1872.)

564. (a) A receiver may be appointed, in the manner provided in this chapter, by the court in which an action or proceeding is pending in any case in which the court is empowered by law to appoint a receiver.

(b) A receiver may be appointed by the court in which an action or proceeding is pending, or by a judge thereof, in the following cases:

(1) In an action by a vendor to vacate a fraudulent purchase of property, or by a creditor to subject any property or fund to the creditor's claim, or between partners or others jointly owning or interested in any property or fund, on the application of the plaintiff, or of any party whose right to or interest in the property or fund, or the proceeds thereof, is probable, and where it is shown that the property or fund is in danger of being lost, removed, or materially injured.

(2) In an action by a secured lender for the foreclosure of a deed of trust or mortgage and sale of property upon which there is a lien under a deed of trust or mortgage, where it appears that the property is in danger of being lost, removed, or materially injured, or that the condition of the deed of trust or mortgage has not been performed, and that the property is probably insufficient to discharge the deed of trust or mortgage debt.

(3) After judgment, to carry the judgment into effect.

(4) After judgment, to dispose of the property according to the judgment, or to preserve it during the pendency of an appeal, or pursuant to the Enforcement of Judgments Law (Title 9 (commencing with Section 680.010)), or after sale of real property pursuant to a decree of foreclosure, during the redemption period, to collect, expend, and disburse rents as directed by the court or otherwise provided by law.

(5) Where a corporation has been dissolved, as provided in Section 565.

(6) Where a corporation is insolvent, or in imminent danger of insolvency, or has forfeited its corporate rights.

(7) In an action of unlawful detainer.

(8) At the request of the Public Utilities Commission pursuant to Section 855 or 5259.5 of the Public Utilities Code.

(9) In all other cases where necessary to preserve the property or rights of any party.

(10) At the request of the Office of Statewide Health Planning and Development, or the Attorney General, pursuant to Section 129173 of the Health and Safety Code.

(11) In an action by a secured lender for specific performance of an assignment of rents provision in a deed of trust, mortgage, or separate assignment document. The appointment may be continued after entry of a judgment for specific performance if appropriate to protect, operate, or maintain real property encumbered by a deed of trust or mortgage or to collect rents therefrom while a pending nonjudicial foreclosure under power of sale in a deed of trust or mortgage is being completed.

(12) In a case brought by an assignee under an assignment of leases, rents, issues, or profits pursuant to subdivision (g) of Section 2938 of the Civil Code.

(c) A receiver may be appointed, in the manner provided in this chapter, including, but not limited to, Section 566, by the superior court in an action brought by a secured lender to enforce the rights provided in Section 2929.5 of the Civil Code, to enable the secured lender to enter and inspect the real property security for the purpose of determining the existence, location, nature, and magnitude of any past or present release or threatened release of

any hazardous substance into, onto, beneath, or from the real property security. The secured lender shall not abuse the right of entry and inspection or use it to harass the borrower or tenant of the property. Except in case of an emergency, when the borrower or tenant of the property has abandoned the premises, or if it is impracticable to do so, the secured lender shall give the borrower or tenant of the property reasonable notice of the secured lender's intent to enter and shall enter only during the borrower's or tenant's normal business hours. Twenty-four hours' notice shall be presumed to be reasonable notice in the absence of evidence to the contrary.

(d) Any action by a secured lender to appoint a receiver pursuant to this section shall not constitute an action within the meaning of subdivision (a) of Section 726.

(e) For purposes of this section:

(1) "Borrower" means the trustor under a deed of trust, or a mortgagor under a mortgage, where the deed of trust or mortgage encumbers real property security and secures the performance of the trustor or mortgagor under a loan, extension of credit, guaranty, or other obligation. The term includes any successor in interest of the trustor or mortgagor to the real property security before the deed of trust or mortgage has been discharged, reconveyed, or foreclosed upon.

(2) "Hazardous substance" means any of the following:

(A) Any "hazardous substance" as defined in subdivision (h) of Section 25281 of the Health and Safety Code.

(B) Any "waste" as defined in subdivision (d) of Section 13050 of the Water Code.

(C) Petroleum including crude oil or any fraction thereof, natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel, or any mixture thereof.

(3) "Real property security" means any real property and improvements, other than a separate interest and any related interest in the common area of a residential common interest development, as the terms "separate interest," "common area," and "common interest development" are defined in Section 4095, 4100, and 4185 of the Civil Code, or real property consisting of one acre or less that contains 1 to 15 dwelling units.

(4) "Release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment, including continuing migration, of hazardous substances into, onto, or through soil, surface water, or groundwater.

(5) "Secured lender" means the beneficiary under a deed of trust against the real property security, or the mortgagee under a mortgage against the real property security, and any successor in interest of the beneficiary or mortgagee to the deed of trust or mortgage.

(Amended by Stats. 2012, Ch. 181, Sec. 44. (AB 806) Effective January 1, 2013. Operative January 1, 2014, by Sec. 86 of Ch. 181.)

565. Upon the dissolution of any corporation, the Superior Court of the county in which the corporation carries on its business or has its principal place of business, on application of any creditor of the corporation, or of any stockholder or member thereof, may appoint one or more persons to be receivers or trustees of the corporation, to take charge of the estate and effects thereof, and to collect the debts and property due and belonging to the corporation, and to pay the outstanding debts thereof, and to divide the moneys and other property that shall remain over among the stockholders or members.

(Amended by Code Amendments 1880, Ch. 15.)

566. (a) No party, or attorney of a party, or person interested in an action, or related to any judge of the court by consanguinity or affinity within the third degree, can be appointed receiver therein without the written consent of the parties, filed with the clerk.

(b) If a receiver is appointed upon an ex parte application, the court, before making the order, must require from the applicant an undertaking in an amount to be fixed by the court, to the effect that the applicant will pay to the defendant all damages the defendant may sustain by reason of the appointment of the receiver and the entry by the receiver upon the duties, in case the applicant shall have procured the appointment wrongfully, maliciously, or without sufficient cause.

(Amended by Stats. 1982, Ch. 517, Sec. 127.)

567. Before entering upon the duties of a receiver:

(a) The receiver must be sworn to perform the duties faithfully.

(b) The receiver shall give an undertaking to the State of California, in such sum as the court or judge may direct, to the effect that the receiver will faithfully discharge the duties of receiver in the action and obey the orders of the

court therein. The receiver shall be allowed the cost of the undertaking.

(Amended by Stats. 1982, Ch. 517, Sec. 128.)

568. The receiver has, under the control of the Court, power to bring and defend actions in his own name, as receiver; to take and keep possession of the property, to receive rents, collect debts, to compound for and compromise the same, to make transfers, and generally to do such acts respecting the property as the Court may authorize.

(Enacted 1872.)

568.1. Any securities in the hands of a receiver may, under the control of the court, be deposited by the receiver in a securities depository, as defined in Section 30004 of the Financial Code, which is licensed under Section 30200 of the Financial Code or exempted from licensing thereunder by Section 30005 or 30006 of the Financial Code, and such securities may be held by such securities depository in the manner authorized by Section 775 of the Financial Code.

(Added by Stats. 1972, Ch. 1057.)

568.2. (a) A receiver of real property containing rental housing shall notify the court of the existence of any order or notice to correct any substandard or unsafe condition, as defined in Section 17920.3 or 17920.10 of the Health and Safety Code, with which the receiver cannot comply within the time provided by the order or notice.

(b) The notice shall be filed within 30 days after the receiver's appointment or, if the substandard condition occurs subsequently, within 15 days of its occurrence.

(c) The notice shall inform the court of all of the following:

(1) The substandard conditions that exist.

(2) The threat or danger that the substandard conditions pose to any occupant of the property or the public.

(3) The approximate cost and time involved in abating the conditions. If more time is needed to approximate the cost, then the notice shall provide the date on which the approximate cost will be filed with the court and that date shall be within 10 days of the filing.

(4) Whether the receivership estate is likely to contain sufficient funds to abate the conditions.

(d) If the receivership estate does not contain sufficient funds to abate the conditions, the receiver shall request further instructions or orders from the court.

(e) The court, upon receipt of a notice pursuant to subdivision (d), shall consider appropriate orders or instructions to enable the receiver to correct the substandard conditions or to terminate or limit the period of receivership.

(Amended by Stats. 2005, Ch. 595, Sec. 3. Effective January 1, 2006.)

568.3. Any tenant of real property that is subject to receivership, a tenant association or organization, or any federal, state, or local enforcement agency, may file a motion in a receivership action for the purpose of seeking further instructions or orders from the court, if either of the following is true:

(a) Substandard conditions exist, as defined by Section 17920.3 or 17920.10 of the Health and Safety Code.

(b) A dispute or controversy exists concerning the powers or duties of the receiver affecting a tenant or the public.

(Amended by Stats. 2005, Ch. 595, Sec. 4. Effective January 1, 2006.)

568.5. A receiver may, pursuant to an order of the court, sell real or personal property in the receiver's possession upon the notice and in the manner prescribed by Article 6 (commencing with Section 701.510) of Chapter 3 of Division 2 of Title 9. The sale is not final until confirmed by the court.

(Amended by Stats. 1982, Ch. 497, Sec. 35. Operative July 1, 1983, by Sec. 185 of Ch. 497.)

569. Funds in the hands of a receiver may be deposited in one or more interest bearing accounts in the name and for the benefit of the receivership estate with one or more financial institutions, provided that all of the following conditions are satisfied:

(a) The deposits are fully guaranteed or insured under federal law.

(b) The financial institution in which the funds are deposited is not a party to the action in which the receiver was appointed.

(c) The receiver does not own 1 percent or more in value of the outstanding stock of the financial institution, is not an officer, director, or employee of the financial institution, and is not a sibling, whether by the whole or half-blood, spouse, aunt, uncle, nephew, niece, ancestor, or lineal descendant of an owner, officer, employee, or director.

(Amended by Stats. 1998, Ch. 932, Sec. 16. Effective January 1, 1999.)

570. A receiver having any funds in his hands belonging to a person whose whereabouts are unknown to him, shall, before receiving his discharge as such receiver, publish a notice, in one or more newspapers published in the county, at least once a week for four consecutive weeks, setting forth the name of the owner of any unclaimed funds, the last known place of residence or post office address of such owner and the amount of such unclaimed funds. Any funds remaining in his hands unclaimed for 30 days after the date of the last publication of such notice, shall be reported to the court, and upon order of the court, all such funds must be paid into the State Treasury accompanied with a copy of the order, which must set forth the facts required in the notice herein provided. Such funds shall be deemed to have been received by the State under Chapter 7 (commencing with Section 1500) of Title 10 of Part 3 of this code and may be recovered in the manner prescribed therein.

All costs and expenses connected with such advertising shall be paid out of the funds the whereabouts of whose owners are unknown.

(Amended by Stats. 1963, Ch. 1762.)

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2019 California Rules Of Court

Rule 3.1175. Ex parte application for appointment of receiver

(a) Application

In addition to any other matters supporting an application for the ex parte appointment of a receiver, the applicant must show in detail by verified complaint or declaration:

- (1) The nature of the emergency and the reasons irreparable injury would be suffered by the applicant during the time necessary for a hearing on notice;
- (2) The names, addresses, and telephone numbers of the persons in actual possession of the property for which a receiver is requested, or of the president, manager, or principal agent of any corporation in possession of the property;
- (3) The use being made of the property by the persons in possession; and
- (4) If the property is a part of the plant, equipment, or stock in trade of any business, the nature and approximate size or extent of the business and facts sufficient to show whether the taking of the property by a receiver would stop or seriously interfere with the operation of the business.

If any of the matters listed above are unknown to the applicant and cannot be ascertained by the exercise of due diligence, the applicant's declaration or verified complaint must fully state the matters unknown and the efforts made to acquire the information.

(Subd (a) amended effective January 1, 2007; previously amended effective January 1, 2002.)

Rule 3.1175 amended and renumbered effective January 1, 2007; adopted as rule 349 effective January 1, 1984; previously amended and renumbered as rule 1900 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1176. Confirmation of ex parte appointment of receiver

(a) Order to show cause

Whenever a receiver is appointed without notice, the matter must be made returnable upon an order to show cause why the appointment should not be confirmed. The order to show cause must be made returnable on the earliest date that the business of the court will admit, but not later than 15 days or, if good cause appears to the court, 22 days from the date the order is issued.

(Subd (a) amended effective January 1, 2002.)

(b) Service of complaint, order to show cause, declarations, and memorandum

The applicant must serve on each of the adverse parties:

- (1) A copy of the complaint if not previously served;
- (2) The order to show cause stating the date, time, and place of the hearing;
- (3) Any declarations supporting the application; and
- (4) A memorandum supporting the application.

Service must be made as soon as reasonably practical, but no later than 5 days after the date on which the order to show cause is issued, unless the court orders another time for service.

(Subd (b) amended effective January 1, 2007; previously amended effective January 1, 2002.)

(c) Failure to proceed or serve adverse party

When the matter first comes on for hearing, the party that obtained the appointment must be ready to proceed. If that party is not ready to proceed or has failed to exercise diligence to effect service upon the adverse parties as provided in (b), the court may discharge the receiver.

(Subd (c) amended effective January 1, 2007; previously amended effective January 1, 2002.)

(d) Continuance

The adverse parties are entitled to one continuance to enable them to oppose the confirmation. If a continuance is granted under this subdivision, the order to show cause remains in effect until the date of the continued hearing.

(Subd (d) amended effective January 1, 2002.)

Rule 3.1176 amended and renumbered effective January 1, 2007; adopted as rule 351 effective January 1, 1984; previously amended and renumbered as rule 1901 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1177. Nomination of receivers

At the hearing of an application for appointment of a receiver on notice or at the hearing for confirmation of an ex parte appointment, each party appearing may, at the time of the hearing, suggest in writing one or more persons for appointment or substitution as receiver, stating the reasons. A party's suggestion is without prejudice to its objection to the appointment or confirmation of a receiver.

Rule 3.1177 renumbered effective January 1, 2007; adopted as rule 353 effective January 1, 1984; previously amended and renumbered as rule 1902 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1178. Amount of undertakings

At the hearing of an application for appointment of a receiver on notice or ex parte, the applicant must, and other parties may, propose and state the reasons for the specific amounts of the undertakings required from (1) the applicant by Code of Civil Procedure section 529, (2) the applicant by Code of Civil Procedure section 566(b), and (3) the receiver by Code of Civil Procedure section 567(b), for any injunction that is ordered in or with the order appointing a receiver.

Rule 3.1178 amended and renumbered effective January 1, 2007; adopted as rule 1902.5 effective January 1, 2004.



2019 California Rules Of Court

Rule 3.1179. The receiver

(a) Agent of the court

The receiver is the agent of the court and not of any party, and as such:

- (1) Is neutral;
- (2) Acts for the benefit of all who may have an interest in the receivership property; and
- (3) Holds assets for the court and not for the plaintiff or the defendant.

(b) Prohibited contracts, agreements, arrangements, and understandings

The party seeking the appointment of the receiver may not, directly or indirectly, require any contract, agreement, arrangement, or understanding with any receiver whom it intends to nominate or recommend to the court, and the receiver may not enter into any such contract, arrangement, agreement, or understanding concerning:

- (1) The role of the receiver with respect to the property following a trustee's sale or termination of a receivership, without specific court permission;
- (2) How the receiver will administer the receivership or how much the receiver will charge for services or pay for services to appropriate or approved third parties hired to provide services;
- (3) Who the receiver will hire, or seek approval to hire, to perform necessary services; or
- (4) What capital expenditures will be made on the property.

Rule 3.1179 renumbered effective January 1, 2007; adopted as rule 1903 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1180. Employment of attorney

A receiver must not employ an attorney without the approval of the court. The application for approval to employ an attorney must be in writing and must state:

- (1) The necessity for the employment;
- (2) The name of the attorney whom the receiver proposes to employ; and
- (3) That the attorney is not the attorney for, associated with, nor employed by an attorney for any party.

Rule 3.1180 amended and renumbered effective January 1, 2007; adopted as rule 1904 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1181. Receiver's inventory

(a) Filing of inventory

A receiver must, within 30 days after appointment, or within such other time as the court may order, file an inventory containing a complete and detailed list of all property of which the receiver has taken possession by virtue of the appointment.

(Subd (a) lettered effective January 1, 2007; adopted as part of untitled subd effective January 1, 2002.)

(b) Supplemental inventory

The receiver must promptly file a supplementary inventory of all subsequently obtained property.

(Subd (b) lettered effective January 1, 2007; adopted as part of untitled subd effective January 1, 2002.)

Rule 3.1181 amended and renumbered effective January 1, 2007; adopted as rule 1905 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1182. Monthly reports

(a) Content of reports

The receiver must provide monthly reports to the parties and, if requested, to nonparty client lien holders. These reports must include:

- (1) A narrative report of events;
- (2) A financial report; and
- (3) A statement of all fees paid to the receiver, employees, and professionals showing:
 - (A) Itemized services;
 - (B) A breakdown of the services by 1/10 hour increments;
 - (C) If the fees are hourly, the hourly fees; and
 - (D) If the fees are on another basis, that basis.

(Subd (a) amended effective January 1, 2007.)

(b) Reports not to be filed

The monthly reports are not to be filed with the court unless the court so orders.

Rule 3.1182 amended effective January 1, 2007; adopted as rule 1906 effective January 1, 2002; previously renumbered effective January 1, 2007.



2019 California Rules Of Court

Rule 3.1183. Interim fees and objections

(a) Interim fees

Interim fees are subject to final review and approval by the court. The court retains jurisdiction to award a greater or lesser amount as the full, fair, and final value of the services received.

(b) Objections to interim accounts and reports

Unless good cause is shown, objections to a receiver's interim report and accounting must be made within 10 days of notice of the report and accounting, must be specific, and must be delivered to the receiver and all parties entitled to service of the interim report and accounting.

Rule 3.1183 renumbered effective January 1, 2007; adopted as rule 1907 effective January 1, 2002.



2019 California Rules Of Court

Rule 3.1184. Receiver's final account and report

(a) Motion or stipulation

A receiver must present by noticed motion or stipulation of all parties:

- (1) A final account and report;
- (2) A request for the discharge; and
- (3) A request for exoneration of the receiver's surety.

(Subd (a) amended and relettered effective January 1, 2004; adopted as part of unlettered subd.)

(b) No memorandum required

No memorandum needs to be submitted in support of the motion or stipulation served and filed under (a) unless the court so orders.

(Subd (b) adopted effective January 1, 2004.)

(c) Notice

Notice of the motion or of the stipulation must be given to every person or entity known to the receiver to have a substantial, unsatisfied claim that will be affected by the order or stipulation, whether or not the person or entity is a party to the action or has appeared in it.

(Subd (c) adopted effective January 1, 2004.)

(d) Claim for compensation for receiver or attorney

If any allowance of compensation for the receiver or for an attorney employed by the receiver is claimed in an account, it must state in detail what services have been performed by the receiver or the attorney and whether previous allowances have been made to the receiver or attorney and the amounts.

(Subd (d) amended and relettered effective January 1, 2004; adopted as part of unlettered subd; amended and lettered effective January 1, 2004.)

Rule 3.1184 amended and renumbered effective January 1, 2007; adopted as rule 1908 effective January 1, 2002; previously amended effective January 1, 2004.

SAMPLE APPOINTMENT ORDER

1 BUCHALTER
A Professional Corporation
2 MICHAEL J MUSE-FISHER (SBN: 253232)
1000 Wilshire Boulevard, Suite 1500
3 Los Angeles, CA 90017-2457
Telephone: 213.891.0700
4 Fax: 213.896.0400
Email: mmuse-fisher@buchalter.com

5 Attorneys for Hero Plaintiff

6
7
8 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
9 **COUNTY OF LOS ANGELES**
10

11 HERO PLAINTIFF,

12
13 Plaintiff,

14 vs.

15
16 BAD DUDE DEFENDANT,

17
18 Defendant.
19

CASE NO.

**[PROPOSED] ORDER GRANTING
PLAINTIFF AND JUDGMENT
CREDITOR'S APPLICATION FOR AN
ORDER APPOINTING A LIMITED
PURPOSE RECEIVER TO MARKET
AND SELL JUDGMENT DEBTOR'S
LIQUOR LICENSE**

1 The Court, having considered Hero Plaintiff’s Application for an Order Appointing a
2 Limited Purpose Receiver to Market and Sell Judgment Debtor’s Liquor License (the
3 “Application”), the Memorandum of Points and Authorities and Declarations filed in support
4 thereof, all pleadings on file in this action, as well as all oral arguments, if any at that the time of
5 hearing, and GOOD CAUSE APPEARING:

6 **ORDER APPOINTING RECEIVER**

7 IT IS HEREBY ORDERED:

8 1. Appointment of Receiver. That Michael J. Brewer (the “Receiver”) is appointed
9 as receiver pursuant to California Code of Civil Procedure sections 564, 708.620, and 708.630 to
10 aid in judgment enforcement and to take possession and control of California Alcoholic Beverage
11 Control License No. _____ (the “Liquor License” or “Receivership Property”) issued to
12 defendant Bad Dude with the power and authority to transfer and sell the license, without further
13 of the Court, in accordance with any applicable statutes or procedures pertaining to the transfer of
14 such license, and to thereafter, apply the net proceeds from the sale of the license to Plaintiff’s
15 judgment. The receiver is also authorized, as may be required, to surrender the ABC License or
16 place the license out of use until such time as there has been satisfaction of the debt.

17 2. Notification to Judgment Debtor. Upon the posting of entry of this Order, the
18 Receiver shall notify the judgment debtor that (a) the Receiver has no authority to attempt to
19 collect the judgment amount or to negotiate any settlement to forestall seizure of the judgment
20 debtor’s liquor license; (b) that any effort to satisfy the judgment, after the appointment of the
21 Receiver, shall be directed to the Plaintiff or Plaintiff’s counsel; (c) that any fees for the Receiver
22 will be set by this Court and not by the Receiver. A form letter the Receiver is authorized to send
23 to the judgment debtor is attached to this Order as **Exhibit A**. The Receiver shall effectuate
24 service of the letter by sending a certified copy, return receipt requested, to Bad Dude Defendant
25 at his last known address of 1234 Not So Easy Street, Los Angeles, California. The Receiver is
26 authorized to provide the judgment debtor with a five (5) calendar day notice of her ability to
27 satisfy the judgment before the license is seized.

1 3. Receiver's Oath. Before performing his duties, the Receiver shall execute a
2 receiver's oath, conditioned upon the faithful performance of the Receiver's duties.

3 4. Receiver's Undertaking. The Receiver shall file a California Code of Civil
4 Procedure Section 567(b) undertaking in the amount of \$1,000.

5 5. Receiver's Fees and Costs. At such time as the Court enters an order approving
6 payment of fees and costs to the Receiver, the Receiver shall forthwith and concurrently pay
7 himself such fees and costs as may be approved by the Court and, as permitted by statute or the
8 Court, pay the balance of the proceeds to Hero Plaintiff exclusive of any tax liens. If any tax liens
9 exist or are discovered at the close of the escrow, any tax liens will take priority before any
10 proceeds are paid to the judgment creditor Hero Plaintiff. Only net proceeds paid to Hero
11 Plaintiff shall be credited against the judgment entered herein. Any claims submitted into escrow
12 by any other creditors of the judgment debtors other than the Hero Plaintiff will only be paid if
13 there are excess proceeds available for distribution after the judgment in this case standing in the
14 name Hero Plaintiff is completely satisfied, unless otherwise required by statute or Court order.
15 The Receiver may engage Escrow Company, Inc. <which the Receiver has an ownership interest
16 in> to act as escrow in effectuating the transfer of the Receivership Property, and may pay for
17 those services in the amount normally charged by escrow companies in California for similar
18 transactions.

19 6. Distribution of Proceeds. In the event that the Receiver is able to generate a
20 sufficient amount of proceeds to satisfy the outstanding judgment issued in the name of Hero
21 Plaintiff in full, including all principal, interest, costs and fees (including receiver fees, escrow
22 fees and broker fees), any excess proceeds will be remitted to the judgment debtor only if no
23 claims have been filed by any other claimants.

24 7. Powers of Receiver. Pursuant to Code of Civil Procedure §708.630(c), the
25 Receiver may exercise the powers of the licensee as necessary and in exercising such powers
26 shall comply with the applicable provisions of Division 9 (commencing with Section 23000) of
27 the Business and Professions Code and applicable regulations of the Department of Alcoholic
28 Beverage Control, and the Receiver is authorized to file an application to transfer the license to

1 the Receiver or to a buyer, and a temporary retail permit shall be obtained during the pendency of
2 the transfer.

3 8. Duties of the Receiver. The Receiver is authorized and empowered to do all of the
4 following in accordance with C.C.P. Section 708.630 and California Rules of Court, Rule 3.1175-
5 3.1184:

6 a. Take possession of ABC License No. _____, issued by the
7 California Department of Alcoholic Beverage Control in the name of Bad Dude Defendant and to
8 exercise all powers of the licensee, Bad Dude Defendant as necessary to comply with the
9 applicable provisions of Division 9 (commencing with Section 23000) of the Business and
10 Professions Code and applicable regulations of the Department of Alcoholic Beverage Control for
11 the purpose of marketing, selling and transferring the license to a third party subject to the
12 approval of the ABC. The Receiver is authorized to surrender the license prior to the sale or
13 transfer of the license if the Receiver determines, in his discretion, that surrendering the license is
14 in the best interest of the Receivership Estate;

15 b. The Receiver may hire brokers, agents and attorneys without further order
16 of this Court as he deems necessary to complete the sale and transfer the liquor license, and as
17 necessary to comply with his obligations set forth in this Appointment Order. If any sale of a
18 liquor license is pending, the Receiver shall be empowered to take over and complete the sale of
19 the liquor license. The Receiver shall be empowered to open an escrow for the transfer of the
20 liquor license and to pay escrow fees and usual and customary broker fees from the proceeds of
21 sale upon close of escrow, if required or applicable. Upon closing of the sale of the liquor
22 license, the Receiver shall hold all net proceeds in trust for the benefit of the Hero Plaintiff and
23 thereafter promptly prepare a statement of fees and costs incurred for all services rendered in
24 connection with the receivership and submit a copy of said bill to Hero Plaintiff for review. Hero
25 Plaintiff shall have fifteen (15) days to object to the billing in writing from the date of mailing of
26 the statement to Hero Plaintiff. After the time to object has passed, the Receiver shall file an
27 application with the court for approval and payment of all fees and costs from the proceeds of the
28 sale of the liquor license.

1 9. Inventory, Reporting and Final Account. The Receiver is excused from the
2 inventory and monthly reporting requirements of California Rules of Court Rules 3.1181 and
3 3.1182. The Receiver shall comply with California Rules of Court Rule 3.1184 and file a final
4 report and apply for compensation as provided in that Rule. The Receiver may hire “brokers” and
5 agents as he deems necessary to complete the sale of the Receivership Property, including
6 License Locators Corporation <which the Receiver has an ownership in> to act as the liquor
7 license “broker”/finder. “Broker’s” fees shall be either \$3,000 or 10% of the value of the
8 Receivership Property at the time of sale, whichever amount is greater. “Broker’s” fees, finder’s
9 fees, agent fees, and escrow fees shall be paid by the purchaser of the Receivership Property as a
10 condition to the closing of any sale of the liquor license. The Receiver shall be entitled to an
11 hourly fee of \$300 per hour for duties performed in this action subject to Court approval. All fees
12 or costs incurred by the Receivership Estate, including fees of the Receiver and the Receiver’s
13 legal counsel shall be paid from any Receivership Estate funds, and if there are insufficient funds,
14 by the Plaintiff following the Receiver’s Motion to Approve The Final Report And Account. To
15 the extent Plaintiff is required to pay for the costs of the Receivership Estate, Plaintiff may add
16 these fees and costs to the amount due and owing under the Judgment against Judgment Debtor,
17 the Valley Inn.

18 10. Further Instructions. The Receiver and the parties to this case may at any time
19 apply to this Court for further instructions or orders and for further powers necessary to enable
20 the Receiver to perform the Receiver’s duties properly. However, the Receiver is authorized to
21 consummate any sale of the Receivership Property without further order of the Court.

22 11. Discharge of Receiver. Discharge of the Receiver shall require a court order after
23 a properly noticed motion approving the Receiver’s Final Report and Account.

24 12. Claims Against the Receiver. No individual or entity may sue the Receiver without
25 first obtaining permission to do so from this Court.

26 IT IS SO ORDERED.

27 Dated: _____

JUDGE OF THE SUPERIOR COURT
COUNTY OF SAN JOAQUIN

**BUSINESS AND
PROFESSIONS CODE
24074**



BUSINESS AND PROFESSIONS CODE - BPC

DIVISION 9. ALCOHOLIC BEVERAGES [23000 - 25762] (*Division 9 added by Stats. 1953, Ch. 152.*)

CHAPTER 6. Issuance and Transfer of Licenses [23950 - 24082] (*Chapter 6 added by Stats. 1953, Ch. 152.*)

ARTICLE 5. Transfer of Licenses [24070 - 24082] (*Article 5 added by Stats. 1953, Ch. 152.*)

24074. Before the filing of such a transfer application with the department, if the intended transfer of the business or license involves a purchase price or consideration, the licensee and the intended transferee shall establish an escrow with some person, corporation, or association not a party to the transfer acting as escrow holder, and the intended transferee shall deposit with the escrow holder the full amount of the purchase price or consideration. The transfer application shall be accompanied by a description of the entire consideration. The description shall include a designation of cash, checks, promissory notes, and tangible and intangible property, and the amount of each thereof. The licensee and intended transferee shall also enter into an agreement, which agreement shall be deposited with the escrow holder, directing the escrow holder, after the requirements for transfer as provided in Section 24049 are satisfied, to pay out of the purchase price or consideration, whether the consideration takes the form of cash, checks, promissory notes, or tangible or intangible property, the claims of the bona fide creditors of the licensee who file their claims with the escrow holder before the escrow holder is notified by the department of its approval of the transfer of the license or if the purchase price or consideration is not sufficient to pay the claims in full, to distribute the consideration as follows:

First, to the United States for claims based on income or withholding taxes; and thereafter for claims based on any tax other than specified in Section 24049.

Second, to the payment of claims for wages, salaries, or fringe benefits of employees of the seller or transferor earned or accruing prior to the sale, transfer, or opening of an escrow for the sale thereof.

Third, to the payment of claims of secured creditors to the extent of the proceeds which arise from the sale of the security.

Fourth, to the payment of claims on mechanics' liens.

Fifth, to the payment of escrow fees and the payment of claims for prevailing brokerage fees for services rendered and claims for reasonable attorney's fees for services rendered.

Sixth, to the payment of claims for goods sold and delivered to the transferor for resale at his licensed premises and the payment of claims for services rendered, performed, or supplied in connection with the operation of the licensed business, and to the payment of claims of a landlord, to the extent of proceeds on past due rent.

Seventh, to the payment of other claims which have been reduced to court-ordered judgments, including claims for court-ordered support of a minor child.

Eighth, to the payment of all other claims. The payment of these claims if sufficient assets are not available for the payment of the claim in full shall be paid pro rata.

If the transferor licensee disputes any claim, the escrow holder shall notify the claimant, and the amount or pro rata amount thereof shall be retained by the escrow holder for a period of 25 days, and if not attached shall be paid to the transferor licensee. The agreement shall also provide that the escrow holder shall make the payment or distribution within a reasonable time after the completion of the transfer of the license.

(Amended by Stats. 1984, Ch. 1570, Sec. 2.)

USEFUL CASES FOR
LIQUOR LICENSE
RECEIVERSHIPS



Cited

As of: March 15, 2019 12:20 AM Z

Doyle v. Coughlin

Court of Appeal of California, Fourth Appellate District, Division Two

March 13, 1974

Civ. No. 13185

Reporter

37 Cal. App. 3d 911 *; 112 Cal. Rptr. 701 **; 1974 Cal. App. LEXIS 1382 ***; 74-1 U.S. Tax Cas. (CCH) P9413; 33 A.F.T.R.2d (RIA) 1084

NORMAN G. DOYLE, Plaintiff, Cross-defendant and Appellant, v. THOMAS R. COUGHLIN et al., Defendants and Respondents; GROVER ESCROW CORPORATION, Defendant, Cross-complainant and Respondent; BANK OF AMERICA, Cross-complainant and Appellant; UNITED STATES OF AMERICA, Cross-defendant and Appellant

Prior History: [***1] Superior Court of Orange County, No. 162343, Walter W. Charamza, Judge.

Disposition: The judgment is therefore affirmed as to Grover and reversed as to the United States. The cause is remanded to the trial court for a determination as to ownership of the remaining \$ 6,162.58 in the escrow account.

Core Terms

escrow, Buyer, Seller, liquor license, escrow holder, license, escrow fund, transferred, ownership, deposit, fixtures, purchase price, levy, Restaurant, conditions, cases

Case Summary

Procedural Posture

Appellants, creditors of seller and the United States, sought review of the decision of the Superior Court of Orange County (California), which held, in an interpleader action by respondent escrow corporation, that respondent was entitled to money for services and attorney's fees, under [Cal. Bus. & Prof. Code § 24074](#), and that appellant U.S. was entitled to money as a creditor of the seller of the liquor license.

Overview

A buyer and seller of a cocktail lounge had their escrow account with respondent escrow corporation. Both the buyer and seller had federal tax liabilities and, after the transfer of the liquor license, the Internal Revenue Service (I.R.S.) levied upon and sold the license, fixtures, and equipment. Appellants, creditors of the seller, argued that they had, under state liquor laws, title to the escrow balance. Appellant United States (U.S.) argued that the escrow never closed and that title was with the buyer. The court affirmed the judgment that entitled respondent to money for escrow services and attorney's fees, under [Cal. Bus. & Prof. Code § 24074](#) because its claim vested upon the transfer of the license. The court reversed the award to appellant U.S. because the transfer of the license was pivotal to transfer of the ownership of the escrow fund, under [Cal. Bus. & Prof. Code § 24074, 24074.1](#), not upon the fulfillment of all escrow conditions, and because appellant U.S. was not a creditor of the seller's, it did not have any ownership rights to the escrow balance. The court remanded the case for the trial court to determine the ownership of the remaining escrow balance.

Outcome

The court affirmed the judgment that awarded respondent escrow corporation money for escrow services and attorney's fees. The court reversed the award to appellant United States (U.S.), because the transfer of a liquor license from the seller to the buyer was pivotal to the transfer of the ownership of the escrow fund, and appellant U.S. was not a creditor of seller's and, therefore, did not have ownership rights to the escrow balance.

LexisNexis® Headnotes

37 Cal. App. 3d 911, *911; 112 Cal. Rptr. 701, **701; 1974 Cal. App. LEXIS 1382, ***1

Civil Procedure > Remedies > Judgment
Liens > General Overview

Tax Law > ... > Tax Credits & Liabilities > Tax
Liens > Property & Rights Subject to Liens

[HN1](#) Remedies, Judgment Liens

A federal tax levy reaches only the property and rights to property of the levied-against taxpayer. [26 U.S.C.S. § 6321](#). State law, not federal law, is determinative on the question of whether such a taxpayer has any then extant interest in the levied-upon property.

Governments > State & Territorial
Governments > Licenses

[HN2](#) State & Territorial Governments, Licenses

See [Cal. Bus. & Prof. Code § 24074](#).

Real Property Law > Purchase & Sale > General
Overview

[HN3](#) Real Property Law, Purchase & Sale

Title to the buyer's money, deposited in escrow, does not pass to the seller until all escrow conditions have been fulfilled.

Governments > State & Territorial
Governments > Licenses

[HN4](#) State & Territorial Governments, Licenses

[Cal. Bus. & Prof. Code §§ 24070- 24082](#) provide a highly comprehensive program to regulate liquor license transfers.

Governments > State & Territorial
Governments > Licenses

[HN5](#) State & Territorial Governments, Licenses

[Cal. Bus. & Prof. Code § 24074](#) requires the opening of an escrow if the intended transfer of the business or license involves a purchase price or consideration. The procedures and priorities of this section are mandatory

and exclusive. They are designed to protect not only buyers and sellers of liquor licenses, but also the creditors of sellers.

Governments > State & Territorial
Governments > Licenses

[HN6](#) State & Territorial Governments, Licenses

Protection for creditors of the licensee-seller is achieved by creating a payment plan dependent upon submission of creditor claims prior to the date when the escrow holder is notified of the state's approval of the liquor license transfer. Such creditor protection (from the escrow fund) is limited to timely filing creditors. This escrow fund-creditor protection plan is intended (1) to prevent use of a liquor license or its transfer, directly or surreptitiously, as a security device and (2) to eliminate races to the courthouse by those creditors first privy to knowledge of an intended liquor license transfer.

Business & Corporate
Compliance > ... > Trademark Cancellation &
Establishment > Conveyances > Valid Transfers

Real Property Law > Fixtures &
Improvements > Tenant & Trade Fixtures

Trademark Law > Special Marks > Trade
Names > General Overview

Governments > State & Territorial
Governments > Licenses

Trademark Law > Conveyances > General
Overview

Business & Corporate
Compliance > ... > Trademark
Law > Conveyances > Licenses

[HN7](#) Conveyances, Valid Transfers

Specific language from [Cal. Bus. & Prof. Code § 24074](#) makes it clear that the requirement of opening an escrow applies broadly to the intended transfer of a business" utilizing a liquor license. The term "business" in the context of this section was construed to include the trade name, goodwill, furniture, fixtures, equipment and other personal property or building improvements

customarily used in connection with the sale of alcoholic beverages.

Governments > State & Territorial
Governments > Licenses

[HN8](#) **State & Territorial Governments, Licenses**

The creditor protection purposes of [Cal. Bus. & Prof. Code § 24074](#) mandate the conclusion the event necessary to transfer title to the escrow fund from buyer to seller (and to seller's creditors) is the transfer of a liquor license and not, as with the ordinary escrow, the fulfillment of all escrow conditions by the parties. Moreover, language from [Cal. Bus. & Prof. Code §§ 24074- 24074.1](#) supports the thesis that transfer of a liquor license is pivotal to transfer of the ownership of the escrow fund.

Governments > State & Territorial
Governments > Licenses

[HN9](#) **State & Territorial Governments, Licenses**

See [Cal. Bus. & Prof. Code §§ 24074, 24074.1](#).

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

In litigation to determine title to the balance in an escrow created for the transfer of a cocktail lounge and liquor license as between the seller's creditors and the United States under a tax claim against the buyer which formed the basis of a levy against the license, the trial court found that the escrow did not close and that as a result, title to the balance was in the buyer. Part of the balance was awarded to the escrow holder for its services and attorney's fees, and the remainder was awarded to the United States. (Superior Court of Orange County, No. 162343, Walter W. Charamza, Judge.)

The Court of Appeal affirmed as to the award to the escrow holder but reversed as to the United States. The court based its holding on the ground that the pertinent provisions of the Business and Professions Code, rather than general escrow laws, govern the escrow referred to in [Bus. & Prof. Code, § 24074](#), that the event which is

necessary to transfer title to the escrow fund is transfer of the license, and that the transfer occurs regardless of whether or not the buyer and seller have fulfilled all the escrow conditions. And, inasmuch as the United States did not claim to have been a creditor of the seller at the time of the transfer of the license, the federal government failed in its attempt to establish ownership of the balance. It was held that after that transfer, the balance, except for that awarded to the escrow holder, belonged to the seller and his timely filing creditors, and the cause was remanded to determine proper allocation of the remainder. (Opinion by Gabbert, J., with Gardner, P. J., and Kaufman, J., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

Classified to McKinney's Digest

[CA\(1\)](#) (1)

Taxation § 229—Property Subject to Lien—Federal Tax Levy.

--A federal tax levy reaches only the property and rights to property of the levied-against taxpayer. And state, rather than federal, law is determinative on the question of whether he has any then extant interest in the levied-upon property.

[CA\(2\)](#) (2)

Intoxicating Liquors § 31—Transfer of License—Statutory Procedures as Exclusive.

--The procedures and priorities of [Bus. & Prof. Code, § 24074](#), relating to the use of escrows in the transfer of liquor licenses, are mandatory and exclusive, and are designed to protect, not only buyers and sellers of such licenses, but also the sellers' creditors.

[CA\(3\)](#) (3)

Intoxicating Liquors § 31—Transfer of License—Purpose of Escrow Procedures.

--The escrow fund-creditor protection plan set forth in [Bus. & Prof. Code, § 24074](#), is intended to prevent use of a liquor license or its transfer, directly or surreptitiously, as a security device and, also, to eliminate races to the court house by those creditors

who are first privy to the knowledge of an intended transfer of a liquor license.

[CA\(4\)](#) (4)

Intoxicating Liquors § 31—Transfer of Licenses—Application of Escrow Procedures.

--The requirement for opening an escrow referred to in [Bus. & Prof. Code, § 24074](#), applies broadly to the intended transfer of a business utilizing a liquor license. As so used, "business" includes the trade name, goodwill, furniture, fixtures, equipment and other personal property or building improvements customarily used in connection with the sale of alcoholic beverages.

[CA\(5\)](#) (5)

Intoxicating Liquors § 31—Transfer of Licenses—Time of Transfer of Escrow Funds.

--As contemplated by [Bus. & Prof. Code, § 24074](#), the event which is necessary to transfer title to the escrow fund from the buyer of a liquor license and related business to the seller and the seller's creditors is transfer of the liquor license and not, as with the ordinary escrow, the fulfillment of all escrow conditions. And transfer of a liquor license is pivotal to transfer of ownership of the escrow fund.

[CA\(6\)](#) (6)

Intoxicating Liquors § 31—Transfer of Licenses—Factors Not Affecting Time of Transfer of Escrow Funds.

--The ownership change envisioned by [Bus. & Prof. Code, §§ 24074, 24074.1](#), occurs regardless of whether or not the buyer and seller have previously complied with instructions concerning, inter alia, consideration and executed bills of sale.

[CA\(7\)](#) (7)

Intoxicating Liquors § 31 — Transfer of Licenses — Title to Escrow Funds—Effect of Tax Claim Against Buyer.

--Title to the balance of funds in an escrow created for the transfer of a cocktail lounge and liquor license lay

with the seller's creditors, and not with the United States on its tax claim against the buyer, where transfer of the liquor license occurred prior to accrual of the back taxes on which the federal government rested its claim, even though the buyer and seller may not have previously complied with escrow instructions concerned with consideration and executed bills of sale.

Counsel: George McGill for Plaintiff, Cross-defendant and Appellant.

Robert H. Fabian, Harris B. Taylor and William C. Rust, Jr., for Cross-complainant and Appellant.

William D. Keller, United States Attorney, Charles H. Magnuson and Calvin M. Young III, Assistant United States Attorneys, for Cross-defendant and Appellant.

No appearance for Defendants and Respondents.

Carden & Gray and Arthur W. Gray, Jr., for Defendant, Cross-complainant and Respondent.

Judges: Opinion by Gabbert, J., with Gardner, P. J., and Kaufman, J., concurring.

Opinion by: GABBERT

Opinion

[*913] [*702] This is an appeal from an action in interpleader brought by Grover Escrow Corporation ("Grover"). At issue is ownership of \$ 8,576.08 currently held on deposit in connection with a combined liquor **[*914]** license-bulk sale escrow. The controverted escrow was established to facilitate sale of a restaurant-cocktail **[***2]** lounge.

King's Row Restaurant, Inc. ("Buyer") and Kric Enterprises, Inc. ("Seller") signed escrow instructions with Grover on June 14, 1967. Pursuant to these instructions, as amended, Buyer was to place into escrow \$ 65,760 (in a combination of cash and notes) and Seller was to deliver an executed bill of sale for the stock in trade, fixtures, equipment and goodwill of its restaurant-cocktail lounge. Consummation of the bulk sale portion of the above sale was **[**703]** conditioned, by express terms of the escrow, upon Buyer's obtaining the state's approval for the transfer to Seller of its (Buyer's) eating and on-sale general liquor license.

Buyer began operation of its purchased business on September 8, 1967, the date the liquor license was transferred from Seller. At that time, there was -- as

there is now -- a cash balance of \$ 8,576.08 in the escrow.¹

[***3] Buyer operated its business, known as King's Row Restaurant, until December 1968 or January 1969. Around those times, the Internal Revenue Service ("I.R.S.") levied upon and sold the liquor license, fixtures and equipment. The levy against the liquor license, in December 1968, was for unpaid tax liabilities of Buyer. These tax liabilities all arose *after* the transfer of the liquor license from Seller.

A second federal levy, this time against certain items of restaurant fixtures and equipment, occurred in January 1969. The I.R.S. applied the proceeds from the resulting sale, not for the account of Buyer, but rather for the account of Seller.²

[***4] The instant interpleader action involves claims by Seller's creditors -- appellants Doyle and Bank of America National Trust and Savings Association ("Bank") -- and by the United States, which has unpaid tax claims [*915] against Buyer. Both Doyle and Bank argue that state liquor laws, properly interpreted, provide that title to the escrow balance lies with creditors of Seller. Doyle and Bank maintain that, at the time the federal government acquired tax liens against Buyer, it (Buyer) no longer had an ownership interest in the \$ 8,576.08. The United States, on the other hand, contends title to that sum must be determined by general escrow law. The United States then argues the instant escrow never closed, thereby preserving with Buyer the title and right to possession of the here

¹ The current escrow balance represents the remaining portion of Buyer deposits into escrow of \$ 20,760. Of that latter sum, \$ 12,146.42 was paid (prior to the transfer of the liquor license) to the State Board of Equalization and \$ 57.50 was paid for the recording of documents.

The record is unclear as to when or whether Buyer deposited into escrow a \$ 45,000 promissory note. Such a note was to constitute the remainder of the \$ 65,760 consideration for the transfer of the liquor license, fixtures, and equipment of Seller's restaurant-cocktail lounge.

² Both Buyer and Seller had long overdue federal tax liabilities during December 1968 and January 1969. The I.R.S. consequently initiated the above outlined levies and sales. The legal propriety (and consistency) of such levies is not an issue before this court. It should be observed, however, that the United States treated the above Buyer-Seller transaction as effectively transferring the liquor license, but not transferring the items under the bulk sale portion of the escrow.

contested fund. The United States urges, since its tax claims against Buyer exceed that amount, that it (the United States) be awarded the *entire* escrow balance.³

[***5] The trial court, in its findings of fact and conclusions of law, reached a decision substantially in accord with the United States' position. The court found the "escrow did not close" and, as a result, "title to the sum of \$ 8,576.08 is in the buyer, King's Row Restaurant, Inc." (*Kelly v. Steinberg*, 148 Cal.App.2d 211, 217-218 [306 P.2d 955].) The court then found, of the escrow balance, Grover was entitled to \$ 2,413.50 in compensation for its escrow services and for its attorney's fees. The remaining \$ 6,162.58 was awarded to the United States, in partial payment of \$ 15,039.56 claimed to be owed by Buyer to the United States.

[CA\(1\)](#)[↑] (1) Appellants Doyle and Bank correctly argue [HN1](#)[↑] a federal tax levy reaches only the "property and rights to property" of the levied-against taxpayer. (*26 U.S.C. § 6321*.) Further, they properly note [*704] that state law, not federal law, is determinative on the question of whether such a taxpayer has any then extant interest in the levied-upon property. (*Aquilino v. United States*, 363 U.S. 509, 513 [4 L.Ed.2d 1365, 1368, 80 S.Ct. 1277]; *United States v. Bess*, 357 U.S. 51, 53 [2 L.Ed.2d 1135, 1139, 78 S.Ct. 1054]; *United States v. Lester*, 235 F.Supp. 115, 119-120.) Doyle and Bank, citing these propositions, then argue that *California Business and Professions Code section 24074*,⁴ vested the escrow funds with

³ Note that, though the Buyer and Seller both have (or have had) overdue tax liabilities, the instant claim of the United States is directed only to Buyer's possible interest in the Grover escrow account.

⁴ [HN2](#)[↑] *Business and Professions Code section 24074*, in pertinent part, reads: "Before the filing of such a transfer application [for a liquor license] with the department [of Alcoholic Beverage Control], if the intended transfer of the business or license involves a purchase price or consideration, the licensee and the intended transferee shall establish an escrow . . . , and the intended transferee shall deposit with the escrow holder the full amount of the purchase price or consideration [for the business]. The transfer application shall be accompanied by a description of the *entire consideration*. . . . The licensee and intended transferee shall also enter into an agreement, . . . directing the escrow holder . . . to pay out of the purchase price or consideration, the claims of the bona fide creditors of the licensee who file their claims with the escrow holder *before* the escrow holder is notified by the department of its approval of the transfer of the license or if the purchase price or consideration is not sufficient to pay the

Seller's [*916] creditors when Grover was notified the state approved the transfer of the liquor license to Buyer. Notification of this transfer, as indicated earlier, occurred prior to the government's establishment of tax liens against Buyer.

[***7] By contrast, the United States denies the existence of any vested claim by Seller or its creditors in the escrow fund. Pursuing counter argument, the United States cites to this court several cases discussing ownership rights to money deposited in escrow. (See, e.g., Kelly v. Steinberg, *supra*, 148 Cal.App.2d 211; Barboza v. Dellota, 130 Cal.App.2d Supp. 890 [279 P.2d 219]; Kellogg v. Curry, 101 Cal.App.2d 856 [226 P.2d 381].) These cases hold that HN3 title to the Buyer's money (deposited in escrow) does not pass to the Seller until *all* escrow conditions have been fulfilled. Business and Professions Code section 24074, is asserted not to change this general rule, but rather *merely* to establish priorities between competing creditor classes. Presumptively, under the government's thesis, these priorities would come into operation only after completion of all escrow conditions and formal closing of the escrow. In the instant case, it was found that such a closing did not take place.⁵

claims in full, to distribute the consideration as follows: [Italics added.]

". . . .

"Third, to the United States for claims based on income or withholding taxes; . . . ;

". . . .

"Fifth, to the payment of escrow fees . . . and claims for reasonable attorney's fees for services rendered;

"Sixth, to the payment of claims for goods sold and delivered to the transferor for resale at his licensed premises and the payment of claims for services rendered, performed or supplied in connection with the operation of the licensed business;

"Seventh, to the payment of all other claims. The payment of these claims if sufficient assets are not available for the payment of the claim in full shall be paid pro rata.

". . . The agreement *shall* also provide that the escrow holder *shall* make the payment or distribution within a reasonable time after the completion of the transfer of the license." (Italics added.)

⁵ The trial court's conclusion that the escrow agreement did not close, in the sense that all conditions precedent in the escrow agreement were not complied with, is supported by substantial evidence. For example, according to the escrow agreement, Seller was to deposit with Grover a bill of sale for the

[***8] Examination of the above arguments, in the light of case law and relevant statutes, leads this court to uphold the position of appellants Doyle and Bank. We find inescapable the conclusion that HN4 sections 24070 through 24082 of the Business and Professions Code provide a highly [*917] comprehensive program to regulate liquor license transfers. This program, in fact, has been described [***705] by our Supreme Court as "giving unmistakable indication of the Legislature's determination to exercise its power to control every phase of such transfers." (Grover Escrow Corp. v. Gole, 71 Cal.2d 61, 64 [77 Cal.Rptr. 21, 453 P.2d 461].)

HN5 Section 24074 requires the opening of an escrow "if the intended transfer of *the business* or license involves a purchase price or consideration." (Italics added.) CA(2) (2) The procedures and priorities of this section are mandatory and exclusive. (Grover Escrow Corp. v. Gole, *supra*, 71 Cal.2d 61, 64-66.) They are designed to protect not only buyers and sellers of liquor licenses, but also the creditors of sellers. (*Ibid.* p. 64.)

HN6 Protection for creditors of the licensee-seller is achieved by creating a payment plan dependent upon submission [***9] of creditor claims *prior* to the date when the escrow holder is notified of the state's approval of the liquor license transfer. Such creditor protection (from the escrow fund) is limited to timely filing creditors. (Pacific Firestone Escrow Co. v. Food Giant Markets, Inc., 202 Cal.App.2d 155, 157 [20 Cal.Rptr. 570].) CA(3) (3) This escrow fund-creditor protection plan is intended (1) to prevent use of a liquor license or its transfer, directly or surreptitiously, as a security device and (2) to eliminate "races to the courthouse" by those creditors first privy to knowledge of an intended liquor license transfer. (Grover Escrow Corp. v. Gole, *supra*, 71 Cal.2d 61, 64-65.)

CA(4) (4) HN7 Specific language from section 24074 makes it clear that the requirement of opening an escrow applies broadly to "the intended transfer of [a] business" utilizing a liquor license. In Gramercy Escrow Co. v. Superior Court, 14 Cal.App.3d 426, 431 [92 Cal.Rptr. 397], the term "business" in the context of this section was construed to include the trade name, goodwill, furniture, fixtures, equipment and other personal property or building improvements customarily used in connection with the [***10] sale of alcoholic beverages. Thus, in the instant situation, it is evident

restaurant fixtures and equipment. This was not done, and Seller does not here contend otherwise.

the provisions of [Business and Professions Code section 24074](#), encompass the entirety of the buyer-seller transaction.

[CA\(5\)](#)^(↑) (5) [HN8](#)^(↑) The creditor protection purposes of [section 24074](#) mandate the conclusion the event necessary to transfer title to the escrow fund from buyer to seller (and to seller's creditors) is the transfer of a liquor license and not, as with the ordinary escrow, the fulfillment of *all* escrow conditions by the parties. Moreover, language from [sections 24074](#) and [24074.1](#) supports the thesis that transfer of a liquor license is pivotal to transfer of the ownership of the escrow fund. Thus, we note that [HN9](#)^(↑) [section 24074](#) states the escrow "agreement shall . . . provide that the escrow holder [***918**] shall make the payment or distribution [to seller's creditors] within a reasonable time after the completion of the transfer of the license." Likewise, [section 24074.1](#) requires that "[any] person desiring to act as an escrow holder under [Section 24074](#) shall . . . (3) Not more than 10 days after the license has been transferred and prior to the distribution of the assets held by said [*****11**] escrow holder . . . advise each creditor who filed a claim against the escrow [as to assets in the escrow fund]." From the above, it is apparent the Legislature intended transfer of a liquor license to change ownership of the [section 24074](#) escrow fund.

[CA\(6\)](#)^(↑) (6) [CA\(7\)](#)^(↑) (7) The described ownership change occurs regardless of whether or not the buyer and seller have previously complied with escrow instructions concerning, inter alia, consideration and executed bills of sale. This conclusion is necessary. Any other conclusion would open the door to transfers of parts of liquor-utilizing businesses without providing the required creditor protection.⁶

⁶The statutory scheme of [Business and Professions Code, sections 24073- 24074.2](#) envisions, in this case, that the entire purchase price of the restaurant-cocktail lounge and liquor license will be in the hands of the escrow holder prior to the time the liquor license is transferred. (This may or may not have occurred. See fn. 1.) A prudent buyer would consequently require the licensee-seller to have all necessary bills of sale (for fixtures and equipment) on deposit with the escrow holder prior to the transfer of the liquor license. Thus, when the state would ultimately approve and transfer the liquor license from seller to buyer, property and money would change hands as contemplated by the parties. If the escrow fund is then found to be insufficient to cover all creditor claims, the priority-establishing portion of [section 24074](#) would come into play.

[*****12**] [****706**] The state government, in the instant case, transferred Seller's liquor license to Buyer on September 8, 1967. As of that date, following the mandatory and exclusive provisions of [section 24074](#), we conclude the escrow monies belonged to Seller and his timely filing creditors. Since the United States does not here claim to have been a creditor of Seller at the time of the transfer of the license, it must fail in its attempt to establish ownership rights to the escrow balance.

In view of our finding the state has enacted specific legislation to control all facets of the transfer of liquor licenses, and in view of our observation that such legislation evidences a special regard for creditors (of the licensee-seller), this court finds to be inapposite the cases on general escrow law cited by the United States. These cases -- [Kelly v. Steinberg, supra, 148 Cal.App.2d 211](#); [Barboza v. Dellota, supra, 130 Cal.App.2d Supp. 890](#); and [Kellogg v. Curry, supra, 101 Cal.App.2d 856](#) -- involve sales of real estate, but without accompanying liquor licenses. Law in these [***919**] cases focuses on the buyer-seller rights in escrowed funds; the opinions are [*****13**] unconcerned with protection of creditors.

The judgment insofar as it finds Grover entitled to \$ 2,413.50 in compensation for its escrow services and attorney's fees is affirmed. Grover's claim is squarely justified by [Business and Professions Code section 24074](#); its claim became vested upon the transfer to Buyer of the Seller's liquor license.

The judgment insofar as it awards \$ 6,162.58 to the United States is reversed. The escrow fund interest of Buyer (for whose account the government seeks to collect back taxes) ceased to exist upon the transfer of the subject liquor license from Seller to Buyer. This transfer occurred *prior* to the accrual of the back taxes which the government now seeks to collect.

Appellants Doyle and Bank, who ask this court to award them the funds which the trial court awarded the United States, do not show, in the record, they filed their claims with Grover *prior* to the transfer of the liquor license and thus are entitled to such funds.

The judgment is therefore affirmed as to Grover and reversed as to the United States. The cause is remanded to the trial court for a determination as to ownership of the remaining [*****14**] \$ 6,162.58 in the escrow account.

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Warning

As of: March 15, 2019 3:57 AM Z

Concorde Equity II v. Bretz

Court of Appeal of California, First Appellate District, Division Three

October 25, 2011, Filed

A131206

Reporter

2011 Cal. App. Unpub. LEXIS 8111 *; 2011 WL 5056295

CONCORDE EQUITY II, LLC, Plaintiff and Respondent, v. JOSEPH Q. BRETZ et al, Defendants; CREDITORS TRADE ASSOCIATION, INC., et al., Claimants and Appellants.

Notice: NOT TO BE PUBLISHED IN OFFICIAL REPORTS. [CALIFORNIA RULES OF COURT, RULE 8.1115\(a\)](#), PROHIBITS COURTS AND PARTIES FROM CITING OR RELYING ON OPINIONS NOT CERTIFIED FOR PUBLICATION OR ORDERED PUBLISHED, EXCEPT AS SPECIFIED BY [RULE 8.1115\(b\)](#). THIS OPINION HAS NOT BEEN CERTIFIED FOR PUBLICATION OR ORDERED PUBLISHED FOR THE PURPOSES OF [RULE 8.1115](#).

Prior History: [*1] City & County of San Francisco Super. Ct. No. CGC-09-492710.

Core Terms

license, liquor license, receiver, licensee, proceeds, secured creditor, Claimants, proceeds of sale, escrow holder, distributed, Alcoholic, Beverage, Escrow, transferred, provides, liquor, pledge

Judges: Pollak, J.; McGuinness, P. J., Jenkins, J. concurred.

Opinion by: Pollak

Opinion

Claimants Creditors Trade Association, Inc. and Tony Carracci appeal from an order granting distribution of the proceeds from the sale of a liquor license to Concorde Equity II, LLC (Concorde) as a secured creditor of the holder of the liquor license. Claimants contend that granting Concorde priority as a secured creditor is prohibited by [Business and Professions Code](#)

[section 24076](#).¹ We disagree and shall affirm the trial court's order.

FACTUAL AND PROCEDURAL HISTORY

On May 5, 2009, Concorde made a loan to Joseph Q. Bretz and David L. Blackford and several limited liability companies they owned, including SF Night Life, LLC (SF Night Life). The loan was evidenced by a promissory note and secured by personal guarantees and security interests in the assets of the companies. When the loans became delinquent, Concorde filed suit. On September 18, 2009, the delinquent parties stipulated to the entry of judgment against them, jointly and severally, in the amount of \$379,950. The stipulation [*2] provided for the entry of judgment permitting foreclosure of Concorde's security interest in all collateral pursuant to the security agreements. The judgment was entered on November 19, 2009.

In a separate action, on November 13, 2009, Creditors Trade Association, Inc. obtained a judgment against S.F. Night Life in the amount of \$4,574.04. On February 9, 2010, after costs were awarded, the judgment was increased to \$8,683.04.

On April 29, 2010, the trial court granted a motion by Concorde for postjudgment enforcement orders and assigned to Concorde "all non-exempt rights to receive payments of any nature or type from debts due, accounts receivable, and other contract rights from each and every business in which Bretz and Blackford have an interest." The court ordered the appointment of Kevin Singer as receiver to take possession of Liquor License No. 466969 held by SF Night Life and to sell the license in accordance with applicable provisions of law and apply the proceeds from the sale to the satisfaction of the debtors' obligations. The receiver was authorized to

¹ All statutory references are to the Business and Professions Code unless otherwise noted.

sell the liquor license free and clear of liens, deposit the net proceeds in trust, determine the validity of disputed liens, [*3] and make a recommendation to the court as to how the proceeds should be distributed.

The receiver proceeded to sell the license to a buyer approved by the Department of Alcoholic Beverage Control (the ABC), opened an escrow for the transfer, and placed the net proceeds of \$73,538.01 in trust for distribution as directed by the court. He then filed a motion recommending that as a first priority creditor he be paid receiver fees of \$23,205.42 and that Concorde receive the remaining balance of \$50,332.59 as a secured creditor of real property under the third statutory priority. No funds from the sale of the liquor license remained to pay the claims of any other creditors.

Claimants objected to the proposed distribution, arguing that Concorde was barred by [section 24076](#) from taking a security interest in a liquor license and therefore was not a secured creditor as to the proceeds of the sale of the license. Over claimants' objection, the court adopted the receiver's recommendation and ordered the sale proceeds to be distributed to the receiver and Concorde.

Claimants filed a timely notice of appeal.

DISCUSSION

1. Alcoholic Beverage Control Act

The California Constitution vests the Legislature [*4] with the exclusive power to license and regulate the manufacture, sale, purchase, possession and transportation of alcoholic beverages within the State. ([Cal. Const., art. XX, § 22](#)) The Legislature has exercised this authority by creating the ABC. (§ 23000 et seq.) The statute vests with the ABC "the power, in its discretion, to deny, suspend or revoke any specific alcoholic beverage license if it shall determine for good cause that the granting or continuance of such license would be contrary to public welfare or morals, or that a person seeking or holding a license has violated any law prohibiting conduct involving moral turpitude." ([Cal. Const., art. XX, § 22, subd. \(d\)](#).) This authority extends to the transfer of liquor licenses. ([Pacific Firestone Escrow Co. v. Food Giant Markets, Inc. \(1962\) 202 Cal.App.2d 155, 158](#).) The authority of the ABC to control the transfer of liquor licenses is the same as its control over the initial issuance of a license. ([Richards v. Department of Alcoholic Beverage Control \(2006\) 139 Cal.App.4th 304, 313](#).) All transfers are subject to

investigation and approval by the ABC. ([Id. at p. 314](#).) Integral to the statutory scheme is [section 24076](#), which provides [*5] that "No licensee shall enter into any agreement wherein he pledges the transfer of his license as security for a loan."² This section qualifies the right of a license holder to transfer a liquor license. ([Golden v. State \(1955\) 133 Cal.App.2d 640, 644](#).)

While a licensee's right to transfer a liquor license is restricted, the statute also prescribes a method by which transfer may be accomplished and creditors of the licensee protected. "The state in the exercise of its police power properly may regulate the manner in which creditors of the licensee may seek some protection in the collection of their debts from the proceeds of the sale [*6] of a license." ([Pacific Firestone Escrow Co. v. Food Giant Markets, Inc., supra, 202 Cal.App.2d at p. 158](#).) Sections 24070 through 24082 provide this method. The licensee must file an application for permission to transfer the license to a particular party, which the ABC must approve. (§ 24073.) If approved, the proceeds from the transfer must be placed in an escrow account from which a court-appointed receiver makes distribution to the licensee's creditors in a prescribed order of priority. (§ 24074.) [Section 24074](#) provides the priority-based system for distributing the proceeds.³ "[T]he Legislature has established a

² [Section 24076](#) provides in full: "No licensee shall enter into any agreement wherein he pledges the transfer of his license as security for a loan or as security for the fulfillment of any agreement. No license shall be transferred if the transfer is to satisfy a loan or to fulfill an agreement entered into more than 90 days preceding the date on which the transfer application is filed, or to gain or establish a preference to or for any creditor of the transferor, except as provided by [Section 24074](#), or to defraud or injure any creditor of the transferor."

³ [Section 24074](#) in pertinent part states: "Before the filing of such a transfer application with the department, if the intended transfer of the business or license involves a purchase price or consideration, the licensee and the intended transferee shall establish an escrow with some person, corporation, or association not a party to the transfer acting as escrow holder, and the intended transferee shall deposit with the escrow holder the full amount of the purchase price or consideration. The transfer application shall be accompanied by a description of the entire consideration. The description shall include a designation of cash, checks, promissory notes, and tangible and intangible property, and the amount of each thereof. The licensee and intended transferee shall also enter into an agreement, which agreement shall be deposited with the escrow holder, directing the escrow holder, after the requirements for transfer as provided in [Section 24049](#) are

mandatory and exclusive system of priorities intended to replace other procedures such as levy and execution in order to protect all parties of the transaction and, at the same time, to prevent the use of liquor licenses or its transfer directly or surreptitiously as a security device." (*Grover Escrow Corp. v. Gole* (1969) 71 Cal.2d 61, 65.) Under this mandatory scheme, sale proceeds are distributed to creditors in a hierarchy of eight priority statuses. The payment of secured creditors is the third priority to the extent the proceeds "arise from the sale of the security." [*7] (§ 24074.) Claimants' claim is of a lower priority.

Code of Civil Procedure section 708.630, subdivision (b) provides: "The court may appoint a receiver for the purpose of transferring the judgment debtor's interest in an alcoholic beverage license that is transferable under Article 5 (commencing with Section 24070) of Chapter 6 of Division 9 of the Business and Professions Code, unless the judgment debtor shows in the proceeding to appoint a receiver that the amount of delinquent taxes described in Section 24049 of the Business and Professions Code and claims of creditors with priority over the judgment creditor pursuant to Section 24074 of the Business and Professions Code exceed the probable sale price of the license."

2. Application to Concorde's Claim

We review the trial court's [*9] interpretation of these statutory provisions de novo. (*California Teachers Assn. v. Governing Bd. of Hilmar Unified School Dist.* (2002) 95 Cal.App.4th 183, 190.) "Our fundamental task in construing a statute is to ascertain the intent of the lawmakers so as to effectuate the purpose of the statute. [Citation.] We begin by examining the statutory language, giving the words their usual and ordinary meaning. [Citation.] If there is no ambiguity, then we presume the lawmakers meant what they said, and the plain meaning of the language governs. [Citations.] If, however, the statutory terms are ambiguous, then we may resort to extrinsic sources, including the ostensible

satisfied, to pay out of the purchase price or consideration, whether the consideration takes the form of cash, checks, promissory notes, or tangible or intangible property, the claims [*8] of the bona fide creditors of the licensee who file their claims with the escrow holder before the escrow holder is notified by the department of its approval of the transfer of the license or if the purchase price or consideration is not sufficient to pay the claims in full, to distribute the consideration as follows: [¶] . . . [¶] Third, to the payment of claims of secured creditors to the extent of the proceeds which arise from the sale of the security."

objects to be achieved and the legislative history." (*Id.* at p. 191.)

Claimants contend that the proceeds from the transfer of the liquor license do not "arise from the sale of the security" within the meaning of section 24074 because under section 24076 a liquor license cannot be pledged as security for a loan. Agreements to transfer a liquor license have been held to violate section 24076 where a loan agreement provides for the transfer of the license as security for the loan. In *Holt v. Morgan* (1954) 128 Cal.App.2d 113, 115, [*10] for example, an agreement between a creditor and liquor licensee under which the creditor agreed to dismiss a claim in exchange for a promissory note secured by a power of attorney authorizing transfer of the liquor license in the event of default was invalidated. In *Citrigno v. Williams* (1958) 255 F.2d 675, an agreement under which the assignee of a lease and liquor license were to retransfer the license to the former owners after the lease expired was held to be invalid.

In the present case, however, there was no pledge of the liquor license to the secured lender or to anyone else. Concorde's loan was not secured by a pledge of the liquor license but by a security interest in the assets of SF Night Life and other businesses. Upon the sale of the license to an approved purchaser, the proceeds of the sale became subject to the security agreement, so that Concorde was a "secured creditor" with respect to those funds within the meaning of section 24074. This process conformed with both the letter and the purpose behind the governing statutory provisions. The "purpose of section 24076 [is] to prevent a transfer of ownership by any means other than the procedure, compliance with which would [*11] limit transfers to those who are qualified to hold licenses." (*Greve v. Leger* (1966) 64 Cal.2d 853, 860.) Under the procedure followed here there was no possibility that the liquor license would become the property of a transferee not approved by the ABC. There is thus no reason why, once the liquor license was transferred with ABC approval, the monetary proceeds of the sale should not be distributed in accordance with the priority scheme specified in section 24074.

Hence the trial court correctly interpreted and applied sections 24074 and 24076 and properly approved the receiver's recommended disposition to Concorde of the remaining proceeds of the sale of the liquor license after making the higher priority distribution for the fees of the receiver.

DISPOSITION

The order appealed from is affirmed.

Pollak, J.

We concur:

McGuinness, P. J.

Jenkins, J.

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1 BUCHALTER NEMER
A Professional Corporation
2 RICHARD P. ORMOND (SBN: 207442)
MICHAEL J. MUSE-FISHER (SBN: 253232)
3 1000 Wilshire Boulevard, Suite 1500
Los Angeles, CA 90017-2457
4 Telephone: (213) 891-0700
Facsimile: (213) 896-0400
5 Email: rormond@buchalter.com

RECEIVED
FEB 19 2013
Clerk of the Court
Superior Court of California
County of Los Angeles

6 Attorneys for Plaintiff and Judgment Creditor
[REDACTED]

8 SUPERIOR COURT OF CALIFORNIA
9 COUNTY OF LOS ANGELES, CENTRAL DISTRICT

10 [REDACTED]
11 [REDACTED]

Case No. [REDACTED]
Hon. Judge [REDACTED]

12 Plaintiff,
13 vs.
14 [REDACTED]
15 [REDACTED]

**EX PARTE APPLICATION OF PLAINTIFF
AND JUDGMENT CREDITOR [REDACTED]
[REDACTED] FOR THE APPOINTMENT OF
A RECEIVER TO ENFORCE MONEY
JUDGMENT; MEMORANDUM OF
POINTS AND AUTHORITIES IN
SUPPORT THEREOF**

16 Defendants.
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[REDACTED]

Date: February 13, 2013
Time: 8:30 a.m.
Dept.: [REDACTED]

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TO THE DEFENDANT AND JUDGMENT DEBTOR, [REDACTED]
CORPORATION AND ITS COUNSEL OF RECORD:

PLEASE TAKE NOTICE THAT Plaintiff and Judgment Creditor, [REDACTED],
[REDACTED] will and hereby does apply *ex parte* for an Order Appointing Receiver to Enforce
a Money Judgment against Defendant and Judgment Debtor [REDACTED]
Specifically, [REDACTED] requests that this Court issue an order appointing a receiver to take possession
of [REDACTED] books and records (maintained in any form), as well as [REDACTED] income, profits,
and revenue ("Receivership Property"). The Receivership Property potentially provides the only
source of recovery of [REDACTED] judgment against [REDACTED] in the amount of \$4,617,500.34, plus
attorneys' fees.

This Application is brought pursuant to California Code of Civil Procedure section
708.610 *et seq.*, and 564 *et seq.*, upon the grounds that the appointment of a receiver is the most
reasonable method to provide for a obtain the fair and orderly satisfaction of [REDACTED] judgment
against [REDACTED]

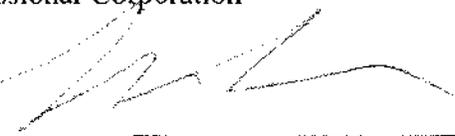
This application is based upon the appended Memorandum of Points and Authorities, as
well as the Declaration of Michael Muse-Fisher and [REDACTED] the Request for Judicial
Notice, the Declaration of [REDACTED] being filed concurrently herewith, along with the pleadings
on file herein, and such further evidence or argument as may be at the hearing on this matter.

EX PARTE NOTICE

As set forth in the Declaration of Micaela Varela, counsel for [REDACTED] provided *ex parte*
notice to [REDACTED] counsel, as required by California Rules of Court, Rule 3.1203.

DATED: February 12, 2013

BUCHALTER NEMER
A Professional Corporation

By: 

RICHARD P. ORMOND
MICHAEL J. MUSE-FISHER
Attorneys for Plaintiff, [REDACTED]

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I. INTRODUCTION

3 On January 21, 2011, this Court entered a Judgment against Defendant and Judgment
4 Debtor [REDACTED] and in favor of [REDACTED] in the
5 amount of \$4,617,500.34 plus attorneys' fees and costs in the amount of \$139,012.25
6 ("Judgment"). Now, two years later [REDACTED] has not paid any amount of the Judgment, despite
7 [REDACTED] considerable collection efforts.

8 At the most recent judgment debtor examination, which had repeatedly been delayed by
9 the actions of [REDACTED] principals, it was disclosed by [REDACTED] CEO, [REDACTED] that
10 [REDACTED] has ceased all operations and a purportedly new entity, [REDACTED]
11 [REDACTED] is managing and operating various commercial and residential properties that [REDACTED]
12 had, up until this point, been managing and operating. Mr. [REDACTED] testified, under oath, that
13 although this purportedly new entity is now managing properties that [REDACTED] had been
14 managing, [REDACTED] has absolutely no relationship to [REDACTED] (although the two companies' names
15 are virtually identical) and he does not "know what the corporate structure is and who [REDACTED]
16 officers and directors are." [REDACTED] Judgment Debtor Examination Transcript
17 ([REDACTED] JD Depo.), 61:4-62:5.] Yet, in direct conflict to Mr. [REDACTED] sworn
18 testimony, [REDACTED] counsel has just learned that Mr. [REDACTED] is unquestionably the CEO of
19 [REDACTED]. Indeed, Mr. [REDACTED] signed documents as CEO of [REDACTED] in another lawsuit recently
20 filed in the Los Angeles Superior Court, entitled [REDACTED] Case No.
21 [REDACTED]

22 The information (or misinformation) provided by Mr. [REDACTED] underscores not only
23 the need for a post-judgment receiver, but also the exigency for the receiver's appointment.
24 [REDACTED] is a property management company that has, at least until recently, managed between ten
25 to fifteen office, apartment, and retail properties located in Los Angeles, Houston, Oklahoma,
26 New York and Las Vegas (the "Properties"). [REDACTED] does not own the Properties. Instead, the
27 Properties are owned by other single purpose entities. However, the officers and directors of
28 those entities happen to be the officers and directors of [REDACTED] and, those individuals are blood

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1 relatives. Thus, any demand made to the owners of the Properties for payment of [REDACTED]
2 management fees to satisfy the Judgment would be no different than making demand on [REDACTED].
3 Given that the principals of [REDACTED] have actively interfered with [REDACTED]'s collections efforts,
4 there is no reason believe that they would act any differently if served with an assignment order in
5 their capacity as officers and directors of owners of the Properties.

6 The impact on [REDACTED]'s ability to collect on its Judgment due to the interrelatedness
7 between [REDACTED] and [REDACTED] debtors, is exacerbated by [REDACTED] concerted efforts to avoid
8 providing [REDACTED] with any information that could be used to collect on the Judgment. Having
9 exhausted other available means of collecting on the Judgment, [REDACTED] has no other option but to
10 seek a post-judgment receiver under Code of Civil Procedure, §§ 708.610 *et seq.*, and 564 *et seq.*

11 Accordingly, [REDACTED] seeks the appointment of a qualified receiver for the purpose of taking
12 possession, custody and control of [REDACTED] books and records, as well as its income, profits and
13 revenue in order to identify [REDACTED] revenue stream and then to collect the proceeds therefrom
14 (collectively, the "Receivership Property"). [REDACTED] nominates [REDACTED] to serve as the receiver
15 (the "Receiver") for this purpose. He is well qualified for such a position, having served in
16 similar capacities on numerous occasions, along with his experience as a property manager. (*See*
17 Declaration of [REDACTED] filed concurrently herewith.)

18 **II. STATEMENT OF FACTS**

19 **A. Procedural Background of Case**

20 This action arises out of a Line of Credit Loan Agreement ("Agreement") and Promissory
21 Note dated January 3, 2008, by and between [REDACTED]. The amount on the line of credit
22 was four million dollars (\$4,000,000.00) (the "Loan"). Declaration of [REDACTED]
23 Decl."), ¶ 6. The Loan matured on March 9, 2009, at which time the entire principal balance, plus
24 accrued and unpaid interest, became immediately due and payable to the Bank. *Id.* at ¶ 9.
25 [REDACTED] failed to pay [REDACTED] any portion of the Loan. *Id.* at ¶ 9.

26 On June 12, 2009, [REDACTED] commenced the underlying action, filing a complaint for breach
27 of contract against [REDACTED] for failing to perform its obligations pursuant to the Loan agreement
28 and promissory note. Declaration of Michael J. Muse-Fisher ("Muse-Fisher Decl."), ¶ 2.

1 On January 21, 2011, the Court granted [REDACTED] Motion for Summary Judgment and
2 entered judgment in favor of [REDACTED] and against [REDACTED] in the amount of \$4,617,500.34 and
3 attorneys' fees and costs in the amount of \$174,312.25. Muse-Fisher Decl., ¶ 3. No part of the
4 Judgment has been paid. [REDACTED] Decl., ¶ 10.

5 **B. Background of [REDACTED] and Related Ownership**

6 [REDACTED] is a real estate management company. Muse-Fisher Decl., Exh. 3 [Deposition I
7 of [REDACTED] Depo.], 11:20]. [REDACTED] operates its business under the
8 [REDACTED] Muse-Fisher Decl., Exh. 6 [Deposition of [REDACTED]
9 (" [REDACTED] Depo. "], 41:8-12]. [REDACTED] is owned by the following individuals:

- 10 • [REDACTED] (30% ownership);
- 11 • [REDACTED] s son (10% ownership);
- 12 • [REDACTED] s son (10% ownership);
- 13 • [REDACTED] s brother (20% ownership);
- 14 • [REDACTED] s son (15% ownership);
- 15 • [REDACTED] s son (15% ownership). [REDACTED] Decl., ¶ 8.

16 [REDACTED] are brothers; [REDACTED] are the sons of
17 [REDACTED]

18 Based on [REDACTED] website¹, [REDACTED] manages between ten to fifteen office, apartment,
19 and retail properties located in Los Angeles, Houston, Oklahoma, New York and Las Vegas.
20 [REDACTED] Depo., 21:14-22:8. [REDACTED] does not own the real property it manages. [REDACTED]
21 Depo., 19:14-16. Instead, the owners of the various properties are single purpose entities; entities
22 over which [REDACTED] s owners also have an ownership or directorial interest. Muse-Fisher Decl.,
23 Exhs. 12-14.

24 As a property manager, [REDACTED] s main source of income appears to be management fees.
25 In addition, [REDACTED] may receive income from consulting fees and syndication fees received
26 during the development phase of the particular properties, as well as a lump sum payment upon
27 completion of development. See e.g., [REDACTED] Depo., 89:16-19; 90:13-92:7; See also, Muse-

28 ¹ [REDACTED]

1 Fisher Decl., Exh. 11 [Judgment Debtor Examination of [REDACTED] ("Yashouafar JD
2 Depo."), 27:9-31:8].

3 As shown in a sampling of the limited number of management agreements that [REDACTED]
4 turned over to Plaintiff as part of earlier judgment debtor examinations, there is no dispute that
5 the owners of [REDACTED] are also the owners/principals of the companies that
6 own the properties:

- 7 • The officers and directors of [REDACTED], Los Angeles,
8 California) are [REDACTED];
- 9 • [REDACTED] is owned by [REDACTED]
10 [REDACTED], which is managed by [REDACTED];
- 11 • [REDACTED] is owned by [REDACTED]
12 [REDACTED], which is owned by [REDACTED] of which [REDACTED] is an
13 officer;
- 14 • [REDACTED] is owned by [REDACTED], of
15 which [REDACTED] is the President;
- 16 • [REDACTED] is owned by [REDACTED]
17 [REDACTED] entities, of which [REDACTED] is the President. Muse-Fisher Decl., Exhs. 12- 15.

18 Based on the Agreements, when you trace the corporate owners of the properties that
19 [REDACTED] manages to the individuals who run them, they are the same – the [REDACTED]

20 This ownership interest makes it difficult, if not impossible, to enforce [REDACTED] judgment
21 without the appointment of a receiver. Without an unrelated third party to intermediate, any
22 demand made on [REDACTED] debtors would be the same as making a demand on [REDACTED] – an
23 entity that has, to this point, done everything in its power to avoid paying [REDACTED]. Without a third
24 party like the Receiver, [REDACTED] has no means to effectively enforce its judgment.

25 **C. [REDACTED]'s Considerable Efforts To Gather Information From [REDACTED] To Collect**
26 **On Its Judgment**

27 Over the course of the last two years, [REDACTED] has attempted to do sufficient fact gathering
28 through judgment debtor examinations, in an effort to collect on its judgment. However, due to

1 numerous delays caused by the multiple non-appearances of [REDACTED]'s principals at the judgment
2 debtor examinations, compounded by further delays caused by the massive budget cuts to the Los
3 Angeles Superior Court System,² the judgment debtor examinations have proceeded at a snail's
4 pace. Muse-Fisher Decl., ¶¶ 6-13.

5 In those rare times where [REDACTED]'s principals have actually appeared for the judgment
6 debtor examinations they have either feigned ignorance, or have been instructed by [REDACTED]'s
7 counsel not to answer. By way of example, throughout [REDACTED]'s Controller, [REDACTED]'s
8 judgment debtor examination, she had to consult with her counsel because she was unsure
9 whether she could testify about some of the more basic aspects of [REDACTED]'s business and
10 [REDACTED] debtors (whom she also does work for). *See e.g.*, [REDACTED] Depo., 19:1-2; 56:4-8; 67:14-
11 22. And, for many questions that she, as the controller, should have the answer, her response was
12 "I don't recall." *See e.g.*, [REDACTED] Depo., 45:13-15; 49:4-9³.

13 [REDACTED]'s judgment debtor examination was no different. Through the course
14 of the examination he routinely said "I don't know" or "I don't believe so" to questions that the
15 CEO of [REDACTED] should know; including when [REDACTED] last maintained bank accounts
16 [REDACTED] JD Depo., 34:7-17]; whether [REDACTED] has any employees [*Id.* at 35:16-18]; whether
17 [REDACTED] has any assets [*Id.* at 35:24-36:3]; how many businesses operate out of the same
18 facilities as [REDACTED] [*Id.* at 39:15-25]; whether [REDACTED] has a lease for its present office [*Id.* at
19 45:11-13], and whether [REDACTED] received any compensation for assigning the property
20 management duties to [REDACTED], a purportedly distinct entity that [REDACTED] is
21 also the CEO. *Id.* at 62: 7-9.

22 Moreover, it is clear that these individuals have repeatedly provided misinformation
23 during the judgment debtor examinations in an effort to avoid having to pay the Judgment.

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27 ² In many instances the earliest date the Court could reset the judgment debtor examinations was three (3) to four (4)
months out.

28 ³ Interestingly, as shown in the transcript, at this time [REDACTED] was brought up during questioning, but
[REDACTED] did not know what "it does," or where [REDACTED] operates out of.

1 **D. One Example of The Machinations and Lengths [REDACTED] Has Gone To Avoid**
2 **Paying The Judgment – [REDACTED] Has Created A Purportedly New Entity To Act**
3 **As Property Manager, [REDACTED]**

4 At Ms. [REDACTED] judgment debtor examination she testified that, at that time, [REDACTED] was
5 managing at least two properties, the [REDACTED] and the [REDACTED]
6 [REDACTED] Depo., 55:10-20. Thus, at that time and pursuant to the express terms of the [REDACTED]
7 [REDACTED] Management Agreement, [REDACTED] role as property manager had been renewed for a
8 period of three (3) years through December 31, 2013. Muse-Fisher Decl., Exh. 12, ¶ 7.1 and 7.3.⁴
9 The [REDACTED] Building Management Agreement provides the exact same terms, and thus it
10 should still be in force and effect through December 31, 2013. Muse-Fisher Decl, Exh. 13. Since
11 these two management agreements should still be in place, [REDACTED] should be collecting
12 considerable fees per month – i.e., \$16,000/month for [REDACTED] and 1.5% of all leasing
13 fees collected per month for the [REDACTED] Center. [REDACTED] Depo., 45:16:-46:5, 47:10-12.

14 In contrast to Ms. [REDACTED] testimony, on October 12, 2012, [REDACTED], the CEO of
15 [REDACTED], testified that [REDACTED] no longer manages *any* properties, and is no longer operating at
16 all. [REDACTED] JD Depo., 60:7-11, 81:24-82:3. Rather, [REDACTED] contends that an entirely new
17 entity, [REDACTED] currently manages the properties that [REDACTED] formerly
18 managed, including [REDACTED] JD Depo., 60:7-13.

19 [REDACTED] testified that neither he nor [REDACTED] has any ownership interest in [REDACTED]. [60:12-
20 14]. Indeed, as provided in the transcript when asked:

21 Q. Okay. Do you know who -- who manages [REDACTED]
22 [REDACTED]
23 [REDACTED]

24 A. I wouldn't know what the corporate structure
25 is and who the -- their officers and director are.

26 So --

27 ⁴ Section 7.3, Renewals - "This agreement shall be automatically renewed on the same terms and conditions set forth
28 in this Agreement, for periods of three (3) years each beyond the expiration date, unless at least 120 days prior to the
original expiration date [December 31, 2010], either party gives the other written notice that it elects to terminate the
Agreement."

1 [REDACTED] JD Depo., 61:20-62:6]

2 This is in direct conflict with pleadings filed by [REDACTED] on November 27, 2012 – one month
3 after the judgment debtor examination – in the lawsuit entitled [REDACTED]
4 [REDACTED] pending in the Los Angeles Superior Court, Case N[REDACTED] (“Lawsuit”),
5 wherein [REDACTED] signed the contract at issue in that case as the CEO of [REDACTED].
6 Request for Judicial Notice (“RJN”), Exh. 1.

7 If it is true that [REDACTED] is a separate and distinct entity than [REDACTED] (which is unlikely
8 giving the history of [REDACTED] and the fact that both companies share the same principals, office
9 space, and business), then this would be an express breach of the [REDACTED] Management
10 Agreement, because the express terms of the Agreement provide that [REDACTED] is the exclusive
11 property manager through at least December 31, 2013.

12 Similarly, one of the properties listed on [REDACTED]’s online portfolio, [REDACTED]
13 Center, is currently in bankruptcy, as the owner [REDACTED] (of which [REDACTED]
14 [REDACTED] is a general partner of the limited partnership of its managing member) filed for
15 bankruptcy. See RJN, Exh. 2. To date, the [REDACTED] has never been disclosed
16 by [REDACTED] as one of the properties it manages. Yet, listed as one of the creditors holding an
17 unsecured claim on [REDACTED]’s Bankruptcy Schedules is [REDACTED]. *Id.* at p. 10. Since
18 [REDACTED] never provided the [REDACTED] Center Management Agreement as part of its
19 post-judgment document production, it is unclear whether [REDACTED], and not [REDACTED] is the
20 authorized property manager. However, given the similarities between [REDACTED]
21 Center, [REDACTED] and the [REDACTED] Building, it is almost certain that [REDACTED] is
22 likely the actual property management company, which [REDACTED] is trying to hide through [REDACTED].

23 Further, although [REDACTED] allegedly transferred its management duties to [REDACTED], [REDACTED]
24 knew no other information about [REDACTED]. (See [REDACTED] JD Depo., 60:7-70:23.) He did not
25 know where [REDACTED]’s offices are located (*Id.* at 63:11-23), whether any other [REDACTED]
26 shareholder also has an ownership interest in [REDACTED] (*Id.* at 60:19-61:19), or who
27 manages [REDACTED] (*Id.* at 61:20-62:11). This seems factually at odds with [REDACTED]
28 [REDACTED] execution of documents as the CEO of [REDACTED] as well as with the

1 information provided on the Summary of Schedules filed in the [REDACTED]
2 bankruptcy. Even more disconcerting is that [REDACTED] did not know whether [REDACTED]
3 paid any money to [REDACTED] in order to assume the property management contracts. (65:11-
4 66:22.) Again, this makes no sense given that he is the CEO of both companies.

5 **III. LAW AND ARGUMENT**

6 **A. THE APPOINTMENT OF A RECEIVER IS PROPER IN THIS ACTION**

7 The Court has wide latitude to appoint a receiver to aid in the enforcement of a judgment.

8 “The court may appoint a receiver to enforce the judgment where the
9 judgment creditor shows that, considering the interests of both the
10 judgment creditor and the judgment debtor, the appointment of a receiver
11 is a reasonable method to obtain the fair and orderly satisfaction of the
12 judgment.”

(Code of Civil Procedure § 708.620.)

13 Here, the remedies requested by [REDACTED] are consistent with the interests of all the parties in
14 satisfying the Judgment. Moreover, the appointment order proposed by [REDACTED] contains all of the
15 protections to [REDACTED], such as the reporting provisions as would be required for a receiver.

16 In so appointing a receiver to enforce a judgment, the provisions of Code of Civil
17 Procedure sections 564 *et seq.* govern the appointment, qualifications, powers, rights and duties
18 of the receiver.

19 Code of Civil Procedure section 564 empowers this Court to appoint a receiver in this
20 case. That section provides, in relevant part, as follows:

21 (b) A receiver may be appointed by the court in which an action or
22 proceeding is pending, or by a judge thereof, in the following cases:
(3) After judgment, to carry the judgment into effect.

23 ...
(6) Where a corporation is insolvent, or in imminent danger of
24 insolvency, or has forfeited its corporate rights.

25 ...
(9) In all other cases where necessary to preserve the property or
rights of any party. Code Civ. Proc., § 564.

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1. Due To [REDACTED] Concerted Effort To Avoid Paying Down The Judgment, [REDACTED] Has No Choice But To Seek The Appointment Of A Receiver

Under the circumstances of this case, the appointment of a receiver is both necessary and proper under Code of Civil Procedure sections 564(b)(3) and 708.620, as only a receiver can enforce the Judgment. [REDACTED] has failed to pay its debt to [REDACTED] under the Judgment, and has shown it has no intention of doing so. [REDACTED]'s purported inability to recall even the most basic information regarding [REDACTED] has further interfered with [REDACTED]'s ability to collect on the Judgment. Despite the numerous attempts to glean information about [REDACTED] and its debtors (the properties it manages), [REDACTED] has offered only the smallest amount of information regarding [REDACTED]'s operations, accounts, and income.

Moreover, since [REDACTED]'s shareholders also own many of the buildings that [REDACTED] manages (or should manage) there is no reason to believe that any other means of collecting on the Judgment, including the issuance of assignment orders, would result in anything different than the *status quo*. Especially, whereas here, the individuals are members of the same family.

The appointment of a receiver is imperative for [REDACTED] to collect on its Judgment. Given that [REDACTED]'s main source of income is its management fees, [REDACTED]'s best source of recovery is by means of assignment orders. However, the interrelated ownership amongst [REDACTED] and the entities it manages would make such assignment orders ineffectual. The alternative post-judgment remedy of an assignment order under California Code of Civil Procedure, Section 708.510, *et seq.*, is significantly less advantageous in that [REDACTED] will simply ignore an order to assign its income to [REDACTED] and any contempt proceedings brought against [REDACTED] for violating an order will only hinder and delay [REDACTED]'s ability to obtain full satisfaction of its Judgment. Thus, a receiver is necessary to review [REDACTED]'s books and records to determine which properties it manages and the fees it receives.

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IV. CONCLUSION

For the foregoing reasons, [REDACTED] respectfully requests that its application be granted, that [REDACTED] be appointed as Receiver to enforce the judgment in this action against [REDACTED], and for such other and further relief as the Court deems just and proper.

DATED: February 12, 2013

BUCHALTER NEMER
A Professional Corporation

By: 

MICHAEL J. MUSE-FISHER
Attorneys for Plaintiff, [REDACTED]

XI

1 BUCHALTER
A Professional Corporation
2 BARRY A. SMITH (SBN: 48697)
MICHAEL B. FISHER (SBN: 203620)
3 1000 Wilshire Boulevard, Suite 1500
Los Angeles, CA 90017-2457
4 Telephone: (213) 891-0700
Facsimile: (213) 896-0400
5 Email: bsmith@buchalter.com; mbfisher@buchalter.com

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County of Los Angeles

APR 06 2017

Sherri R. Carter, Executive Officer/Clerk
By Javier Flores, Deputy
Javier Flores

6 Attorneys for Plaintiff and Judgment Creditor

7 [REDACTED]

8 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
9 **COUNTY OF LOS ANGELES, CENTRAL DISTRICT**

10 [REDACTED]

CASE NO. [REDACTED]

~~Proposed~~

**ORDER APPOINTING POST-JUDGMENT
RECEIVER OVER ASSETS OF JUDGMENT
DEBTORS** [REDACTED]

14 Plaintiff/Judgment Creditor,

15 vs.

**AND TO ENFORCE MONEY JUDGMENT
AND PRELIMINARY INJUNCTION IN AID
THEREOF**

16 [REDACTED]

[REDACTED]

18 Defendants/Judgment
19 Debtors.

28

1 **ORDER**

2 This Court, having considered the *Ex Parte* Application of the Plaintiff/Judgment
3 Creditor [REDACTED] or an
4 Order Appointing Receiver to Enforce Money Judgment, and considered the credentials of
5 [REDACTED] as receiver in this matter, and in furtherance of the Judgment entered in this
6 action and good cause appearing therefore:

7 **IT IS ORDERED, ADJUDGED AND DECREED that:**

8 I. Appointment of Receiver. [REDACTED] is hereby appointed as the receiver (the
9 "Receiver") to enforce the money judgment obtained by [REDACTED] against [REDACTED]
10 [REDACTED] (the "Judgment") and to take
11 possession of the "Receivership Property" (as herein defined), collect all income, revenue, and
12 profits of such property and distribute the proceeds thereof in satisfaction of the Judgment and as
13 ordered by the Court. The "Receivership Property" shall be defined to include:

14 A. Any and all of the [REDACTED] income, revenue and profits, and the proceeds
15 therefrom.

16 B. All assets directly or indirectly owned or controlled by the [REDACTED] or
17 which is being held or controlled by another for the benefit of the [REDACTED] including all of the
18 [REDACTED] real and personal property, tangible and intangible property, inventory, chattel paper,
19 assets, stocks, bonds, deposit accounts, equipment, general intangibles, contract rights, and
20 ownership interests in corporate entities, including but not limited to, stocks, corporate shares,
21 limited liability memberships, subscriptions, and partnership interests, wherever these assets are
22 located.

23 C. All of the [REDACTED] books, records (including, but not limited to,
24 electronically stored records), documents, computers, books, papers, and accounts.

25 II. Oath and Bond. The Receiver shall immediately, and before performing any duties,
26 execute and file a Receiver's Oath and file an undertaking required by Code of Civil Procedure, §
27 567(b) in the amount of \$ 10,000.00.

28

1 III. Possession by Receiver. The Receiver is hereby authorized to take possession
2 immediately of all the Receivership Property wherever located.

3 IV. Duties and Powers of Receiver. The Receiver shall have all the powers, duties and
4 authority as provided by California law and is hereby authorized to protect, possess, preserve, and
5 distribute the Receivership Property. Such authority shall include, but is not limited to, the
6 following:

7 A. Enter, gain access to and take possession of the Receivership Property
8 wherever located (including opening any locked drawers, fixtures, cabinets, doors or other locked
9 storage areas). The Receiver shall have full access in and to the Receivership Property including
10 the [REDACTED] residences, as well as buildings or office space out of which the [REDACTED] currently
11 operate. The Receiver shall further be entitled to engage a locksmith for the purposes of gaining
12 entry to any property that is the subject of this receivership and through any security system, in
13 order to obtain any property or documents to which the Receiver is entitled pursuant to this Order,
14 as well as giving any notices which may be required in performing the Receiver's duties. The
15 Receiver may have locks or security codes changed (except for the [REDACTED] residences), or have
16 keys created that will work for the existing locks. The Receiver is authorized to engage the
17 assistance of the Los Angeles County Sheriff or Police Department, or any other law
18 enforcement, in order to gain access to the foregoing locations as may be required.

19 B. Enter, gain access to and take possession of all of the real and personal,
20 tangible and intangible property, including all documents, books, records, papers, and accounts
21 pertaining to the Receivership Property, wherever located and regardless of whether they are in
22 the possession of the [REDACTED] or a third party with notice of this Order, as the Receiver deems
23 necessary for the proper administration and/or control of the Receivership Property. Said books
24 and records may be made available to [REDACTED] or the [REDACTED] or their agents, servants, employees
25 or representatives as is reasonably necessary upon one (1) week notice, at a time and place set
26 forth by the Receiver;

27 C. Demand, collect, and receive any income, revenue, profits, receivables, and
28 proceeds relating to the Receivership Property in direct or indirect possession or control of the

1 [REDACTED] or their respective agents, servants, employees or representatives, and all persons or
2 entities acting under or in concert with the [REDACTED] or any third parties, that are now due and
3 hereafter due from any sale, transfer, assignment, or use of all or any portion of the Receivership
4 Property (“Proceeds”), and the Receiver shall be authorized to disburse, without further order of
5 the Court, all income, revenue, profits, receivables, and proceeds relating to the Receivership
6 Property to [REDACTED];

7 D. Take possession of and receive from any and all banks, credit unions and/or
8 any financial institutions any monies and funds on deposit in said banks, credit unions and/or any
9 financial institutions for the benefit of the Receivership Property or in the name of the [REDACTED]
10 as well as all available bank records, and the Receiver’s receipt of said monies and funds shall
11 discharge said banks, credit unions and/or any financial institutions from further responsibility for
12 accounting to said account holder for monies and funds for which the Receiver shall give his or
13 its receipt. The Receiver may, at his discretion, maintain or transfer control and signatory
14 authority on any and all of the [REDACTED] bank accounts to the Receiver for the deposit of funds
15 generated by the Receivership Property in such federally insured financial institution(s) as the
16 Receiver shall decide;

17 E. The Receiver is empowered to establish bank accounts for the deposit of
18 monies and funds collected and received in connection with the Receivership Property, at any
19 federally insured financial institution, such that all amounts on deposit are fully insured. Monies
20 coming into the possession of the Receiver and not expended for any purposes herein authorized
21 shall be held by the Receiver until further order of this Court;

22 F. The Receiver shall comply with the notice and confirmation procedures
23 specified in Sections 568.5 and 701.510 et seq. of the California Code of Civil Procedure;

24 G. Take any and all steps necessary to receive, collect, open and review all mail
25 addressed to, and for the benefit of the Receivership Property, and at the Receiver’s discretion,
26 instruct the U.S. Postmaster to re-route, hold and/or release said mail to said Receiver;

27 H. Employ agents, servants, employees, locksmiths, security guards, clerks,
28 accountants, investigators, guards, and other consultants and persons deemed by the Receiver to

1 be necessary or advisable to assist him in performing his duties hereunder and to administer the
2 Receivership Property, and to collect the Proceeds, if the Receiver shall deem necessary, and to
3 pay the reasonable value of said services from the Receivership Property.

4 I. Enter into contracts affecting the Receivership Property as required in the
5 ordinary course of operating the Receivership Property;

6 J. Present for payment any checks, money orders, drafts, warrants and other
7 forms of payment made payable to the [REDACTED] which constitute proceeds, endorse same and
8 collect the proceeds thereof, such proceeds to be used and maintained as provided in this order;

9 K. To do any and all acts necessary, convenient, and incidental to the foregoing;

10 L. To have the powers granted by California statutes;

11 M. The Receiver is authorized to use the [REDACTED] social security numbers or
12 their company(ies)' tax identification numbers as may be required. Notwithstanding the
13 foregoing, the Receiver shall have no responsibility for filing federal or state income tax returns
14 or federal or state payroll tax returns of the [REDACTED] and shall not be responsible for operating
15 any businesses owned by the [REDACTED]. The responsibility for such filings, payments and business
16 operations lies exclusively with the [REDACTED] and their agents, employees and representatives.
17 The Receiver shall grant the [REDACTED] and their agents, employees, and representatives
18 reasonable access to books and records of the [REDACTED] which the [REDACTED] need for the
19 foregoing purposes.

20 N. The Receiver shall have no personal liability for acts taken in compliance with
21 this Order, or any other Orders of the Court. No person or entity shall be able to bring suit against
22 the Receiver without prior approval from this Court;

23 O. The Receiver has no obligation to advance funds, but may do so and be
24 reimbursed if exigency requires based on the Receiver's discretion; and

25 P. The Receiver and the Parties are authorized to seek further orders from the
26 Court on notice motion or *ex parte* basis, as the exigencies may require.

27 V. Inventory. To the extent feasible, within 30 days after qualifying, the Receiver shall
28 file an inventory of all the Receivership Property possessed under this order.

1 VI. Monthly Accounting of Receiver's Income, Expenses and Fees.

2 A. The Receiver shall, each month, prepare and serve on the parties, but not file,
3 an accounting of the income and expenses incurred in the administration of the Receivership
4 Property, including the Receiver's fees and expenses.

5 B. The Receiver may pay the Receiver's own fees and expenses only by the
6 following procedures:

7 1. By serving and filing a notice of intent to pay to which no objection is
8 filed within 15 days of the date the notice is mailed; or

9 2. By serving and filing a request for interim payment, which the Court
10 then approves; or,

11 3. By filing the Receiver's final accounting and report which the Court
12 then approves.

13 VII. Receiver's Final Report and Account and Discharge.

14 A. Motion Required. Discharge of the Receiver shall require a Court order upon
15 noticed motion for approval of the Receiver's final report and account and exoneration of the
16 Receiver's bond;

17 B. Time. Not later than 60 days after the Receivership terminates, the Receiver
18 shall file, serve and obtain a hearing date on a motion for discharge and approval of the final
19 report and account;

20 C. Notice. The Receiver shall give notice to all persons of whom the Receiver is
21 aware who have potential claims against the Receivership Property; and

22 D. Contents of Motion. The motion to approve the final report and account and
23 for discharge of the Receiver shall contain at least the following: (i) A declaration by the Receiver
24 stating what was done during the Receivership and certifying the accuracy of the final
25 accounting; and (ii) An accounting summary. A summary of the receivership accounting, which
26 shall include the total revenues received, the total expenditures identified and enumerated by
27 major categories, the net amount of any surplus or deficit, and evidence of necessary supporting
28 facts.

1 VIII. Receiver's Rates and Fees. The Receiver fees shall be charged at a rate of \$325 per
2 hour for his services. Others affiliated with the Receiver shall charge between \$95 and \$125 per
3 hour and the Receiver's forensic accountant shall charge \$175 per hour. The Receiver shall also
4 be entitled to the payment of all of his out of pocket expenses associated with the Receivership,
5 including without limitation the expenses for any bond and the expense for any liability or other
6 insurance to cover his activities hereunder.

7 INJUNCTIVE RELIEF AGAINST THE [REDACTED] AND THIRD PARTIES

8 IX. The [REDACTED] and their agents, representatives, property managers, employees,
9 partners, family members, and any businesses, corporations, limited liability companies,
10 partnerships, limited partnerships, and all other persons acting under, in concert with, or for them,
11 with actual or constructive knowledge of this order, shall:

12 A. Deliver forthwith to the Receiver possession of the Receivership Property and
13 all Proceeds generated thereby;

14 B. Deliver forthwith to the Receiver possession of the records, books of account,
15 ledgers and all other business records of the [REDACTED] their companies, their business dealings,
16 and their agents or representatives, wherever located and in whatever mode maintained, that relate
17 to the Receivership Property or the Receiver's role as manager of the Receivership Property or as
18 the collector of the Proceeds, banking records, statements and canceled checks relating to any
19 bank account(s) into which the [REDACTED] and all persons acting under them have been depositing
20 the net operating income generated by the Receivership Property (e.g., operating statements,
21 budgets, personnel records and real estate tax bills). In the event the Receiver needs additional
22 information or documents related to the Receivership Property, the [REDACTED] shall provide such
23 information and documents within twenty-four (24) hours of demand by the Receiver;

24 C. Deliver forthwith to the Receiver all documents or records as requested by the
25 Receiver as necessary to take custody and control over the Receivership Property;

26 D. Deliver forthwith to the Receiver a copy of all leases, royalty agreements,
27 licenses, or other agreements of any kind whatsoever, whether currently in effect or lapsed,
28 relating to any interests in the Receivership Property;

1 E. Shall cooperate with and reasonably assist the Receiver with respect to his
2 operation of the Receivership Property, including but not limited to promptly responding to any
3 inquiry by the Receiver for information;

4 F. Shall turn over to the Receiver and direct all other third parties in possession
5 thereof to turn over all keys, leases, books, records, rent rolls, books of account, ledgers,
6 operating statements, control and passwords to website(s) and/or web domains, budgets, tenant
7 lease deposits, and all other Receivership Property records relating to the Receivership Property,
8 wherever located, and in whatever mode maintained, including information contained on
9 computers and any and all software relating thereto as well as all banking records, statements and
10 cancelled checks;

11 G. Shall turn over to the Receiver all contracts involving the Receivership
12 Property;

13 H. The [REDACTED] their family members, agents, representatives, property
14 managers, employees, partners, and any businesses, corporations, limited liability companies,
15 partnerships, limited partnerships, and all other persons acting under, in concert with, or for them,
16 with actual or constructive knowledge of this order, shall not in any manner, directly or indirectly:

17 1. Cancel, reduce or modify any and all insurance coverage currently
18 in existence with respect to the Receivership Property;

19 2. Commit or permit any waste of the Receivership Property or any
20 part thereof, or suffer or commit or permit any act on the Receivership Property or any part
21 thereof in violation of law, or remove, transfer, encumber or otherwise dispose of any of the
22 property or of the Receivership Property or any part thereof;

23 3. Directly or indirectly interfere in any manner with the discharge of
24 the Receiver's duties under this Order or the Receiver's possession of and operation or
25 management of the Receivership Property;

26 4. Expend, disburse, transfer, assign, sell, convey, devise, pledge,
27 mortgage, create a security interest in, encumber, conceal or in any manner whatsoever deal in or
28 dispose of the whole or any part of the Receivership Property without prior specific Court Order;

1 5. Withhold any Receivership Property assets, books, records, or
2 funds from the Receiver;

3 6. Destroy or conceal any records, documents, electronic data,
4 electronic equipment or software, or any other medium that contains information related to the
5 Receivership Property; and

6 7. Do any act which will, or which will tend to impair, defeat, divert,
7 prevent or prejudice the preservation of the Receivership Property

8 X. Receiver's Duties Upon Bankruptcy Filing. If the Receiver received notice that a
9 bankruptcy has been filed and part of the bankruptcy estate includes property that is the subject of
10 this order, the Receiver shall have the following duties:

11 A. Turn over property if no relief from stay will be sought. The Receiver shall
12 immediately contact █████ and determine whether █████ intends to move in the bankruptcy court
13 for an order for (1) relief from the automatic stay, and (2) relief from the Receiver's obligation to
14 turn over the property (11 U.S.C. § 543). If █████ has no intention to make such a motion, the
15 Receiver shall immediately turn over the property to the appropriate entity either to the trustee in
16 bankruptcy if one has been appointed or, if not, to the debtor in possession — and otherwise
17 comply with 11 United States Code section 543.

18 B. Remain in possession pending resolution. If █████ intends to seek relief
19 immediately from both the automatic stay and the receiver's obligation to turn over the property,
20 the Receiver may remain in possession and preserve the property pending the ruling on those
21 motions (11 U.S.C. § 543(a)). The Receiver's authority to preserve the property shall be limited
22 as follows:

- 23 1. The Receiver may continue to collect rents and other income;
- 24 2. The Receiver may make only those disbursements necessary to
25 preserve and protect the property;
- 26 3. The Receiver shall not execute any new leases or other long-term
27 contracts; and

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4. The Receiver shall do nothing that would effect a material change in the circumstances of the property.

C. Turn over property if no motion for relief is filed within 10 days after notice of the bankruptcy. If the plaintiff fails to file a motion within 10 court days after his receipt of notice of the bankruptcy filing, the Receiver shall immediately turn over the property to the appropriate entity either to the trustee in bankruptcy if one has been appointed or, if not, to the debtor in possession and otherwise comply with 11 United States Code section 543.

D. Retain bankruptcy counsel. The Receiver may petition the court to retain legal counsel to assist the Receiver with issues arising out of the bankruptcy proceedings that affect the receivership.

DATED: 5/3/17





MidFirst Bank is proud to support the

California Receivers Forum

and its esteemed members.

Through our specialized business unit, MidFirst Bank provides tailored banking products and services to receivers, fiduciaries and insolvency professionals.

With \$21.6 billion in assets, Oklahoma City-based MidFirst Bank is one of the largest privately owned banks in the country. MidFirst Bank has banking centers in Oklahoma, Arizona, California, Colorado and Texas and provides commercial lending, wealth management, private banking and mortgage servicing nationally



George Sacco | SVP, Specialized Deposits
323-203-7455 | gsacco@1cbank.com | midfirst.com

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MIRMAN, BUBMAN & NAHMIA, LLP

www.mbnlawyers.com

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- > Representation of Receivers
- > Commercial real estate documentation and litigation
- > Enforcement of Judgments
- > Financial institution representation
- > Real and personal property secured transactions
- > Provisional Remedies (receivership, attachment, possession)
- > Business litigation
- > Representation of healthcare professionals and long term care providers

Mirman, Bubman & Nahmias, LLP

21860 Burbank Boulevard, Suite 360

Woodland Hills, CA 91367

Tel: (818) 451-4600

Alan M. Mirman

amirman@mbnlawyers.com

Michael E. Bubman

mbubman@mbnlawyers.com

**USING RULE 66 TO UNWIND
WHITE COLLAR CRIME:
Federal Equity Receiverships**

Panelists

Stephen J. Donell

FedReceiver

Steve.donell@fedreceiver.com

Krista Freitag

E3 Advisors

kfreitag@ethreadvisors.com

Thomas A. Seaman, CFA

Thomas Seaman Company

tom@thomasseaman.com

Moderator

Kathy Bazoian Phelps

Diamond McCarthy LLP

kphelps@diamondmccarthy.com

**California Receivers Forum Conference
January 2020**

Receiver's Checklist for a Fraud Case¹

I. Pre-Appointment: Developing Game Plan

A. The Initial Steps

- Conflicts check
- Investigation
 - Public records search
 - Social media
 - Pending litigation

B. Gathering the Team

- Clear calendars of key staff members and professionals
- Evaluate prospects of case
- Select outside professionals
- Meet with new team to strategize

C. Preparing for Risks

- Prepare to hold the assets, documents and other evidence still
 - Contact private security firm
 - Contact US Marshall service
 - Coordinate locksmiths
- Evaluate pending criminal or other regulatory proceedings for possible interference
- Prepare to take videographer and computer forensics team to the takeover to document current state of affairs
- Plan on someone stealing assets or records because it will happen; take every precaution

D. Preparing for Extension of Jurisdiction

- Identify other jurisdictions in which assets might be located
- Prepare to file complaint and order of appointment in other jurisdictions pursuant to 28 U.S.C. § 754

II. First Day Issues

A. Securing the Assets

- Assign each member of the team tasks in advance
 - Secure assets

¹ This checklist is intended to be an issue-spotting aid in a fraud case and is not intended to be a comprehensive list of all actions to be taken by a receiver in connection with a receivership or fraud case.

- Contain employees, prevent removal of records or assets
- Obtain passwords
- Interview key employees
- Communicate with landlord, vendors, customers
- Identify and visit any storage facility; research payables for any offsite storage facilities
- Time the entry onto the premises
- Secure the premises
 - Doors and windows
 - Computers and passwords
 - Mail
 - Ensure remote access to computers is restricted

B. The Initial Interviews

- When and where
- Employee questionnaires
- Personal property
- Transfers of cash or property
- Location of assets
- Knowledge of wrongdoing

C. Notice of Receivership

- To financial institutions regarding asset freeze
 - Bank, brokerage, investment accounts
 - Credit card processing companies
- To employees, vendors, landlords and other key parties
- To investors/website
- Hand out certified copies of order of appointment
- Contact landlord
- Post notice at all facilities of Debtor

D. Preserving Evidence

- Video premises on first day
- Check desk drawers and trash receptacles
- Diagram and tag offices, file cabinets and documents
- Locate and preserve back up tapes and off-site storage facilities including colocation facilities
- Obtain all company property from employees, including laptops and phones
- Obtain website and email hosting information and preserve data
- Consider if litigation hold notice is appropriate, especially if operations or employees may continue

III. Operational Issues

A. Immediate Operational Issues

- Transfer utilities
- Identify recurring expenses to preserve necessary ones and terminate unnecessary
- Evaluate relocating employees or documents
- Open new operating accounts
- Evaluate payroll and insurance
- Terminate unnecessary employees and benefits

B. Longer Term Operational Issues

- Maintain property
- Continue or locate management company
- Obtain assistance of key employees
- Evaluate leased equipment
- Evaluate any ancillary businesses
- Monitor cash flow
- Review credit card bills
- Work with building security

IV. Communications

A. Communication with Investors

- Open lines of communication
- Appoint communication liaison to field inquiries
- Create website
- Prepare FAQs for website
- Prepare quarterly updates
- Post status reports, relevant articles and pleadings

B. Communication with Employees, Vendors, and Others

- Employees
- Vendors and customers
- Court
- Media
- Prepare email distribution list
- Prepare reports for the investors and Court

V. Immediate Accounting Issues

- Take control of both electronic and hard copy accounting records
- Evaluate cash requirement and develop plan to fund expenses
- Review bank activity
- Review financial statements
- Obtain W-2 forms and 1099's
- Determine vendor balances
- Establish estate books and accounting system
- File Form 56 with Internal Revenue Service (Note Concerning Fiduciary Relationship) if appropriate

VI. Asset Identification

A. Using Financial and Other Records to Locate Assets

- Locate all bank accounts, subpoena records if necessary
- Review bank activity
- Identify lease agreements, identify leased items
- Review most current financial statements
- Search receivable and payment records for any diverted accounts receivable payments
- Send letters to all vendors that indicate credit balances on monthly statements and request refunds.
- Review any prepaid accounts and pursue recovery
- Review payments made for pre-paid expenses and attempt to recover expenses if appropriate.
- Review status of all retainers paid to legal counsel and other professionals.
- Review and recover utility deposits.
- Review and determine any possible recovery from landlord security deposits
- Review Fed-Ex, UPS and other delivery service invoices from Defendant's offices to determine if there may be unauthorized asset transfers shipped directly from the Debtor's offices
- Determine if company has any automobiles and where located
- Research information regarding intellectual property and market these assets.
- Review all insurance riders for specific assets
- Review partial membership interests in LLC's
- Consider that Debtor may have Bitcoins or other cryptocurrency and search electronic records for information on "bitcoins" and inquire about in depositions

- Review any recent divorce agreements to search for asset transferred to spouse for asset protection purposes
- Review all trust agreements to search for assets transferred in asset protection trusts
- Research domain names owned by Debtor and determine if there are additional domains that continue to operate.
- Evaluate whether any assets have been transferred and are recoverable as fraudulent transfers
- Determine if there are perfected security interests in any of the assets
- Search for information regarding any liens filed against the prospective defendant, i.e., UCC's, judgments, etc.

B. Accounting - Forensic Accounting

- Create data base of sources and uses of funds
- Prepare funds tracing database of all cash transactions
- Prepare insolvency analysis
- Consider possible tax refunds for taxes paid on fraud income, status of net operating losses, other potential tax benefits

C. Electronic Data Discovery

- Immediately secure all on-site and cloud-based servers
- Contact internet/email service providers and capture emails hosted on other servers
- Make images of phones with emails, text messages, social media communications if Debtor's property
- Contact website provider to change password
- Image mainframe computers and networks and develop method to safeguard while providing access to data - image before accessing data
- Utilize forensic data recovery software to review erased files of key computers
- Beware of privacy consideration and privileged information
- Take appropriate precautions to protect all data and have office systems and firewalls checked and upgraded
- Print all documents still loaded into memory on copiers and faxes.
- Arrange to have all recorded voice mails from every phone saved. Cut off access to phones and voice mail from other parties

VII. Turning It Into Cash

A. Asset Disposition

- Arrange to have all physical assets identified and secured
- Prepare detailed inventory of all assets as of the date of appointment.

- Obtain appraisals on all real property to be sold
- Evaluate any liens or competing claims to property
- Determine whether to employ broker or sell by auction
- Verify all machinery and equipment is operating at time of sale
- Advise liquidation team and auctioneers not to sell the file cabinets and key computers that need to be retained by the Trustee
- Determine date of expiration of trademarks and other intellectual property.
- Liquidate securities on timely basis and do not play the market

B. The Auction

- List assets for sale on web site for public notice
- Employ auctioneer for asset sale with online bidding
- Email all creditors with auction details and preview as they may have information on assets
- Review auction contract and any contract with estate sales company to ensure they are properly collecting sales tax.
- If competitive bidding for real property is anticipated, consider having current title search, survey and current appraisal prepared
- Personally inspect assets prior to the auction to verify and make certain what property is being sold
- After auction, arrange for junk dealer to remove and sell remaining assets
- Consider contacting the media when the auction is planned to provide update on the story and get free press for the auction.

C. Preparing for Litigation

- Business Records
 - Resist the temptation to abandon unnecessary and burdensome business records
 - Beware of possible discovery issues and future need of records in litigation
 - Don't destroy records until the case concludes
 - Make sure that ESI is properly imaged and preserved at beginning of case. Don't underestimate the importance of ESI and the need for access when litigation commences.
- Net Winner Fraudulent Transfer Actions
 - Review possible recovery of false profits known as claw-back claims.
 - Prepare a cost benefit analysis to determine which actions should be pursued.

- Determine threshold recovery amounts to preserve assets of the estate.
- Evaluate likely collectability against possible targets.
- Principals, Related Parties, and Affiliates
 - Investigate transactions with principals and related parties and determine if any causes of action exist.
 - Review documents regarding other entities controlled by Debtor and related parties and determine whether there are other subsidiaries that should be considered for substantive consolidation
- Banks
 - Draft letter to all banks, investment houses, brokerages, etc. where Debtor had accounts to ensure that all accounts have been frozen and/or closed.
 - Investigate relationships and transactions with bank for consideration of potential liability
 - Subpoena all bank account records and begin tracking all documents produced
- Charitable Organizations
 - Evaluate recovery of charitable contributions or gifts
 - Consider collectability, costs and optics
- Brokers and Sales Agents
 - Consider recovery of commissions paid to brokers
 - Compare amounts paid to market rates
 - Consider collectability
 - Identify investors that given broker solicited
- Insurance
 - Obtain copies of all insurance policies
 - Review all applicable insurance policies to evaluate possible insurance coverage
 - Take note of exceptions when preparing litigation claims

VIII. Organizing the Litigation Investigation

A. Assembling a Team

- Lawyers
 - General counsel v. litigation counsel
 - Flexible fee arrangements
- Forensic accountants
 - Investigative work
 - Litigation support experience
 - Expert witness experience
- Financial Advisors

- Auditors
- Investigators

B. Gathering Information

- Interviews
 - Principals
 - Employees
 - Investors
 - Auditor/Accountant
- Existing Records
 - Files on site
 - Storage facilities
 - Electronically stored information
 - Online access to bank records
 - Web-based stored records
 - Social media
- Third Party Records
 - Financial Institutions
 - Records from foreign financial institutions
 - Escrow companies
 - Investors
- Prior Professionals
 - Counsel
 - Accountants
 - Brokers
- Drafting subpoenas

C. Preliminary Issues for Counsel

- Administrative Issues
 - Employ counsel
 - Establish budget and staffing
- Employee Issues
 - Ensure litigation holds are in place
 - Preserve testimony and records
- Evaluate pending litigation
 - Stay litigation against Debtor
 - Evaluate litigation in which Debtor is a plaintiff
- Evaluate available insurance before making allegations in reports, disclosure statements or litigation; coordinate with litigation counsel
 - Directors and Officers

- Malpractice
- Liability
- Attorney-client privilege issues
 - On company computers
 - In information obtained from prior counsel
- Personally identifiable information
- Evaluate costs of litigation

D. Discovery and Evidence

- Know your forum
 - Federal court
 - State court
 - Arbitration
- Map out a discovery plan
- Electronically stored information
 - Where to find it
 - How to preserve it
 - The scope of discovery requests
- Social Media
 - Business v. personal sites
- Where to look for hidden assets
 - Public searches
 - Bank records
 - Real estate records
 - Tax returns
 - Credit card statements
- Chain of custody issues
- Privacy and Protective Orders
- Depositions
 - Percipient witnesses
 - Expert witnesses

IX. Fraudulent Transfer Claims

A. Identify the transfers

B. Create a database

- Identify relevant accounts
- Obtain data from bank, credit and investment statements
- Create appropriate fields for the database
- Create an index

- C. Analyze the data
 - Tracing funds
 - Dealing with commingled funds
 - Sort to identify transferees
 - Locate relevant related documentation
 - Identify subsequent transferees

- D. Elements of the Claim
 - Actual fraudulent transfer claims
 - Constructive fraudulent transfer claims
 - Ponzi scheme presumption
 - Good faith defense

- E. Targets of fraudulent transfer claims
 - Net winners
 - Brokers commissions
 - Insiders
 - Friends and family

- X. Other Litigation Issues
 - A. Standing
 - Claim belonging to estate
 - Individual claims

 - B. *In Pari Delicto*

 - C. Related Class Actions

 - D. Types of third-party litigation claims
 - Breach of Fiduciary Duty
 - Negligence
 - Negligent Misrepresentation/ Negligent Supervision
 - Malpractice and Professional Negligence
 - Fraud/Fraudulent Misrepresentation or Concealment
 - Aiding and Abetting Fraud
 - Aiding and Abetting Breach of Fiduciary Duty
 - Conspiracy
 - Conversion
 - Securities law violations
 - Deepening insolvency

XI. Expert Reports

- A. Assess the needs of the case
- B. Locate a qualified expert
 - Vetting the witness
 - References
 - Personal interview
- C. The engagement letter
 - Compensation
 - Confidentiality
- D. Define the scope of opinions needed for the expert report
- E. Assistance of counsel in preparing the expert report

XII. Issues in Operating Case

- A. Review cash flow
- B. Accounts receivable
- C. Inventory
- D. Employee files
- E. Credit card usage
- F. Types of fraud in operating business
 - Cash larceny
 - Embezzlement from accounts receivable
 - Billing fraud
 - Fraudulent expense reports
 - Financial statement fraud

XIII. Mediation and Settlement

- A. Confidentiality concerns
- B. Drafting settlement agreements

Stephen J. Donell, CPM[®], ARM[®], CCIM is President of Jalmar Properties, Inc., a full service real estate management/investment/brokerage firm, and is President of FedReceiver, Inc. both of which are based in Los Angeles, California. Mr. Donell has been active in various fields of real estate and business operations since 1984. Since that time, Mr. Donell has been involved in the acquisition, development, marketing, receivership and/or management of properties and businesses located throughout the country with a market value in excess of \$1 billion.

Since 1990, Mr. Donell has administered and/or been appointed as a receiver in more than 600 cases in state /US District Court. Mr. Donell has decades of experience in receivership matters involving residential and commercial real estate, asset and business operations and liquidations, oil and gas partnerships, post judgment enforcement actions, hotel/motel, assisted living facilities, single family and condominium construction completion/entitlements, gas station/c-stores, marital dissolutions, sub-standard housing as well as additional types of equity/specialty receivership appointments.

Mr. Donell has also administered and/or been appointed in federal court as receiver in actions filed by the United States Securities and Exchange Commission, the Federal Trade Commission and other government enforcement actions involving business fraud.

Mr. Donell, who is a California licensed real estate broker, is also President of Donell Expert Service, Inc. where he serves as a property management standard of care expert witness. Jalmar Properties, Inc. is a licensed broker in California, Arizona and Nevada. He authors articles and lectures frequently on the topic of state/federal court receivership matters, in 2013 completed his third consecutive year as the Co-President Los Angeles/Orange County chapter of the California Receivers Forum (CRF) and is a Past President of the National Association of Federal Equity Receivers (N.A.F.E.R.).



Since co-founding E3 Advisors in 2011, Krista Freitag and E3 Advisors have provided federal and state court receivership, trustee and advisory services for dozens of projects located throughout the United States. Such projects represent various asset classes including retail, hospitality, multi-family and single-family residential, assisted-living facilities, quick-service restaurants, industrial facilities, and raw land. Ms. Freitag has served as Receiver for retail assets alone exceeding \$300 million of asset value. She also has served or is currently serving as Receiver or Monitor in several United States Securities and Exchange Commission, Federal Trade Commission and Consumer Financial Protection Bureau cases representing nearly \$600 million of alleged fraudulent activity.

Prior to founding E3 Advisors, Ms. Freitag served as Managing Director and Consultant for Douglas Wilson Companies for nearly nine (9) years. Ms. Freitag provided project management, asset management, property management, accounting, forensic accounting, financial analysis, and homeowner's association services for dozens of clients, real estate assets and operating businesses throughout the United States. She provided project management services for receivership assets exceeding \$400 million of asset value and managed the disposition of nearly \$100 million worth of retail and operating business assets.

Before joining Douglas Wilson Companies, she worked as an Investment Manager for Brio Investment Group, where she managed and analyzed a multi-million dollar private investment portfolio, which primarily included multi-family, boutique hotel and private equity assets. Prior to joining BRIO Investment Group, she worked for the REIT, Burnham Pacific Properties, where she prepared and coordinated the company's SEC reporting, prepared and coordinated portfolio performance reports for management and outside investors, coordinated the quarterly and year-end audits and monitored and analyzed all leasing activity for the 100 property/2,000 tenant portfolio (including CalPER's managed portfolio).

Ms. Freitag holds a MS in Business Administration with a concentration in Finance from San Diego State University, a BS in Accounting from Northwestern Oklahoma State University, where she graduated Magna Cum Laude, and a Master Certificate in Essentials of Hospitality Management from Cornell University's School of Hotel Administration. Ms. Freitag is a member of the International Council of Shopping Centers and the California's Receivers Forum. She has served on the Board of Directors for two non-profit organizations and was a San Diego County 2009 Tribute to Women in Industry (TWIN) Award honoree.

CURRICULUM VITAE
THOMAS A. SEAMAN, CFA

3 PARK PLAZA, SUITE 550
IRVINE, CA 92614
TELEPHONE (949) 222-0551
E MAIL tom@thomasseaman.com

THOMAS A. SEAMAN IS PRINCIPAL AND SOLE SHAREHOLDER OF THOMAS SEAMAN COMPANY. MR. SEAMAN HAS SERVED AS A RECEIVER IN WELL OVER 200 MATTERS AND CURRENTLY SERVES AS RECEIVER IN 5 FEDERAL EQUITY RECEIVERSHIPS BROUGHT BY THE SEC OR THE FTC. MR. SEAMAN BRINGS HIS SKILL AS A CHARTERED FINANCIAL ANALYST TO HIS ASSIGNMENTS. MR. SEAMAN HAS THE CAPABILITY TO MANAGE AND ADMINISTER A BROAD RANGE OF ASSET CLASSES INCLUDING OPERATING COMPANIES, FINANCIAL ASSETS, REAL PROPERTY AND CONSTRUCTION PROJECTS.

MR. SEAMAN EARNED A BACHELOR OF SCIENCE DEGREE IN FINANCE FROM THE UNIVERSITY OF ILLINOIS IN 1979 AND THE INSOLVENCY ARENA IN 1989 WORKING AFTER SERVING AS A CONTROLLER AND CHIEF FINANCIAL OFFICER IN THE AEROSPACE INDUSTRY. MR. SEAMAN WAS GRANTED A CHARTERED FINANCIAL ANALYST DESIGNATION IN 1993. MR. SEAMAN HAS 40 YEARS' BUSINESS EXPERIENCE, BOTH IN PRIVATE INDUSTRY AND AS A COURT-APPOINTED FIDUCIARY.

MR. SEAMAN HAS MANAGED AND DISPOSED OF MYRIAD ASSETS INCLUDING SEVERAL OPERATING COMPANIES, TROUBLED REAL ESTATE ASSETS OF NEARLY EVERY ASSET CLASS, SENIOR LIVING PROJECTS, LAND, PARTNERSHIP INTERESTS, EVEN A NUCLEAR ACCELERATOR AND THE LARGEST YACHT THEN IN NEWPORT BEACH, AMONG OTHERS.

MR. SEAMAN'S FINANCIAL SKILLS HAVE ALSO BEEN EMPLOYED BY THE COURT AND LITIGANTS TO SUPPORT THE UNDERLYING LITIGATION AND HAVE RESULTED IN THE GRANTING OF MOTIONS FOR SUMMARY JUDGMENT AND CRIMINAL INDICTMENTS. IN MATTERS WHERE THE BUSINESS IS VIABLE AND OPERATIONS ARE CONTINUED, MR. SEAMAN IS ABLE TO EXERT FINANCIAL CONTROL OVER AND OPERATE THE ENTITY.

IN RENTS AND PROFITS MATTERS, MR. SEAMAN HAS RESOLVED PROBLEMS WITH ENTITLEMENTS, COMPLETION, HEALTH & SAFETY VIOLATIONS, MARKETING, LEASING, MANAGEMENT, PLANT, ENVIRONMENTAL, SEISMIC, EMINENT DOMAIN, AND OTHER ISSUES AFFECTING REAL ESTATE.

MR. SEAMAN'S FIRM IS ALSO LICENSED BY THE STATE OF CALIFORNIA AS A REGISTERED INVESTMENT ADVISER AND AS A CALIFORNIA REAL ESTATE BROKER. MR. SEAMAN IS A MEMBER OF THE INSTITUTE OF CHARTERED FINANCIAL ANALYSTS, THE LOS ANGELES SOCIETY OF FINANCIAL ANALYSTS, THE CALIFORNIA RECEIVER'S FORUM, AND THE ORANGE COUNTY BAR ASSOCIATION, AS A NON-LAWYER AND IS A FOUNDING MEMBER OF THE NATIONAL ASSOCIATION OF FEDERAL EQUITY RECEIVERS.



Biography of Kathy Bazoian Phelps

Kathy Bazoian Phelps
Diamond McCarthy LLP
1999 Avenue of the Stars, Suite 1100
Los Angeles CA 90067
310-651-2997 (office)
310-488-4883 (cell)
kphelps@diamondmccarthy.com

Kathy Bazoian Phelps is lawyer at Diamond McCarthy LLP, a board director on three non-profit boards, and an author. She has been practicing law since 1991, with experience in bankruptcy law, fiduciary representation, and fraud litigation. She is particularly knowledgeable about fraud detection and the administration of Ponzi scheme cases in bankruptcies and receiverships. She has served as a bankruptcy trustee and federal equity receiver.

Kathy is a frequently requested speaker on topics ranging from bankruptcy, financial compliance, fraud detection, and Ponzi schemes. She applies her knowledge across a wide variety of industries ranging from financial institutions to real estate-related businesses.

Kathy's publications include the following:

- *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes*. co-authored with Hon. Steven Rhodes (Ret.) (LexisNexis® 2012)
- *Fraud and Forensics: Piercing Through the Deception in a Commercial Fraud Case*, co-author (American Bankruptcy Institute 2015)
- *Ponzi-Proof Your Investments: An Investor's Guide to Avoiding Ponzi Schemes and Other Fraudulent Scams* (IRR Publishing 2013)
- *The Depths of Deepening Insolvency: Damage Exposure For Officers, Directors and Others*, co-authored with Prof. Jack F. Williams (American Bankruptcy Institute 2013)
- Author of *The Ponzi Scheme Blog* at www.theponziscHEMEblog.com

In addition to her roles as lawyer, speaker and author, Kathy also serves as a mediator and is currently on the mediation and arbitration rosters for the Financial Industry Regulatory Authority, as well as the Bankruptcy Mediation Panel for the Central District of California and the Bankruptcy Mediation Panel for the District of Arizona.

1 ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP
2 DAVID R. ZARO (BAR NO. 124334)
PETER A. GRIFFIN (BAR NO. 306201)
3 865 South Figueroa Street, Suite 2800
Los Angeles, California 90017-2543
4 Phone: (213) 622-5555
Fax: (213) 620-8816
5 E-Mail: dzaro@allenmatkins.com
pgriffin@allenmatkins.com

6 EDWARD G. FATES (BAR NO. 227809)
7 501 West Broadway, 15th Floor
San Diego, California 92101-3541
8 Phone: (619) 233-1155
Fax: (619) 233-1158
9 E-Mail: tfates@allenmatkins.com

10 Attorneys for Temporary Receiver
THOMAS A. SEAMAN

11
12 **UNITED STATES DISTRICT COURT**
13 **CENTRAL DISTRICT OF CALIFORNIA**
14 **SOUTHERN DIVISION**

15 SECURITIES AND EXCHANGE
COMMISSION,

16 Plaintiff,

17 v.

18 EMILIO FRANCISCO; PDC CAPITAL
GROUP, LLC; CAFFE PRIMO
INTERNATIONAL, INC.; SAL SENIOR
19 LIVING, LP; SAL CARMICHAEL, LP; SAL
CITRUS HEIGHTS, LP; SAL KERN
20 CANYON, LP; SAL PHOENIX, LP; SAL
WESTGATE, LP; SUMMERPLACE AT
21 SARASOTA, LP; SUMMERPLACE AT
CLEARWATER, LP; SUMMERPLACE AT
22 CORRELL PALMS, LP; TRC TUCSON, LP;
23 CLEAR CURRENTS WEST, LP; CAFFE
PRIMO MANAGEMENT, LP; CAFFE
24 PRIMO MANAGEMENT 102, LP; CAFFE
PRIMO MANAGEMENT 103, LP; CAFFE
25 PRIMO MANAGEMENT 104, LP; CAFFE
PRIMO MANAGEMENT 105, LP; CAFFE
26 PRIMO MANAGEMENT 106, LP; CAFFE
PRIMO MANAGEMENT 107, LP; and
27 CAFFE PRIMO MANAGEMENT 108, LP,

28 Defendants.

Case No. 8:16-cv-02257-CJC-DFM

**TEMPORARY RECEIVER'S
FIRST REPORT AND
RECOMMENDATIONS**

Ctrm: 9B, 9th Floor
Judge: Hon. Cormac J. Carney

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I. INTRODUCTION

1
2 By order of this Court entered on January 5, 2017, Thomas A. Seaman
3 ("Temporary Receiver") was appointed temporary receiver for Defendants
4 PDC Capital Group, LLC ("PDC"); Caffe Primo International, Inc. ("Caffe Primo");
5 SAL Senior Living, LP ("SAL Senior Living"); SAL Carmichael, LP ("SAL
6 Carmichael"); SAL Citrus Heights, LP ("SAL Citrus Heights"); SAL Kern
7 Canyon, LP ("SAL Kern Canyon"); SAL Phoenix, LP ("SAL Phoenix"); SAL
8 Westgate, LP ("SAL Westgate"); Summerplace at Sarasota, LP ("Sarasota");
9 Summerplace at Clearwater, LP ("Clearwater"); Summerplace at Correll Palms, LP
10 ("Correll Palms"); TRC Tucson, LP ("TRC Tucson"); Clear Currents West, LP
11 ("Clear Currents"); Caffe Primo Management, LP ("CPM"); Caffe Primo
12 Management 102, LP ("CPM 102"); Caffe Primo Management 103, LP
13 ("CPM 103"); Caffe Primo Management 104, LP ("CPM 104"); Caffe Primo
14 Management 105, LP ("CPM 105"); Caffe Primo Management 106, LP
15 ("CPM 106"); Caffe Primo Management 107, LP ("CPM 107"); Caffe Primo
16 Management 108, LP ("CPM 108"); and their subsidiaries and affiliates, including
17 but not limited to, Summerplace Management, LLC ("Summerplace Management");
18 PDC Partners Management, Inc. ("PDC PM"); and FDC Partners Management, Inc.
19 ("FDC PM"), (collectively, "Receivership Entities"), with full powers of an equity
20 receiver, including, but not limited to, full power over all assets and property
21 belonging to, being managed by or in the possession or control of the Receivership
22 Entities, and was immediately authorized, empowered and directed to take certain
23 actions as set forth in the Temporary Restraining Order ("TRO"). Dkt. No. 17. This
24 report contains a summary of work performed by the Temporary Receiver thus far,
25 as well as his preliminary observations and recommendations.

26 Pursuant to the TRO, the Temporary Receiver has been charged with, among
27 other things, (1) assuming control over the Receivership Entities and their assets
28 ("Receivership Assets"), (2) performing an accounting of the assets and financial

1 condition of the Receivership Entities, (3) investigating, locating, and recovering
2 Receivership Assets, (4) pursuing claims and causes of action of the Receivership
3 Entities, and (5) preparing reports for the Court.

4 This is a preliminary report based upon the information available to date. If
5 the Temporary Receiver is appointed as Permanent Receiver, he will continue his
6 investigation which may result in the modification of the contents of this
7 preliminary report. As discussed below, if appointed as Permanent Receiver,
8 Mr. Seaman proposes to file interim reports on a quarterly basis and also plans to
9 file a special report and recommendation relating to one of the assisted living
10 projects in the next two weeks.

11 II. EXECUTIVE SUMMARY

12 This receivership involves a complex and wide ranging group of enterprises
13 and assets, which raised money from approximately 137 investors, each of whom
14 invested \$500,000 as EB-5 Immigrant Investor applicants ("EB-5 Investors") and
15 paid an administrative fee of approximately \$50,000 seeking permanent residency in
16 the United States. The EB-5 Investor funds were to be invested in various projects
17 including assisted living real estate developments or certain Caffe Primo restaurants,
18 with the intention that each investment would result in the creation of 10 jobs.
19 There is also one project outside the assisted living projects and the restaurants,
20 known as Clear Currents, which is purportedly a green products company.

21 None of the assisted living developments are operational. Construction for
22 one project – the TRC Tucson project (a skilled nursing facility) – has reportedly
23 been completed and the project obtained a Certificate of Occupancy in
24 December 2016. The project is co-owned with an entity named Sante Partners that
25 has operational responsibility for the project, and whose efforts to open the facility
26 the Temporary Receiver has been supporting. While the hope is that the facility will
27 be able to accept patients in the coming months, the facility is not expected to
28

1 generate returns for a year, yet appears to have adequate capital and financing in
2 place to support operations for a year or possibly more.

3 In addition, the Lincoln project appears to be a viable project. Site
4 preparation is underway and, if bond financing proceeds, then it appears possible
5 that the project may be successfully completed.

6 Other assisted living projects may also be viable, but currently lack funding
7 and/or are behind schedule. Some of the projects that have already obtained
8 construction financing are facing default. Overall, most of the other assisted living
9 projects face serious obstacles to completion or commencing operations. Some of
10 the EB-5 Investors' money has not been made available to the projects and there are
11 no funds in the escrow accounts that received EB-5 Investor funds. More
12 information on each project is provided below.

13 With respect to the Caffe Primo restaurants, none of the eight projects are
14 solvent. Two have been forced to closed, two are about to fail, and four have not
15 been completed and never opened. An immediate sale or significant capital infusion
16 would be required to save the eight restaurants. Most of the restaurants were
17 capitalized with \$1,500,000 of EB-5 Investor funds, which should have been
18 sufficient to build out and bring the restaurants to stability. Every lease is in default
19 in addition to significant current liabilities, including unpaid payroll, unpaid payroll
20 taxes on prior pay checks, unpaid sales taxes, and unpaid food vendors, utilities, and
21 suppliers. The total amount turned over from Caffe Primo frozen accounts thus far
22 is \$31,000. The status of the restaurants is discussed in further detail below.

23 Finally, the Clear Currents project is the subject of litigation and is not
24 producing returns for investors.

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1 **III. SUMMARY OF TEMPORARY RECEIVER'S ACTIVITIES**

2 **A. Securing and Taking Control of Assets**

3 1. Company Offices

4 On January 5, 2017, the Temporary Receiver took control and possession of
5 the premises located at 250 Fischer Avenue, Costa Mesa, California ("Company
6 Offices"), a stand-alone one-story building containing a suite of offices. Several
7 people were present in the Company Offices at the time of the takeover, but none
8 claimed to be employees of the Receivership Entities, with the exception of one
9 paralegal. The Receivership Entities share the Company Offices with several other
10 entities, including the law firm of Marilyn Thomassen & Associates ("Thomassen
11 Law Firm") and a company called Uniglobe Aerospace, which appears to be run by
12 Defendant Emilio Francisco and his brother, Joseph Francisco.

13 With the exception of the one paralegal, all personnel present at the Company
14 Offices, including the in-house accountant for the EB-5 fund raising entities and the
15 related projects, stated they were not employees of the Receivership Entities, but
16 rather of the Thomassen Law Firm. Some of these employees perform debt relief
17 services, which do not appear to be related the Receivership Entities' enterprises.
18 There were also employees of Uniglobe Aerospace that work in a separate area of
19 the building.

20 The in-house accountant and EB-5 staff, located within the Thomassen Law
21 Firm offices, stated that they were managed by and took direction from PDC and
22 KPF Capital, LLC through Emilio Francisco, Robert Ferrante and Eric Bronk,
23 believed to be counsel to PDC and KPF, but were employees of the Thomassen Law
24 Firm. The accountant stated that all EB-5 Investor funds were initially received into
25 Marilyn Thomassen's trust accounts, then transferred to her personal or firm

1 account.¹ The accountant further stated that the funds were then paid to the projects'
2 limited partnership accounts and then to the LLC accounts established for each of
3 the projects. The tracking of EB-5 Investor funds received by the Thomassen Law
4 Firm and then paid to the various LPs and LLCs established for the projects was
5 performed by the in-house accountant and the banking records are located at the
6 Company Offices.

7 There is an unrelated landscaping company that shares the Company Offices
8 with the Receivership Entities. As noted above, Mr. Francisco and his brother
9 operate another entity in the building, Uniglobe Aerospace, an aerospace parts
10 distributor, whose finances do not appear to be related the PDC Capital enterprise.
11 Mr. Francisco's other brother also maintains an office at the building.

12 The Company Offices appeared to have been largely cleaned out in that most
13 of the file cabinets in the Receivership Entities' space were empty and copies of
14 remaining documents had been placed into a series of binders containing documents
15 relating to corporate formation, due diligence and acquisition of the properties,
16 project documents, and documents provided to EB-5 Investors. A sign in the
17 women's bathroom instructed employees not to empty waste from the paper
18 shredder into the garbage in the bathroom, but to take the waste directly to the
19 dumpster.

20 Upon the takeover of the office premises, the Temporary Receiver's IT
21 consultants eliminated external access to the Receivership Entities' computer
22 systems and conducted an orderly shut-down of the computer systems. The IT
23 consultants then conducted a bit stream back-up of all digital information located at
24 the Company Offices. The bit stream back-up is a forensically sound and

25

26

27 ¹ The funds appear to have been moved between accounts controlled by
28 Ms. Thomassen. There were no funds in the escrow accounts at the time of the
Receiver's appointment.

1 unalterable image of the digital information as it existed upon the appointment of a
2 temporary receiver.

3 2. Interview with Mr. Francisco

4 Defendant Emilio Francisco was not present when the Temporary Receiver
5 took control of the Company Offices; however, on January 11, 2017, the Temporary
6 Receiver and counsel met with Mr. Francisco and his counsel to discuss a variety of
7 issues. The meeting lasted only about 1½ hours because Mr. Francisco was leaving
8 on a flight to Brazil. Mr. Francisco offered to meet again when he returned from
9 Brazil, but was not sure exactly when he was returning (he indicated it would be a
10 few weeks.)

11 The meeting focused primarily on the Temporary Receiver's efforts to gain
12 information as to the operations of the Receivership Entities, identifying assets, and
13 understanding certain transactions. Given the limited time and Mr. Francisco's lack
14 of knowledge, the Temporary Receiver was left with a lot of questions. The
15 information gathered from Mr. Francisco clarified a few issues and did assist in the
16 Temporary Receiver's better understanding of the enterprise. The project-specific
17 information has been integrated into appropriate sections of this Report.

18 Prior to concluding of the meeting, Mr. Francisco indicated he had two non-
19 project related matters he wished to convey to the Temporary Receiver. First, he
20 indicated his brother, Joseph Francisco, was not involved in the PDC enterprise, but
21 rather just signed documents as a favor to Mr. Francisco. The Temporary Receiver
22 asked if it was appropriate to call Joseph Francisco the surrogate of Emilio
23 Francisco, and Mr. Francisco agreed.² Second, Mr. Francisco said his daughter and
24 he did not steal any money. Specifically, he indicated the credit card in his
25 daughter's name was used by Mr. Francisco, not his daughter. This was done

26
27
28 ² Joseph Francisco is the signer on several accounts and his expertise is cited in the PPMs provided to EB-5 Investors.

1 because at some point, Mr. Francisco needed a credit card and could not get one in
2 his own name.

3 3. Related Entities

4 Based on the Temporary Receiver's review of records, in addition to the
5 identified Receivership Entities, since 2014, the enterprise, including but not limited
6 to the purchase and sale of the real properties using the EB-Investors' money, was
7 managed and controlled through a series of affiliated corporate entities, which
8 appear have been managed, controlled, and/or owned by Mr. Francisco and Robert
9 Ferrante or their relatives and employees. These entities include, but are not limited
10 to: FCM Capital Partners, LLC; FCM Development Group, LLC; KPF Capital,
11 LLC; Trident Family Trust, and Angel Family Trust.

12 The Temporary Receiver went to KPF's office to meet with Mr. Fox and
13 Mr. Bronk (Mr. Bronk previously represented the PDC entities.) The KPF offices
14 are located a few blocks from the Company Offices. The Temporary Receiver
15 observed that the employees or personnel at KPF's offices consisted of many of the
16 same people who were either previously on PDC's payroll, were paid as independent
17 contractors, listed on PDC telephone lists, or had PDC email accounts.

18 The Temporary Receiver requested to image KPF's computers and to
19 interview Mr. Ferrante. KPF refused to allow the computers to be imaged. After
20 the meeting, however, KPF delivered certain binders of documents to the Company
21 Offices. The Temporary Receiver's request to image the computer's at KPF remains
22 outstanding. Mr. Ferrante's counsel has asked the Temporary Receiver to provide a
23 list of topics for Mr. Ferrante's interview prior to agreeing to produce Mr. Ferrante
24 (his counsel indicated that this was because of Mr. Ferrante's concerns related to tax
25 problems with the IRS.)

26 **B. Status of EB-5 Investor Applications**

27 There are 137 EB-5 Investors that invested approximately \$550,000 each,
28 \$500,000 of which was to be invested in the various projects and \$50,000 of which

1 was to be an administrative fee. The Temporary Receiver has met with the counsel
 2 and staff administering the EB-5 Investor applications. Based on records
 3 maintained on computers in Ms. Thomassen's office, the status of the EB-5 Investor
 4 applications with the USCIS can be summarized as follows:³

5	Approved I-529	4
6	Notice of Intent to Revoke	2
7	Applications withdrawn	3
8	Pending	54
9	Request for Evidence	20
10	Notice of Intent to Deny	2
11	Denied	37
12	Status unknown	15 ⁴

13 The Temporary Receiver plans to closely examine each of the projects to
 14 determine if it is feasible for it to continue and if they can be brought into
 15 compliance with the Private Placement Memoranda for the applicable offering such
 16 that the EB-5 Investors can continue to pursue their USCIS applications.

17 **C. Transfers of Assets to Affiliated Entities**

18 Prior to the agreements discussed below, the PDC entities appear to have been
 19 owned and/or controlled by Mr. Francisco and Robert Ferrante.

20 1. January Agreement

21 Attached hereto as **Exhibit A** is the Agreement dated as of January 1, 2016
 22 ("January Agreement") between The Angel Family Trust, Chanel Ferrante trustee,
 23 KPF Capital, LLC, a Delaware limited liability company and affiliated entities
 24

25 ³ The Temporary Receiver has not yet verified the current status of each of the
 26 applications with USCIS. As discussed below, however, the Temporary
 27 Receiver has met with the in-house immigration counsel at the Thomassen Law
 Firm and been in contact with outside retained EB-5 counsel.

28 ⁴ These EB-5 Investors are represented by law firms other than Marilyn
 Thomassen.

1 ("KPF"), Mr. Ferrante (collectively the "Ferrante Parties"), on the one hand, and
2 PDC, the Trident Family Trust, Joseph Francisco, Trustee, Emilio Francisco,
3 (collectively the "Francisco Parties"), on the other hand. Pursuant to the January
4 Agreement, PDC loaned KPF \$180,000. The January Agreement also provided that
5 the Ferrante Parties transfer their 50% interest in PDC to the Francisco Parties. In
6 exchange, the Francisco Parties transferred their interests in certain PDC, FDC, and
7 ADC projects to KPF set forth in Exhibit A to the January Agreement.⁵

8 Mr. Francisco stated during the Temporary Receiver's interview that the
9 Francisco Parties retained 100% ownership of the projects commonly known as
10 Lincoln, Carmichael, Citrus Heights, Kern Canyon, Westgate, Tucson and Sarasota.
11 In addition, the Francisco Parties retained 100% interest in the eight Caffé Primo
12 entities. According to Mr. Francisco, the balance of the projects on Exhibit A,
13 including Clearwater Orlando and Phoenix, were transferred to the Ferrante Parties.

14 Mr. Francisco also stated there was no valuation conducted with regard to
15 these projects in connection with the January Agreement and that they had more or
16 less divided the assets along geographic lines; with most of the Florida projects
17 going to the Ferrante Parties, while the Francisco Parties retained the California
18 projects along with those in Tucson, Arizona and Sarasota, Florida.

19 The January Agreement does not reflect how the EB-5 investors interests in
20 each of the projects will be treated, nor the reason for the transfer of \$180,000 from
21 PDC to KPF. It is further unclear how Mr. Ferrante or the Ferrante Parties became
22 the owners of KPF. Documents obtained and reviewed from PDC reflect that KPF
23 Capital, LLC was a "subsidiary of PDC Capital Group, LLC." However, the
24 Temporary Receiver has received documents from counsel for MSL that he is
25 reviewing which may address this issue. Mr. Francisco did state during his
26 interview that the FDC and ADC entities were affiliates of PDC and that they had

27 _____
28 ⁵ It should be noted that the Temporary Receiver has two signed versions of the
January Agreement with different charts attached.

1 simply used the "F" [FDC] and "A" [ADC] to delineate the geographic location of
2 the project as being in Arizona or Florida.

3 While the Temporary Receiver has only begun collecting and examining
4 records, his preliminary analysis of records recovered from PDC reflect significant
5 commingling among these various project related entities, including but not limited
6 to the projects transferred pursuant to the January Agreement (*i.e.*, the Sarasota,
7 Tucson, and Phoenix Projects.) The commingling and inter-company transfers are
8 discussed further below. There is no indication the parties to the January Agreement
9 took into account the transfer of EB-5 Investor funds into and among the various
10 projects. There appears to have been no accounting or valuation of projects to
11 address the transfer of EB-5 Investor funds into and among the projects at the time
12 these interests were divided and purportedly transferred between the Francisco
13 Parties and the Ferrante Parties.

14 2. May Agreement

15 Pursuant to an agreement dated May 20, 2016 (the "May Agreement"), a copy
16 of which is attached hereto as **Exhibit B**, PDC and PDC Capital Partners, LLC
17 (collectively "PDC") purportedly transferred to MSL US Fund I ("MSL"), PDC's
18 interests in the following projects: Lincoln, Carmichael, Kern Canyon, Westgate,
19 Citrus Heights, and Lincoln Village I (the "California Projects"). The Temporary
20 Receiver has raised a number of questions in connection with the May Agreement
21 and has received documents and information from counsel for MSL. The
22 Temporary Receiver is reviewing these documents and records and looks forward to
23 further communication and interaction with MSL as to each of the California
24 Projects.

25 Mr. Francisco stated that PDC was unable to obtain financing to develop the
26 California Projects. Accordingly, Mr. Francisco said that PDC's interests were
27 transferred out of PDC so they could obtain financing for the construction of the
28 proposed senior living facilities. The Temporary Receiver has raised concerns

1 regarding the consideration for the transaction as well as MSL's ability to comply
2 with the original PPM's, and how the interests of PDC and the EB-5 Investors are
3 being protected. Again, counsel for MSL has provided documents and information
4 in an effort to address the Temporary Receiver's concerns, which he is reviewing.
5 The Temporary Receiver is further exploring the impact of the commingling of
6 EB-5 Investor and PDC funds as to the California Projects and EB-5 investors
7 interest in the transferred projects.

8 **D. Commingling and Insider Transactions**

9 At this early stage of the receivership, the Temporary Receiver has already
10 observed significant commingling of funds between and among the Receivership
11 Entities for the various senior living and Caffe Primo projects. This may have
12 resulted from the severe liquidity issues facing many of the projects.

- 13 • Summerplace at Sarasota, LLC. EB-5 Investors invested \$11 million in
14 SAL Sarasota, L.P., only \$4.9 million of which was paid to Summerplace
15 at Sarasota, LLC (the project LLC). The remaining \$6.1 million was
16 transferred to other projects or affiliates. A portion of the land purchased
17 by Summerplace at Sarasota, LLC was later sold and FDC Capital Partners
18 received \$6.483 million, but Summerplace at Sarasota, LLC (the project
19 LLC) did not receive any of the sale proceeds. FDC used \$2.2 million of
20 the funds to purchase an ammunitions company in Montana called
21 Prograde, which is not an EB-5 Investor project. FDC appears to have
22 retained \$250,000 for its own uses. The balance of approximately
23 \$4 million was transferred to the Thomassen trust account and disbursed to
24 several other assisted living and Caffe Primo projects, with none going to
25 Summerplace at Sarasota, LLC.
- 26 • It appears an entity affiliated with Mr. Francisco and the Receivership
27 Entities – FCM Development Group, LLC ("FCMDG") – was involved in
28 purchasing the land for several of the assisted living projects and selling

1 the same land to the LLCs for the projects shortly thereafter. For example,
2 for the Westgate project, the purchase and sale documents located at the
3 Company Offices indicate FCMDG bought the property for \$1.95 million
4 in April 2014 and then sold the property to SAL Westgate, LLC for
5 \$5.45 million in June 2014. FCMDG is also shown as the seller/grantor on
6 the grant deed for the Citrus Heights property. Mr. Francisco's brother,
7 Joseph Francisco, signed documents as Managing Member of FCMDG.

- 8 • All of the Caffè Primo balance sheets reflect amounts due to and from
9 other Caffè Primo entities. This suggests funds were transferred between
10 restaurants with liquidity needs.
- 11 • The Caffè Primo entities made payments to FCMDG, which then made
12 payments for what appear to be Mr. Ferrante's personal expenses,
13 including school tuition and bankruptcy counsel fees, which were
14 accounted for as pre-development expenses.
- 15 • Some of the funds received from EB-5 Investors for one project were
16 transferred to other projects.

17 **E. Status of Assisted Living Projects**

18 The Defendants and their affiliated entities purchased various undeveloped
19 properties for the purpose of developing them into senior living facilities.
20 Defendants raised funds from EB-5 Investors which were intended to be used as the
21 equity required to obtain loans to fund the development of the senior living
22 facilities. Investor funds were initially transferred to an escrow account maintained
23 by the Thomassen Law Firm. From there, the funds appear to have been moved
24 between different accounts controlled by Marilyn Thomassen (there appear to have
25 been at least 10 bank accounts used), and then transferred to the limited partnership
26 ("LP") established for the senior living project, such as SAL Westgate, L.P. PDC
27 was the general partner of the LP and the EB-5 Investors were limited partners.
28 PDC Capital retained 90% of the equity in the LPs, although it does not appear to

1 have contributed any capital. The LP would then make an unsecured loan to the
2 LLC established to hold the property for development of the senior living facility.
3 Like the LPs, the LLCs bore the name of the project, such as SAL Westgate, LLC.
4 PDC Partners Management was the managing member of the LLCs. The
5 information the Temporary Receiver has been able to gather so far about each of the
6 senior living projects is as follows:

7 **Tuscon TRC.** Construction of this skilled nursing facility ("SNF") was
8 completed on November 30, 2016. The project is jointly owned with a healthcare
9 developer and operator (Sante Partners). The SNF has applied for licensure and a
10 Medicare certificate. Licensing approval is expected in February, which will
11 reportedly lead to licensing conducting a survey with the ability to take patients and
12 operate as a SNF in March.

13 There are unused HUD construction funds in the amount of approximately
14 \$3,000,000 to fund operating losses during the ramp-up period. The SNF is
15 expected to reach break-even occupancy in one year. The Temporary Receiver
16 supports continuation of this project given that appropriate fiscal controls are in
17 place for the HUD loan proceeds.

18 **SAL Phoenix.** This project is for the conversion of an office building to a
19 189 unit senior living facility providing assisted living, memory care, and skilled
20 nursing services. The office building was purchased for \$8.89 million, comprised of
21 a note carried by the seller in the amount of approximately \$1.3 million, which
22 matures in March, 2017, a hard money loan of \$4.8 million, which also matures in
23 March 2017, and \$3.29 million from SAL Phoenix, LP. The joint owner (Sante
24 Partners) has made the first loan payments to avoid default. The EB-5 Investors
25 invested \$7,500,000 into SAL Phoenix, LP; however, the project accounting records
26 indicate only \$4.768 million was provided to the project.

27 **Lincoln.** One of the EB-5 investments offered by PDC was SAL Assisted
28 Living, LP. The offering was for 12 units at \$545,000 per unit. The PPM described

1 the investment as one in which the EB-5 investors' \$6 million would be used to
2 develop a 190 unit, 228 bed senior living and memory care facility in Lincoln,
3 California.

4 Upon his appointment, the Temporary Receiver learned of a \$5,000,000
5 construction loan from MCC US, Inc. to SLALMC, LLC dba Summerplace at
6 Lincoln, the Receivership Entity that owns the property. The loan, which was taken
7 on December 2, 2016, has a 90-day term and would be repaid from the proceeds of a
8 contemplated bond offering to finance the construction and initial operating deficits.
9 The funds appear to have been used at least in part for architectural fees and grading
10 of the site. The Temporary Receiver has asked counsel for MSL to provide an
11 accounting of the uses of the loan proceeds and to turn over the unused proceeds.
12 An accounting has not yet been provided and \$2.31 million was turned over to the
13 Temporary Receiver. The Temporary Receiver has been communicating with
14 existing developer's counsel and one of the principals of the developer. In addition,
15 the Temporary Receiver has met with counsel for BB&T Capital Markets and the
16 BB&T Managing Director responsible for the underwriting of the below-described
17 bonds.

18 Based upon the Temporary Receiver's preliminary investigation, it appears
19 the Lincoln project has received funding or financing from the EB-5 Investors
20 (\$6 million) and the short-term loan from MCC US, Inc. (\$5 million). Grading and
21 site work for the project may have begun in or around September 2016 and is
22 continuing at the present time. Financing for completion of construction of the
23 Lincoln Project will be through the issuance of Series 2016 A-I Bonds totaling
24 approximately \$53 million. The Bonds will be issued by the California Statewide
25 Communities Development Authority. The Bond funds will be used to fund the
26 loan to finance the construction and initial operations of the Lincoln Project.

27 The Temporary Receiver is in discussions with the identified developer,
28 MPoint Land and Development and its affiliates with regard to the development. In

1 particular, the Temporary Receiver is focused on securing permanent financing and
2 understanding and establishing controls with regard over the construction financing,
3 repayment of PDC related and the EB-5 investors. While all parties have been
4 cooperative, the Temporary Receiver continues to obtain and review important
5 information as it is received from counsel and the parties.

6 The Temporary Receiver currently supports the Lincoln Project and has been
7 working with all parties toward the issuance of the Bonds and completion of a
8 successful project. It is important to note that the success of the Lincoln Project will
9 play an important role as to the success of the applications of the 12 EB-5 investors
10 who each contributed \$500,000 in capital to the project. If appointed as Permanent
11 Receiver, Mr. Seaman plans to file a report and recommendation specific to the
12 Lincoln project and proposed bond financing in the coming weeks.

13 **Lincoln Village IL** (*i.e.* independent living). These are undeveloped parcels
14 adjacent to the Lincoln project. Loans were taken against the property and on
15 January 19, 2017, the Temporary Receiver received notices of default on loans that
16 appear to have matured in December 2016.

17 **Clearwater.** This is a five-acre parcel of land originally acquired to be
18 developed as an assisted living facility. The Defendants apparently determined that
19 an assisted living facility was not feasible and have reported receiving an offer to
20 purchase three of the five acres for \$1.91 million. The Temporary Receiver has
21 been asked to consent to the sale. The Temporary Receiver is conducting due
22 diligence in order to be able to make a recommendation to the Court.

23 **Carmichael.** This project is for the development of a 130 unit assisted living
24 facility in Carmichael, California. EB-5 Investors invested \$5,000,000 into the
25 project. FCM bought the land for \$1,000,000 in June 2013 and sold the land to SAL
26 Carmichael for \$1.9 million in July 2015. A debt owed to Neil Richardson, a
27 partner of the Defendants, was assumed by SAL Carmichael in connection with a
28 resolution of a tri-party dispute between PDC, FCM Capital Partners, and Neil

1 Richardson. However, the deed of trust was recorded against the SAL Westgate
2 project, discussed below.

3 SAL Carmichael borrowed \$650,000 on December 8, 2016, secured by a deed
4 of trust on the property. The Temporary Receiver has not located the proceeds of
5 the loan and is issuing a subpoena to the lender to determine the recipient of the loan
6 proceeds.

7 **Westgate.** This a 6.72 acre site to be developed as a 94 unit assisted living
8 and 80 unit memory care facility. EB-5 Investors invested \$5,000,000. FCM
9 bought the land for \$1,950,000 in April 2014. Two months later, FCM transferred
10 the property to SAL Westgate for \$5,450,000. A portion of the \$5.45 million on
11 SAL Westgate's balance sheet reflects a recorded deed of trust for the
12 aforementioned loan payable to Neil Richardson for \$2,000,000, which is to be
13 repaid upon a refinance or sale of the project. The transfer also includes payments
14 of \$1,500,000 to PDC for purported pre-operating expenses that had been
15 capitalized. It appears architecture work has been performed on the project.

16 **Citrus Heights.** The EB-5 Investors invested \$5,500,000 in this project,
17 which is for the development of 109 unit assisted living and memory care facility in
18 Citrus Heights, California. A loan was taken on the property for \$850,000 on
19 December 8, 2016. The Temporary Receiver has not located the proceeds of the
20 loan and issuing a subpoena to the lender to determine the recipient of the loan
21 proceeds.

22 **Kern Canyon.** EB-5 investors invested \$5,000,000 in this project. A loan
23 was taken on the project for \$1,200,000 on December 8, 2016. The Temporary
24 Receiver has not located the proceeds of the loan and is issuing a subpoena to the
25 lender to determine the recipient of the loan proceeds.

26 **Other Assisted Living Projects.** There is evidence of other assisted living
27 projects not listed above, including large loans taken on the projects. The
28 Temporary Receiver's investigation of these projects is ongoing.

1 **F. Status of Caffe Primo Restaurants**

2 The Caffe Primo restaurants are all located in desirable, high traffic areas, but
3 all appear to have been grossly mismanaged since the creation of the project LLCs
4 that operate them. The restaurants were capitalized entirely with EB-5 Investor
5 funds through loans made from the LPs to the project LLCs. However, as noted
6 above, rather than properly funding the construction of the restaurants and the
7 working capital needs, investor funds were diverted to FCMDG purportedly for
8 capitalized pre-development costs. Funds were also diverted for the personal use of
9 Mr. Ferrante. This left insufficient funding for construction and caused occupancy
10 and commencement deadlines to be missed. To preserve the leases, the restaurants
11 started paying rent before they opened, thus further depleting working capital. In
12 addition, Mr. Francisco stated the previous manager for the restaurants embezzled
13 funds, although this has not yet been confirmed. In order to meet current liquidity
14 needs, funds were commingled among the troubled restaurants. It appears the
15 restaurants have never recovered from inadequate funding.

16 **Caffe Primo 101, Santa Barbara.** The landlord obtained an unlawful
17 detainer judgment and writ of possession just prior to the appointment of the
18 Temporary Receiver. The Temporary Receiver gave notice of the stay contained in
19 the TRO to the landlord so the Temporary Receiver could determine the viability of
20 the restaurant.

21 The amount of cash on hand as of the time of the TRO was \$9,800. Since
22 then, there have been additional receipts of \$15,000. Approximately \$25,000 was
23 turned over to the Temporary Receiver from the frozen accounts on January 19,
24 2017. The Temporary Receiver used the funds to pay the employees for their pay
25 checks that were due on January 13, 2017. For the time being the restaurant is
26 operating; however, it is clear the restaurant is completely insolvent. The past due
27 rent is approximately \$65,000 and is delinquent over four months. The restaurant
28 also failed to pay employee payroll taxes that it withheld from employee pay checks

1 prior to that time. There also unpaid sales taxes and unpaid vendors. An immediate
2 cash infusion of \$200,000 would be required to pay these critical liabilities and
3 restore operations. Accordingly, there appears to be no viable path forward for the
4 restaurant.

5 The landlord filed a response to the OSC asking that the Temporary Receiver
6 make a decision no later than January 30, 2017 as to whether to assume or reject the
7 lease. Dkt. No. 20. If appointed, the Temporary Receiver will discuss a stipulation
8 to lift the stay of legal proceedings as to this location with counsel for the Securities
9 and Exchange Commission and counsel for the landlord and focus on preserving the
10 value of the fixed assets.

11 **Caffe Primo 102, San Diego.** This restaurant failed on November 3, 2016.
12 Before closing, Caffe Primo 102's operations were subsidized by the other
13 restaurants, as discussed above. The Temporary Receiver estimates that a cash
14 infusion of \$150,000 would be required to reopen the restaurant, and another
15 \$100,000 would be required to fund working capital and ramping up to stability.

16 The Temporary Receiver was initially informed that the landlord indicated a
17 willingness to negotiate a solution, but then withdrew the offer to forebear. On
18 January 19, 2017, the Temporary Receiver's counsel was contacted by the landlord
19 and informed that the landlord had obtained a writ of possession and had executed
20 on the writ, retaking possession of the space on January 18, 2017. The Temporary
21 Receiver was not aware that an unlawful detainer complaint had been filed, which
22 would had to have occurred prior to his appointment in order for a writ of
23 possession to be issued and executed on as of January 18, 2017. The Temporary
24 Receiver has requested copies of the complaint, writ of possession, and other court
25 documents and is looking into whether the documents were properly served on
26 Caffe Primo 102.

27 **Caffe Primo 103, Santa Monica.** Construction of this restaurant has not
28 been completed, notwithstanding that the lease was executed on April 18, 2014 with

1 an amended commencement date of February 1, 2016. The landlord is owed
2 \$120,000 and has instituted an unlawful detainer action. Work costing \$40,000
3 would be required to obtain a Certificate of Occupancy, with another \$100,000 for
4 dishes, inventory, and working capital. The tenant is entitled to reimbursement of
5 \$130,000 for tenant improvement costs from the landlord; however, the landlord
6 would likely seek to offset the tenant improvement allowance by its alleged
7 damages.

8 **Caffe Primo 104, Anaheim.** The landlord is owed \$55,000. There are
9 unpaid payroll taxes and vendors. Prior sales taxes collected from customers have
10 not been paid. The bank account is overdrawn. The unpaid critical liabilities
11 exceed \$150,000. The restaurant has a liquor license and has been operationally
12 profitable at times, but is deeply underwater.

13 **Caffe Primo 105, Figueroa Street, Los Angeles.** Construction of this
14 restaurant has not been completed. The contractor is owed \$150,000. The landlord
15 is owed \$100,000 and has instituted an unlawful detainer action. Rent continues to
16 accrue at \$22,637.50 per month.

17 **Caffe Primo 106, Woodland Hills.** Construction of this restaurant is not
18 complete. \$100,000 would be required to complete construction. \$300,000 is
19 needed for furniture and equipment. \$50,000 would be needed for inventory, dishes,
20 and staffing. Monthly rent of \$18,200 commenced on January 1, 2017 and has not
21 been paid. The Temporary Receiver has received a proposal to buy the restaurant.
22 The buyer would inject \$500,000 and agree to fund an additional \$150,000 in
23 exchange for an 80% ownership interest in the restaurant. The interests of Caffe
24 Primo International, Inc. and PDC would be extinguished and the EB-5 Investors
25 loan would convert to a 20% equity interest. The Temporary Receiver is evaluating
26 the offer.

27 **Caffe Primo 107, Arizona Street, Santa Monica.** This is a very desirable
28 Santa Monica location, but the space has not been built. The rent is already in

1 arrears by \$36,000. A capital investment of \$333,000 to build out the space,
2 purchase inventory and dishes, bring the lease current, and for staffing costs would
3 be required to open the restaurant.

4 **Caffe Primo 110 (formerly Caffe Primo 108), Sunset Blvd.** The restaurant
5 closed in December because the electricity was shut-off.

6 **G. Clear Currents West, LLC**

7 There were few records located with regards to the Receivership Entity called
8 Clear Currents West, LLC ("Clear Currents") at the premises. During the
9 Temporary Receiver's interview, Mr. Francisco stated that PDC's interest in Clear
10 Currents was based upon two EB-5 Investors, who put in \$500,000 each, plus an
11 investment by PDC of \$300,000. These funds apparently went into the development
12 of a manufacturing facility in Northern California and into the effort to obtain a
13 license to market and sell Clear Currents' products in China. The Clear Currents
14 enterprise was described by Mr. Francisco as a 50/50 joint venture with Clear
15 Currents, Inc. To date, the Temporary Receiver has not been able to verify any of
16 the foregoing information.

17 Based on discussions with Mr. Francisco and a review of the records located
18 at the premises, there appears to be a number of disputes regarding Clear Currents'
19 business, including but not limited to the rights to the product produced and the
20 conversion or diversion of assets. The Temporary Receiver is pursuing information
21 regarding this from counsel as well as from the records of the Receivership Entities.

22 **H. Books and records**

23 The Temporary Receiver's document recovery and analysis efforts are in the
24 very early stages. The Defendants enterprise is comprised of the named
25 Receivership Entities and many other subsidiaries and affiliates whose finances and
26 relationships appear to be closely intertwined. Quickbooks files immediately
27 available to the Temporary Receiver appear to have been reconstructed over the
28 course of the last 11 months. Most of the entries are comprised of summary journal

1 entries and not the actual receipts, disbursements, and transfers of cash of the
2 entities. A prior single version of a Quickbooks file, consolidating the finances of
3 the various entities was identified and was in use through August 2016. The
4 Temporary Receiver cannot rely on the defendant's Quickbooks with certainty.

5 **I. Funds Recovered to Date**

6 As noted above, the Temporary Receiver has taken control of numerous bank
7 accounts and funds of the Receivership Entities. To date, the Temporary Receiver
8 has taken possession of approximately \$2,426,907.95, which was turned over to the
9 Temporary Receiver by financial institutions as a result of the Court's TRO. The
10 Temporary Receiver continues to investigate and trace funds with regard to various
11 transfers made prior to entry of the TRO.

12 **J. Control Over Computer Hardware, Software and Documents**

13 As noted above, immediately upon the takeover, the Temporary Receiver's
14 computer forensic consultants began an orderly shutdown of the computer systems
15 and conducted a bit-stream back-up of all digital information in order to have a
16 forensically sound and unalterable image. The Temporary Receiver will be able to
17 use the electronic data to both identify and address the assets, the inter-relationship
18 among Receivership Entities, and to prepare the accounting provided for in the
19 TRO.

20 In addition, the Temporary Receiver is establishing a website to efficiently
21 disseminate information to EB-5 Investors and interested parties. The website
22 address is www.pdcreceiver.com and will be made operational upon Mr. Seaman's
23 appointment as Permanent Receiver. Due to the fact that the majority of the EB-5
24 Investors are located in China, the website will include a tab where the content can
25 be viewed in Mandarin, which has been helpful in Mr. Seaman's other EB-5-related
26 receivership. Mr. Seaman also employs a Mandarin speaking bookkeeper who is
27 helpful in these matters.

28

1 **K. Information Gathered From Third Parties**

2 As part of his effort to investigate the Receivership Entities activities,
3 preserve and protect their assets, and preserve electronic and hard copy documents,
4 the Temporary Receiver also sent attorneys, accountants, vendors, and other third
5 parties copies of the TRO and made a demand that each of these parties preserve all
6 electronic and other documents in their possession, custody or control as provided
7 for in the TRO. The Temporary Receiver has also met with and/or had telephone
8 calls with Marilyn Thomassen, Chris Fox, Eric Bronk and attorney Rick Weintraub,
9 bond counsel/underwriter for the Lincoln project, and Sante Partners, among others.

10 Prior to the Temporary Receiver's appointment, the Receivership Entities had
11 engaged the law firm of Seyfarth Shaw to represent them in connection with the
12 SEC Action, attorney Eric Chess Bronk to represent them in connection with
13 various transactional and business matters, and attorney Brian Sirota to represent
14 them in connection with a breach of contract lawsuit filed by Neil Richardson and
15 certain other matters. After his appointment, the Temporary Receiver, through his
16 counsel, requested that these firms/attorneys turn over all files in their possession
17 relating to the engagement and any retainer or other funds they were holding in
18 connection with the engagement.

19 The Receivership Entities had also engaged and paid a retainer to the law firm
20 of Kurzban, Kurzban, Weinger & Tetzeli, P.A. ("Kurzban Firm") prior to the
21 Temporary Receiver's appointment to represent certain EB-5 Investors in connection
22 with their applications to USCIS. The Temporary Receiver's counsel has been in
23 contact with the Kurzban Firm about the status of this work and believes the
24 Kurzban Firm is well-qualified to assist investors in this specialized area of law.
25 Accordingly, the Temporary Receiver is in discussions with the Kurzban Firm about
26 the possibility of continuing this work for the benefit of the EB-5 Investors.

27
28

1 **L. Territorial Jurisdiction Over Receivership Assets**

2 By filing the Complaint and the TRO with other federal district courts in the
3 United States, the territorial jurisdiction of this Court over receivership assets is
4 extended to such districts. 28 U.S.C. § 754, *see also Haile v. Henderson Nat'l Bank*,
5 657 Fed. 2d 816, 822 (6th Cir. 1981). Based on information obtained to date
6 regarding property owned by Receivership Entities or in which they may have a
7 security interest and in conformity with section 754 and the federal law, the
8 Temporary Receiver has filed the Complaint and the TRO in the United States
9 District Courts for the Eastern and Southern Districts of California, the District of
10 Arizona, the Middle District of Florida, and the District of Oregon. As additional
11 information becomes available, the Temporary Receiver will file the Complaint and
12 TRO in additional districts.

13 **M. Engagement of Professionals**

14 The TRO authorizes the Temporary Receiver to engage attorneys,
15 accountants, and other professionals as necessary to assist in the performance of his
16 duties. TRO, Section IX. In light of the scope and complexity of the legal issues
17 facing the Receivership Entities, the Temporary Receiver immediately engaged
18 Allen Matkins Leck Gamble Mallory & Natsis LLP ("Allen Matkins") as his general
19 counsel for the receivership. Allen Matkins has extensive experience in
20 representing Court-appointing receivers in federal equity receivership cases.

21 A primary component of this case is the EB-5 investment program. Having
22 served as receiver in an unrelated SEC enforcement action involving the raising of
23 EB-5 investor funds, the Temporary Receiver is aware of the process required to
24 obtain permanent residency. In addition, Allen Matkins has represented receivers
25 for several EB-5 funded enterprises and has gained significant expertise in EB-5
26 matters through that work. As noted above, the Temporary Receiver is also in
27 contact with outside counsel retained by PDC to represent certain EB-5 Investors
28 and who specializes in immigration law (the Kurzban Firm).

1 The Temporary Receiver also engaged Berkeley Research Group ("BRG") to
2 provide forensic computer imaging and related technology consulting services.
3 BRG immediately began work to preserve and image all data on the Receivership
4 entities servers and hard drives.

5 No fees or costs of the Temporary Receiver or his professionals have been or
6 will be paid until approved by the Court via noticed fee applications. As discussed
7 below, the Temporary Receiver recommends fee applications of the Temporary
8 Receiver and has professionals be filed on a quarterly basis.

9 **IV. PRELIMINARY RECOMMENDATIONS**

10 The Temporary Receiver's efforts to marshal the assets and recover assets and
11 relevant Receivership Entity documents and records are ongoing. The assets and
12 materials obtained to date clearly do not provide a complete picture of the
13 Receivership Entities' assets, liabilities, history, and financial activities. In the near
14 term, the Temporary Receiver and his professionals make the following
15 recommendations with regard to their efforts to better understand and document the
16 financial activities of the Receivership Entities.

17 **A. Document Recovery Efforts**

18 The Temporary Receiver will obtain records from all financial institutions
19 where the Receivership Entities maintained accounts as well as from attorneys and
20 accountants engaged by the Receivership Entities. The Temporary Receiver has
21 served subpoenas on certain institutions, individuals, and entities and proposes to
22 proceed with these efforts to obtain documents, assets, and information. It may also
23 be necessary to take the depositions of certain individuals to obtain a complete
24 picture of the enterprise.

25 **B. Receivership Asset Recovery Efforts and Investigation**

26 The Temporary Receiver will seek to locate any presently unaccounted for
27 receivership assets that may exist. As noted above, it is believed that certain assets
28 may be located once the Temporary Receiver has had an opportunity to review the

1 electronic records of the company. The Temporary Receiver will take appropriate
2 steps to secure such assets and preserve their value.

3 **C. Accounting**

4 Once the Temporary Receiver has obtained bank records and records held by
5 third parties, the Temporary Receiver will complete his accounting to establish,
6 among other things, where the funds obtained by the Receivership Entities came
7 from and where they went after they were received by the Receivership Entities.

8 **D. Repatriation of Overseas Assets**

9 The Temporary Receiver will investigate what, if any, assets are located in
10 overseas banks and institutions. The Temporary Receiver will then report to the
11 Court and advise on proposed measures that may be taken in order to repatriate
12 these assets.

13 **E. Maintain Operations of the Assisted Living Projects**

14 To the extent it is feasible, the Temporary Receiver proposes to continue
15 operations of the assisted living projects to preserve their value and preserve the
16 opportunity for the EB-5 Investors to pursue visa applications. In doing so, the
17 Temporary Receiver will consider the contracts in place and determine what, if any,
18 changes may be necessary to preserve and protect the value of the assets.

19 **F. Identify Investors and Propose Methods to Disseminate**
20 **Information**

21 The Temporary Receiver will continue to gather information and identify the
22 investors and creditors of the Receivership Entities. The Temporary Receiver will
23 then propose to the Court a methodology to disseminate information to investors,
24 likely through the receivership website.

25 **G. Provide Reports to the Court on a Quarterly Basis or as Otherwise**
26 **Directed**

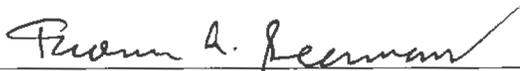
27 The Temporary Receiver proposes to provide quarterly reports to the Court,
28 with his next report being due in April 2017 and covering his investigation and other

1 activities through March 31, 2017. In the meantime, as noted above, the Temporary
2 Receiver anticipates filing a report and recommendation in the next two weeks
3 addressing the Lincoln project and the proposed bond financing. The Temporary
4 Receiver also recommends and proposes he and his professionals file applications
5 for approval of their fees and costs on a quarterly basis.

6 **V. CONCLUSION**

7 Based upon his preliminary investigation and findings, the Temporary
8 Receiver recommends and requests that the Court order him to continue to perform
9 his duties pursuant to TRO and proposed Preliminary Injunction Order. The
10 Temporary Receiver also requests the Court approve this first report and the
11 recommendations discussed herein.

12 Dated: January 20, 2017


THOMAS A. SEAMAN
Temporary Receiver

13
14
15 Dated: January 20, 2017

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

16
17 By: /s/ Edward Fates
EDWARD G. FATES
Attorneys for Temporary Receiver
THOMAS A. SEAMAN

1 DAVID R. ZARO (BAR NO. 124334)
 JOSHUA A. DEL CASTILLO (BAR NO. 239015)
 2 ALLEN MATKINS LECK GAMBLE MALLORY & NATSIS LLP
 515 South Figueroa Street, Ninth Floor
 3 Los Angeles, California 90071-3309
 Phone: (213) 622-5555
 4 Fax: (213) 620-8816
 E-Mail: dzaro@allenmatkins.com
 5 jdelcastillo@allenmatkins.com

6 Attorneys for Receiver
 Stephen J. Donell

8 UNITED STATES DISTRICT COURT
 9 SOUTHERN DISTRICT OF CALIFORNIA

11 SECURITIES AND EXCHANGE
 12 COMMISSION,

13 Plaintiff,

14 v.

15 PLUS MONEY, INC. and MATTHEW LA
 MADRID,

16 Defendants,

17 THE PREMIUM RETURN FUND LIMITED-
 18 LIABILITY LIMITED PARTNERSHIP, ET
 AL.,

19 Relief Defendants.
 20

Case No. 3:08-cv-0764 MMA (NLS)

EIGHTH INTERIM REPORT OF RECEIVER,
 STEPHEN J. DONELL, AND PETITION FOR
 INSTRUCTIONS

NO ORAL ARGUMENT REQUIRED

Date: February 21, 2012
 Time: 2:30 pm
 Ctrm: 5

21 Stephen J. Donell, the Court-appointed permanent receiver (the "Receiver") for Defendant
 22 Plus Money, Inc. ("Plus Money") and Relief Defendants The Premium Return Fund Limited-
 23 Liability Limited Partnership, The Premium Return Fund II Limited-Liability Limited Partnership,
 24 The Premium Return Fund III Limited-Liability Limited Partnership, Return Fund, LLC, Return
 25 Fund II, LLC, Return Fund III, LLC, Return Fund IV, LLC, Return Fund V, LLC, Return Fund
 26 VI, LLC, and their subsidiaries and affiliates (collectively with Plus Money, the "Receivership
 27 Entities"), appointed pursuant to this Court's Preliminary Injunction and Order: (1) Freezing
 28

1 Assets; (2) Appointing a Permanent Receiver; (3) Requiring Accountings; and (4) Prohibiting the
2 Destruction of Documents (the "Appointment Order"), entered on May 16, 2008, hereby submits
3 this Eighth Interim Report of Receiver and Petition for Instructions (the "Report") pursuant to
4 Local Rule 66.1(e) and the Order in Aid of Receivership entered on June 11, 2008.

5 Pursuant to the Appointment Order and law governing federal equity receivers, the
6 Receiver has been charged with, among other things, assuming control over the Receivership
7 Entities and their assets ("Receivership Assets"); performing an accounting of known
8 Receivership Assets and the financial condition of the Receivership Entities; investigating,
9 locating, and recovering Receivership Assets; preparing reports for the Court; and preparing an
10 appropriate claim allowance and investor/creditor distribution plan.

11 As more thoroughly described in this Report, the information obtained by the Receiver to
12 date provides for a significant explanation of the activities and financial condition of the
13 Receivership Entities, including the financial transactions and business in which they engaged.
14 The Receiver has assembled a detailed database reflecting the business activities of the
15 Receivership Entities, including those relating to investments in and payments from the
16 Receivership Entities, which has enabled the Receiver to provide an accounting to the Court, draw
17 conclusions regarding the Ponzi-like investment scheme conducted by the Receivership Entities,
18 enter into settlements with third parties in possession of Receivership Assets, complete an analysis
19 of investor and creditor (taxing entity) claims against the Receivership Entities, make
20 recommendations to the Court regarding the treatment of those claims and the anticipated
21 distribution of Receivership Assets, and complete an interim distribution of Receivership Assets.

22 This Report provides a brief summary of the Receiver's most significant prior activities,
23 along with a more detailed description of the Receiver's actions during the reporting period, with
24 particular attention to: (1) the Receiver's Receivership Asset recovery efforts; (2) the distribution
25 of Receivership Assets to claimants whose claims were allowed – in whole or in part – by the
26 Court; (3) settlement payments still due and owing to the Receiver; and (4) the Receivers'
27 recommendations for the administration of the receivership case going forward.

28

1 Due to the volume and nature of the information acquired to date, the nature and
2 complexity of the matters and transactions analyzed by the Receiver and his Professionals¹, and
3 the Receiver's efforts to secure additional information, this Report is not final. The Receiver may
4 need to modify its contents after further investigation and consideration.

5 **I. GENERAL BACKGROUND.**

6 The Court and interested parties are directed to the following materials² for a general
7 summary of the relevant facts underlying the above-captioned case and the previous activities of
8 the Receiver and his Professionals:

- 9 • Securities and Exchange Commission's (the "Commission") Complaint (filed
10 April 28, 2008, Docket No. 1);
- 11 • Stipulation and Request for Order to Amend Preliminary Injunction and Order
12 (filed July 17, 2008, Docket. No. 38) (the "Palladium Stipulation");
- 13 • Receiver's First Interim Report and Supporting Accounting Report (filed July 30,
14 2008, Docket No. 42);
- 15 • Supplement to First Interim Report of Receiver (filed August 27, 2008, Docket No.
16 51);
- 17 • Receiver's Second Interim Report and Supporting Accounting Report (filed
18 November 19, 2008, Docket No. 70);
- 19 • Order Adopting in Full Report and Recommendations of Magistrate Judge (entered
20 December 5, 2008, Docket No. 83);
- 21 • Order Finding Palladium Stipulation as Moot (entered January 13, 2009, Docket
22 No. 100);
- 23 • First Amended Complaint (filed in Case No. 08-cv-0823 [the "Parallel Case"] on
24 December 15, 2008, Docket No. 15);

27 _____
28 ¹ The Receiver's forensic accountant, counsel, and other related agents are occasionally referred
to herein as the Receiver's "Professionals."

² All identified materials may be viewed at the Receiver's website, www.fedreceiver.com.

- 1 • Consent of Defendant Matthew La Madrid ("La Madrid") to Judgment of
2 Permanent Injunction and Other Relief (the "Consent Judgment") (entered February
3 27, 2009, Docket No. 108);
- 4 • Receiver's Third Interim Report and Supporting Accounting Report (filed March 2,
5 2008, Docket No. 109);
- 6 • Indictment of Donald Lopez ("Lopez") (filed in Case No. 09cr2006 [the "Lopez
7 Criminal Case"] on May 26, 2009, Docket No. 1);
- 8 • Indictment of La Madrid (filed in Case 09cr2582 [the "La Madrid Criminal Case"]
9 on July 7, 2009, Docket No. 1);
- 10 • Receiver's Fourth Interim Report and Supporting Accounting Report (filed on
11 July 31, 2009, Docket No. 124);
- 12 • Entry of Default against Lopez, Palladium Holding Company ("Palladium"), and
13 National Environmental Control Center, Inc. (entered in Parallel Case on
14 November 16, 2009; Docket No. 59);
- 15 • Receiver's Fifth Interim Report (filed December 30, 2009, Docket No. 139);
- 16 • Order and Judgment re Plaintiff's Application for Joint and Several Default
17 Judgment (entered in Parallel Case on February 1, 2010, Docket No. 65);
- 18 • Order Granting Receiver's Motion to Approve Proposed Summary Procedures for
19 Administration of Claims and Resolution of Disputes, Including Request to Set
20 Claims Bar Date and Approval of Proposed Distribution Plan (entered March 23,
21 2010, Docket No. 146);
- 22 • Complaint against Pennee La Madrid (filed in Case No. 10-cv-00891 [the "La
23 Madrid Disgorgement Case"] on April 27, 2010, Docket No. 1);
- 24 • Receiver's Sixth Interim Report (filed May 7, 2010, Docket No. 148);
- 25 • Entry of Default (entered on June 1, 2010 in the La Madrid Disgorgement Case,
26 Docket No. 5);

27
28

- 1 • Amended Default Judgment against Pennee La Madrid in the amount of
- 2 \$304,382.99 (entered on September 16, 2010 in the La Madrid Disgorgement Case;
- 3 Docket No. 10);
- 4 • Receiver's Motion to (1) Reallocate and Transfer Receivership Assets; (2) Amend
- 5 Plan for Distribution; and (3) Allowing Proportional Transfers of Future
- 6 Recoveries (the "Reallocation Motion") (filed November 1, 2010, Docket No. 157);
- 7 • Order granting Receiver's Reallocation Motion (entered November 30, 2010,
- 8 Docket No. 160);
- 9 • Preliminary Order of Criminal Forfeiture (entered in Case 09cr2582 on January 11,
- 10 2011, Docket No. 184);
- 11 • Receiver's Omnibus Motion to Approve Recommended Treatment of Claims (filed
- 12 January 13, 2011, Docket No. 165);
- 13 • Memorandum of Points and Authorities in Support of Receiver's Omnibus Motion
- 14 to Approve Recommended Treatment of Claims (filed January 13, 2011, Docket
- 15 No. 165-1);
- 16 • Declaration of Stephen J. Donell in Support of Receiver's Omnibus Motion to
- 17 Approve Recommended Treatment of Claims (filed January 13, 2011, Docket No.
- 18 165-2).
- 19 • Receiver's Seventh Interim Report (filed February 28, 2011, Docket No. 167); and
- 20 • Court's Order Granting Receiver's Unopposed Omnibus Motion to Approve
- 21 Recommended Treatment of Claims (entered March 15, 2011, Docket No. 169).

22 **II. RELATED CRIMINAL PROCEEDINGS.**

23 As addressed in earlier Interim Reports, La Madrid, Lopez, and Richard Hersch, the
24 principal of All States ATM, Inc. – an entity to which substantial amounts of Receivership Assets
25 were transferred – have each been indicted on criminal charges. The Receiver understands that La
26 Madrid, Lopez, and Richard Hersch have all begun serving criminal sentences. Each criminal
27 case is being prosecuted by the United States Attorneys, and the Receiver has no control over the
28 timing or results of these cases.

1 **III. DETAILS OF RECEIVER'S ACTIVITIES.**

2 Since the inception of the Receivership Case, and in connection with his responsibilities as
3 defined by the Appointment Order, the Receiver has concentrated his efforts in the following
4 areas:

5 **A. Information Recovery, Review, And Analysis.**

6 **1. Document Recovery.**

7 The Receiver obtained documents and records from a variety of sources, including, but not
8 limited to the following: Commercial Mail Receiving Agency; banks including Bank of America,
9 California Bank & Trust, Wells Fargo Bank, US Bank, Charles Schwab, Inc., Huntington National
10 Bank, Wells Fargo Bank, JP Morgan Chase Bank; All States ATM, Inc.; Richard Hersch; Equity
11 Trust Company; Lance La Madrid; Lopez; Palladium; Seaforth Yacht Sales; Auto Gallery (of San
12 Diego); and multiple title and escrow companies. Although the Receiver's efforts to recover
13 documents from some of these entities and individuals were hampered by pending criminal
14 charges or other circumstances, the Receiver ultimately recovered in excess of 33,000 pages of
15 materials relating to the business and financial activities of the Receivership Entities and their
16 principals and insiders, the bulk of which were produced by banks and other corporate entities.

17 Based on these and other materials, the Receiver, with the assistance of his forensic
18 accountant, created a customized database of transactions (the "Forensic Accounting"), which
19 enabled the Receiver to access reports showing all identified transactions for each individual and
20 entity that conducted business with or invested in the Receivership Entities. The Forensic
21 Accounting provided the basis for many of the Receiver's conclusions presented in previous
22 Interim Reports (and approved by the Court), was instrumental in identifying profiting investors
23 and other sources of potential Receivership Asset recovery, and enabled the Receiver to complete
24 an analysis of investor claims against the Receivership Entities and to make recommendations to
25 the Court regarding the treatment of those claims and – ultimately – the distribution of
26 Receivership Assets.

27 The Receiver's document recovery, review, and analysis efforts are substantially complete,
28 with additional information largely supplementing – rather than materially adding to – the

1 Receiver's existing understanding of the business and financial activities of the Receivership
2 Entities.

3 **2. Witness Interviews And Discovery.**

4 Since his appointment, the Receiver and his Professionals have received, reviewed, and
5 responded to investor "tips," participated in discussions with investors, and arranged or concluded
6 brief witness interviews with select Receivership Entity insiders.

7 On February 10, 2011, the Receiver and his counsel participated in a witness interview of
8 La Madrid. At the interview, La Madrid provided the Receiver with additional information
9 relating to the transfer of at least \$7 million in Receivership Assets to Lopez, and clarified the
10 roles of the parties in the transaction. In addition, La Madrid detailed the relationship between the
11 Receivership Entities and numerous real property lending and investment entities not a part of the
12 instant receivership estate – information that may actually assist the Receiver in administering a
13 related receivership estate also administered by the Receiver.

14 La Madrid also identified additional investors and insiders who might have profited from
15 their investments in the Receivership Entities, and promised to provide the Receiver with
16 documents relating to these potential sources of recovery,. Ultimately, the limited number of
17 documents provided to the Receiver were insufficient to establish the receipt of significant
18 Receivership Assets by any previously unidentified third party, and have not led to the recovery of
19 additional Receivership Assets. During the remaining pendency of the receivership case, the
20 Receiver will continue to undertake any actions which, in his reasonable business judgment, are
21 likely to result in a net recovery of Receivership Assets. Nonetheless, and given the limited
22 amount of funds presently available, the Receiver's actions from this point forward will be limited.

23 The has also propounded judgment debtor interrogatories to Lopez and Pennee La Madrid
24 in connection with the judgments entered in the Receiver's favor in the Parallel Case and the La
25 Madrid Disgorgement Case. Lopez and Ms. La Madrid failed to respond, and the Receiver may
26 elect to take judgment debtor exams, if, in his reasonable business judgment, they are likely to
27 result in a net recovery of Receivership Assets.

28

1 **B. Accounting For And Characterizing The Receivership Entities' Financial**
2 **Activities As A Ponzi-Like Enterprise.**

3 Based on the most information available from the Forensic Accounting, the Receiver has
4 reaffirmed his conclusion that the activities of the Receivership Entities are highly suggestive of a
5 Ponzi-like scheme, as discussed below:

6 The Receiver's Forensic Accounting discloses the following:

- 7 • The Receivership Entities kept no reliable accounting of reported profits and losses
8 arising in connection with so-called covered call option trading or other
9 investments;
- 10 • The Receivership Entities' accounts were significantly out of balance;
- 11 • The Receivership Entities did not earn sufficient profit from their investment
12 activities to support the withdrawals and pay-outs made from their accounts;
- 13 • There was significant commingling of assets among the Receivership Entities;
- 14 • Distributions are likely to have been made to investors from funds received from
15 later investors;
- 16 • Significant cash withdrawals were made from the accounts of the Receivership
17 Entities by Defendant La Madrid;
- 18 • Individuals controlling the various brokerage accounts of the Receivership Entities
19 engaged in systematic borrowing against the securities portfolios of the
20 Receivership Entities, subjecting the entities to potentially millions in
21 unrecoverable interest; and
- 22 • Large amounts of Receivership Assets were transferred from the Receivership
23 Entities to third party entities.

24 Because the Receiver's investigation and document recovery efforts are ongoing, the
25 conclusions presented may require modification if new, contrary evidence is discovered.

26 The hallmark of a Ponzi-like investment scheme is that early investors are paid returns, not
27 from profits generated by business or investment activities, but from moneys raised from later
28 investors. See Cunningham v. Brown, 265 U.S. 1, 7 (1924). The Receiver's Forensic Accounting

1 strongly suggests that the Receivership Entities earned very little from any so-called covered call
 2 option trading or other investment activities. It further suggests that the Receivership Entities did
 3 not earn sufficient profit from their investment activities to support the withdrawals and
 4 distributions made from their accounts, and that distributions to earlier investors were made from
 5 funds received from later investors, as reflected in the disparity between profits earned and pay-
 6 outs to investors. The activities of the Receivership Entities are thus highly suggestive of a Ponzi-
 7 like scheme, as reported in greater detail in previous Interim Reports.

8 **C. Recovering Receivership Assets.**

9 As detailed in previous Interim Reports, the Receiver's efforts to recover Receivership
 10 Assets since the inception of this matter have been significant. The Receiver's efforts have largely
 11 concentrated on the following:

- 12 • Recovery of more than \$2 million from Lopez and Palladium;
- 13 • Securing a judgment against Lopez and Palladium for more than \$8 million;
- 14 • Securing the disgorgement of more than \$120,000 from Equity Trust Company³;
- 15 • Pursuing disgorgement demands and lawsuits against profiting Receivership Entity
 16 investors and insiders;
- 17 • Securing a judgment against Lopez for all unrecovered portions of the \$10 million
 18 (presently in excess of \$8 million) transferred to him by La Madrid;
- 19 • Securing judgments against select profiting Receivership Entity investors and
 20 insiders for more than \$326,000, in the aggregate; and
- 21 • Entering into settlement agreements with select profiting Receivership Entity
 22 investors and insiders for more than \$235,000, in the aggregate.⁴

23 **1. Judgments Obtained By The Receiver.**

24 As bites above, the Receiver has secured judgments against select profiting Receivership
 25 Entity investors and insiders for more than \$326,000, in the aggregate, along with a judgment of
 26

27 ³ Of these funds, approximately \$12,000.00 were requested and disgorged in reliance on
 incomplete information, and have been returned to an appropriate custodian.

28 ⁴ A number of these settlements are payable over time, with payment terms ending, at the latest,
 in the first half of 2012.

1 over \$8 million against Lopez. As of the date of this Report, neither Lopez nor Pennee La Madrid
 2 have made any disgorgements or payments to the Receiver in connection with the judgments
 3 obtained. Based on the Receiver's review of documents relating to Lopez's expenditure of
 4 Receivership Assets, it is likely that few, if any, funds remain available to recover. On the other
 5 hand, it is unclear what funds Pennee La Madrid may have available to the Receiver, and the
 6 possibility of a judgment debtor exam and subsequent attachment proceedings remains.

7 **2. Recovery Of Receivership Assets Through Settlements.**

8 With the exception of the funds initially recovered from Lopez, Palladium, and Equity
 9 Trust Company, and the judgments the Receiver has obtained, the largest source of recovery of
 10 Receivership Assets has been through settlement with profiting investors. As of the date of this
 11 Report, the Receiver has entered into eight settlement agreements, with a face value of over
 12 \$235,000. All but two of these settlements have been paid in full⁵, and the remaining agreements
 13 have payment terms that end in no later than April 2012.

14 **D. Preparing And Submitting Tax Documents For The Receivership Entities And** 15 **Responding To Tax-Related Investor Inquiries.**

16 In prior reporting periods, the Receiver and his forensic accountant prepared Receivership
 17 Entity tax returns for 2207, 2008, and 2009. In addition, the Receiver and his Professionals also
 18 responded to various penalty notices from the Internal Revenue Service (the "IRS"), succeeding in
 19 securing the abatement of at least \$339,331.21 in penalties previously assessed by the IRS. These
 20 abatements reflect penalties that the Receivership Entities will not be obligated to pay, and thus
 21 reflect a substantial savings to the receivership estate. Recently, the Receiver and his
 22 Professionals addressed numerous notices of past-due taxes, interest, and penalties received from
 23 California's Franchise Tax Board (the "FTB"), and successfully caused the FTB to release at least
 24 four liens against two Receivership Entities, which had been recorded as a result.

25 Finally, as in prior reporting periods, the Receiver and his forensic accountant continued to
 26 respond to investor inquiries regarding tax documents submitted and in process.

27
 28 ⁵ One settling investor is a month late in his settlement payments, but the Receiver believes this
 situation will be rectified shortly.

1 **E. Assembling A Reliable List Of Receivership Entity Investors And Creditors.**

2 The Receiver has assembled a preliminary list of 225 investors and creditors, which
3 appears to be substantially complete.

4 **F. Funding A Related Receivership.**

5 As detailed in a previous Interim Report, in 2010, the Receiver was appointed as receiver
6 in a separate, though related action styled SEC v. Pacheco, USDC Southern District of California
7 Case No. 09-cv-1355 (the "Advanced Money Action"). In its Complaint in the Advanced Money
8 Action, the Commission alleged that numerous Defendants operated a Ponzi-like investment
9 scheme that raised approximately \$15 million from over 200 investors. The Commission further
10 alleged that \$3 million of the funds raised in the scheme were transferred to Vision Quest
11 Investments, an entity controlled by La Madrid, and subsequently to Lopez and Palladium.

12 The Receiver's Forensic Accounting confirmed the subject \$3 million transfer to Vision
13 Quest Investments, which commingled the funds with at least \$7 million in Receivership Assets,
14 prior to transferring \$10 million to Palladium and Lopez. Based on this information, and in his
15 reasonable business judgment, the Receiver determined that the receivership estate in the
16 Advanced Money Action was entitled to 30% – less fees and costs – of the funds recovered from
17 Lopez and Palladium. The Receiver consequently filed his Reallocation Motion on November 1,
18 2010, requesting authorization to reallocate and transfer approximately \$729,000.00 to the
19 receivership estate in the Advanced Money Action, and reduce the amount of the interim
20 distribution to investors in this action to \$310,000.00. The Court granted the Reallocation Motion
21 on November 30, 2010. The Receiver has completed the requested reallocation and transfer, along
22 with his contemplated interim distribution of \$310,000.00 to investors who suffered losses as a
23 result of their investments in the Receivership Entities, as discussed below.

24 **G. Claims Procedure And Distribution Of Receivership Assets.**

25 **1. Interim Distribution By The Receiver.**

26 On March 23, 2010, this Court approved the Receiver's proposed claims administration
27 and dispute resolution process, along with his proposed plan (the "Plan") for distributing
28 Receivership Assets to investors and creditors.

1 Pursuant to the Plan, the Receiver notified Receivership Entity investors and creditors of
2 their right to submit claims against the receivership estate, with a bar date for claims submission of
3 June 1, 2010, and provided appropriate claim forms, which were also posted to the Receiver's
4 website. The Receiver then processed all proper investor claims, and filed his Omnibus Motion to
5 Approve Recommended Treatment of Claims, which contained the Receiver's recommendations to
6 the Court regarding the Receiver's recommended treatment for investor claims, along with IRS
7 and FTB requests for payment.

8 The Court granted the Receiver's Omnibus Motion to Approve Recommended Treatment
9 of Claims on March 15, 2011. Immediately after the entry of the Court's Order, the Receiver
10 commenced sending distribution checks to investors. As of the date of this Report, all \$310,000 in
11 interim distribution funds have been distributed to investors, on a *pro rata* basis as provided for in
12 the Plan.

13 2. Potential Distribution By U.S. Attorney's Office.

14 In connection with his recent "guilty" plea in the La Madrid Criminal Case, the presiding
15 court subsequently entered a Preliminary Order of Forfeiture which directs that, among other
16 things, La Madrid must forfeit numerous real properties to the United States. The Receiver
17 understands that the proceeds of the sale of any forfeited properties will result in a fund that may
18 be used to compensate the victims of the criminal conduct alleged in the La Madrid Criminal
19 Case, including investors in the Receivership Entities who lost money as a result of their
20 investment. The Receiver has no control over and will not be administering this potential
21 distribution of assets.

22 IV. ANTICIPATED TRAJECTORY OF RECEIVERSHIP CASE.

23 As noted above, the Receiver recently allocated and transferred approximately
24 \$729,000.00 to the receivership estate in the Advanced Money Action. As of his most recent
25 accounting, the Receiver held \$309,001.51 for the benefit of the Receivership Entities, *after* the
26 interim distribution of \$310,000.00 to investors with allowed claims. As a consequence, the
27 funding available to administer the instant receivership is extremely limited, and the Receiver
28 recommends administering the estate of the Receivership Entities in a such a manner so as to

1 maximize the preservation of all remaining Receivership Assets, and makes the following
2 recommendations:

3 **A. Recovery Of Available Receivership Assets.**

4 As detailed above, the Receiver has entered into eight settlement agreements in connection
5 with his disgorgement demands and/or related lawsuits, for a total face value of approximately
6 \$235,000.00. Of these, all but two have been paid in full. The remaining settlements have
7 payment terms running through no later than April 2012. The Receiver will continue to monitor
8 these settlements and ensure that proper and timely payments are received from each settling
9 investor for the duration of each settlement's payment term. In the event that the Receiver
10 identifies additional investors who profited from their investments in the Receivership Entities, the
11 Receiver reserves the right to initiate any disgorgement suits which he believes, in his reasonable
12 business judgment, will result in a net recovery of Receivership Assets.

13 In addition, the Receiver has obtained judgments in excess of approximately \$9 million
14 against Lopez, Palladium, Pennee La Madrid, and other profiting Receivership Entity investors.
15 As of the date of this Report, although each judgment has been properly recorded, none of the
16 judgment debtors – including Lopez – have made any payments to the Receiver, and it appears
17 unlikely that they will do so in the future. Future expenditure on recovery efforts may therefore
18 not be warranted, although, as noted above, the Receiver may elect to take judgment debtor
19 exams, if he believes they will be likely to result in a net recovery of Receivership Assets.

20 **B. Distribution Of Remaining Receivership Assets.**

21 As of the date of this Report, the Receiver has completed an interim distribution of
22 \$310,000.00. Pursuant to the Plan, all remaining Receivership Assets, after payment of priority
23 claims (e.g. administrative expenses), including future payments from settling investors, any
24 additional funds recovered by the Receiver, and any payments from La Madrid due and owing
25 under the Consent Judgment⁶, will be distributed immediately prior to the close of the above-

26
27 ⁶ Pursuant to the terms of the Consent Judgment, La Madrid agreed to disgorge ill-gotten gains
28 and pay a civil penalty to the Receiver, in an amount to be set upon motion by the
Commission. The Preliminary Order of Criminal Forfeiture, entered in the La Madrid
Criminal Case, directs La Madrid to make his disgorgement to the U.S. Attorney's Office, not

1 captioned receivership case. The Receiver will also coordinate with and assist the U.S. Attorney's
2 Office in connection with its distribution of assets to investors, as appropriate.

3 **C. Periodic Reporting And Closure Of Receivership Case.**

4 Given the limited funding available and the relatively minimal likelihood of recovering
5 substantial additional Receivership Assets, the Receiver believes that it will be appropriate to
6 bring the instant receivership to a close and request his discharge as Receiver upon the receipt of
7 all outstanding settlement payments and the completion of any then-pending administrative tasks.
8 If any outstanding judgments remain unsatisfied at that time, the Receiver will explore selling the
9 judgments to recover additional funds to be disbursed to Receivership Entity investors and
10 creditors in accordance with the Plan.

11 Given the above, the Receiver anticipates filing his next, and final Interim Report in the
12 second half of 2012. As detailed in previous Interim Reports, contemporaneously with the
13 Receiver's filing of his final Interim Report, the Receiver will file a Request for Discharge, all
14 final fee applications for himself and his Professionals, and will submit proposed orders thereon.
15 In addition, and pursuant to the terms of the Plan, the Receiver anticipates making a final
16 distribution of available funds to investors with allowed claims against the Receivership Entities at
17 the close of the receivership case.

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27 the Receiver or the Commission. At present, it is unclear to whom La Madrid will make his
28 disgorgement, but it is the Receiver's understanding that, in the event La Madrid makes his
disgorgement to the U.S. Attorney's Office, any funds disgorged will be added to a pool that
may be used to compensate victims, including investors in the Receivership Entities. This
pool will not be administered by the Receiver.

1 **V. CONCLUSION.**

2 Based on the Receiver's investigation and findings as described above, the Receiver
3 recommends and requests that the Court order that the receivership continue pursuant to the
4 Appointment Order and any supplemental Orders issued by the Court. The Receiver requests that
5 the Court approve his continuing investigation and this Report, and accept his findings and
6 conclusions as presented herein.

7
8 Dated: January 11, 2012

By: /s/ Joshua A. del Castillo
DAVID R. ZARO
JOSHUA A. DEL CASTILLO
ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP
Attorneys for Receiver
Stephen J. Donell

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Biographies

Kathy Bazoian Phelps

Kathy Bazoian Phelps is lawyer at Diamond McCarthy LLP, a board director on three non-profit boards, and an author. She has been practicing law since 1991, with experience in bankruptcy and receivership law, fiduciary representation, and fraud litigation. She is particularly knowledgeable about fraud detection and the administration of Ponzi scheme cases in bankruptcies and receiverships.

Kathy is a frequently requested speaker on topics ranging from bankruptcy, financial compliance, fraud detection, Ponzi schemes, and handling disruptive personalities in corporations. She applies her knowledge across a wide variety of industries ranging from financial institutions to real estate-related businesses.

Kathy's publications include the following:

- *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes*, co-authored with Hon. Steven Rhodes (Ret.) (LexisNexis® 2012)
- *Fraud and Forensics: Piercing Through the Deception in a Commercial Fraud Case*, co-author (American Bankruptcy Institute 2015)
- *Ponzi-Proof Your Investments: An Investor's Guide to Avoiding Ponzi Schemes and Other Fraudulent Scams* (IRR Publishing 2013)
- *The Depths of Deepening Insolvency: Damage Exposure For Officers, Directors and Others*, co-authored with Prof. Jack F. Williams (American Bankruptcy Institute 2013)
- Author of *The Ponzi Scheme Blog* at www.theponziscHEMEblog.com

In addition to her roles as lawyer, speaker and author, Kathy also serves as a mediator and is currently on the mediation and arbitration rosters for the Financial Industry Regulatory Authority, as well as the Bankruptcy Mediation Panel for the Central District of California and the Bankruptcy Mediation Panel for the District of Arizona.

Steve Donnell

Stephen J. Donell, CPM®, CCIM®, ARM® has been active in various fields of real estate since beginning his business career in 1984. Since that time, Mr. Donell has been involved in the acquisition, development, marketing and management of properties located in the western United States. Property types include office, commercial, retail, industrial, multi-family, hotel, single family and condominiums.

Since 1990, Mr. Donell has administered and/or been appointed as a federal and state court receiver in hundreds of cases throughout the country. He has extensive experience involving asset and business liquidations, gas stations, restaurants, residential, retail and commercial real estate. In addition, Mr. Donell has administered cases involving commercial and residential owners associations, post judgment

enforcement actions, marital dissolution cases, single family and condominium construction completion/entitlements, accounts receivable collections, collateral seizure cases, including medical practices and coin laundry facilities, skilled nursing facilities and/or Residential Care Facilities for the Elderly and other types of receivership appointments. Mr. Donell has also administered and/or been appointed in federal court as receiver in United States Securities and Exchange Commission and other government enforcement actions involving business fraud. These cases have involved over 25,000 investors and invested funds totaling more than \$750 million and involve the recovery of assets in multiple foreign jurisdictions.

Mr. Donell is the President of Jalmar Properties, Inc. AMO[®], a real estate investment and property management company specializing in the acquisition, development and management of commercial, retail, industrial and multi-family housing. The company was formed in 1985 and has provided management services for real estate properties with a market value in excess of one billion dollars. Jalmar Properties, Inc. AMO[®] is licensed as a Real Estate Broker in California, Arizona and Nevada, and the company was awarded the designation of AMO[®] Company of the Year in 2005 by the Institute of Real Estate Management (IREM[®]). Mr. Donell is also President of FedReceiver[®], Inc., which employs four full-time receivers.

Mr. Donell serves as an expert witness for both plaintiffs and defendants in connection with premises liability cases. He has served as an expert in matters including but not limited to slip and fall, habitability, mold, bedbugs, asbestos, lead-based paint and overall standard of care issues related to the ownership, operation and management of residential and commercial real estate. He also serves as an expert in matters involving the duties and obligations of court appointed receivers.

Michael Kasolas

Michael G. Kasolas is a Certified Public Accountant in San Francisco, California, where he has served as a Receiver and Referee in civil litigation matters since 2002, a U.S. Bankruptcy Trustee since 2009 and a professional trustee for family trusts since 2009. He is a California Real Estate Broker actively selling residential, multi-family residential, hospitality and commercial real estate since 1985. He also serves as a California Probate Referee – appointed in San Francisco County (1998) and San Mateo County (2018). Mr. Kasolas has been employed as a Senior Manager with PricewaterhouseCoopers (formerly Coopers & Lybrand), serving Bank of America, the Conservation and Liquidation Office of the California Insurance Commissioner, and other notable clients. Mr. Kasolas earned his B.S. degree in business administration from San Jose State University and a minor in Cybernetic Systems.

Thomas A. Seaman

Thomas A. Seaman is Principal and sole shareholder of Thomas Seaman Company. Mr. Seaman has served as a receiver in well over 200 matters and currently serves as receiver in 5

federal equity receiverships brought by the SEC or the FTC. Mr. Seaman brings his skill as a Chartered Financial Analyst to his assignments. Mr. Seaman has the capability to manage and administer a broad range of asset classes including operating companies, financial assets, real property and construction projects.

Mr. Seaman earned a Bachelor of Science Degree in Finance from the University of Illinois in 1979 and the insolvency arena in 1989 working after serving as a controller and Chief Financial Officer in the aerospace industry. Mr. Seaman was granted a Chartered Financial Analyst designation in 1993. Mr. Seaman has 40 years' business experience, both in private industry and as a court-appointed fiduciary.

Mr. Seaman has managed and disposed of myriad assets including several operating companies, troubled real estate assets of nearly every asset class, senior living projects, land, partnership interests, even a nuclear accelerator and the largest yacht then in Newport Beach, among others.

Mr. Seaman's financial skills have also been employed by the court and litigants to support the underlying litigation and have resulted in the granting of motions for summary judgment and criminal indictments. In matters where the business is viable and operations are continued, Mr. Seaman is able to exert financial control over and operate the entity. In rents and profits matters, Mr. Seaman has resolved problems with entitlements, completion, health & safety violations, marketing, leasing, management, plant, environmental, seismic, eminent domain, and other issues affecting real estate.

Mr. Seaman's firm is also licensed by the State of California as a Registered Investment Adviser and as a California Real Estate Broker. Mr. Seaman is a member of the Institute of Chartered Financial Analysts, the Los Angeles Society of Financial Analysts, the California Receiver's Forum, and the Orange County Bar Association, as a non-lawyer and is a founding member of the National Association of Federal Equity Receivers.



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Contact:
Dennis Gemberling
Receiver/Property Manager

One Market Plaza, Spear Tower, Suite 3600
San Francisco, CA 94105-1120 USA
Tel 800.580.3950 • Fax 415.293.8001 • dpg@perrygroup.com
www.perrygroup.com

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Curtis R. Wright, Esq.

CWright@SilverWrightLaw.com
909-833-5420



Matthew R. Silver, Esq.

MSilver@SilverWrightLaw.com
949-200-6727

www.SilverWright.law

207 Cal.App.4th 681

Court of Appeal, Fourth District, Division 1, California.

CITY OF CHULA VISTA, Plaintiff,

v.

Maria E. GUTIERREZ, Defendant;

Mark S. Adams, Claimant and Appellant;

Wachovia Mortgage, Objector and Respondent.

No. D059364.

June 4, 2012.

Synopsis

Background: Court-appointed receiver for four-unit residential building sought payment from lender, which had acquired building after foreclosing on its deed of trust and conveyed the building to a third party. The Superior Court, San Diego County, No. 37–2008–00074648–CU–PT–SC, William S. Cannon, Retired Judge, awarding receiver a portion of the compensation he requested, and receiver appealed.

Holdings: The Court of Appeal, McIntyre, J., held that:

lender was not unjustly enriched by services which receiver performed, and

lender was not directly liable under statute for expenses of receiver.

Affirmed.

Attorneys and Law Firms

****690** California Receivership Group, Los Angeles, and Andrew F. Adams for Claimant and Appellant.

Anglin Flewelling Rasmussen Campbell & Trytten, Pasadena, Frederick J. Hickman and Robert C. Little for Objector and Respondent.

Opinion

McINTYRE, J.

***684** Mark S. Adams, a court-appointed receiver, appeals from an order awarding him a portion of the compensation he requested for his services. On appeal, Adams contends: (1) the court abused its discretion in refusing to order Wachovia Mortgage (Wachovia) to pay all receivership fees because Wachovia was unjustly enriched, and (2) Wachovia is responsible for receivership fees under Health and Safety Code section 17980.7 (section 17980.7). (Undesignated statutory references are to the Health and Safety Code.) We reject Adams's arguments, and affirm.

Wachovia has filed an unopposed request for judicial notice, requesting that we take judicial notice of the legislative history of section 17980.7. We grant Wachovia's request.

FACTUAL AND PROCEDURAL BACKGROUND

Maria E. Gutierrez owned a four-unit residential building in the City of Chula Vista (the City). In 2006, Gutierrez borrowed \$440,000 from World Savings Bank, which was secured by a first deed of trust on the property. World Savings Bank eventually became Wachovia. Gutierrez defaulted on the loan, causing the lender to record a notice of default in February 2008.

In April 2008, the City began conducting inspections and notified Gutierrez of multiple violations concerning the condition of the property. Gutierrez, however, was in prison in Washington. Thus, in November 2008, the City filed a petition seeking to ****691** have a receiver appointed under section 17980.7 for the purpose of correcting the problems and operating the building. The court appointed California Receivership Group (CRG) as the receiver. It appears that Adams, CRG's president, performed the receiver's duties as he is identified in multiple reports and court documents as the receiver. The court's order of December 2008 appointing the receiver stated that it was not applicable to Wachovia.

The property was boarded up within two days of the receiver's appointment and within three weeks, the families living at the property were relocated. In January 2009, Adams informed the court that he “believe[d] that the lender w [ould] foreclose and be responsible for rehabilitating [the property] prior to resale. That being the

case, [Adams] also believe[d] that th[e] receivership c[ould] be closed out within 2 months time.”

*685 In February 2009, in response to Adams's request for a receivership certificate that would be superior to Wachovia's deed of trust, the court authorized Adams to file a secondary lien against the property for his fees and costs. There is nothing in the record indicating that this lien was perfected or recorded against the property. In July 2010, Wachovia took ownership of the property through a \$330,424 credit bid at the foreclosure sale, and in October 2010, it conveyed the property to a third party.

In November 2010, nearly two years after he was appointed, Adams filed his final report requesting a receiver's certificate lien in the amount of \$41,545.72 against the property. After determining that Wachovia conveyed the property to a third party, Adams changed his request to seek direct payment from Wachovia and reduced the amount to \$37,541.72. The court denied Adams's request and stated that although it found “it would be appropriate to charge Wachovia for the receiver's expenses during the time period that Wachovia owned the property[,] July 8 through October 28, 2010[,] the only expense incurred during that time period [was] \$408.33 to review the file. Given that the tenants were no longer on the property, the property had been foreclosed on, and the receiver was well-acquainted with the facts the court [was] not persuaded this was an appropriate expense to charge Wachovia.” Despite this statement, in its final order discharging the receiver, the court ordered Wachovia to pay Adams the sum of \$408.33.

DISCUSSION

I. ALLEGED UNJUST ENRICHMENT

A. General Legal Principles

A receiver is an agent and officer of the court, and is under the control and supervision of the court. (Code Civ. Proc., § 568; Cal. Rules of Court, rule 3.1179.) The receiver is also a fiduciary who must act for the benefit of all parties interested in the property. (*Shannon v. Superior Court* (1990) 217 Cal.App.3d 986, 992, 266 Cal.Rptr. 242.)

Receivers are entitled to compensation for their own services and the services performed by their attorneys. (*Venza v. Venza* (1951) 101 Cal.App.2d 678, 680, 226 P.2d

60.) Generally, the costs of a receivership are paid from the property in the receivership estate. (See *Andrade v. Andrade* (1932) 216 Cal. 108, 110, 13 P.2d 676; *McCarthy v. Poulsen* (1985) 173 Cal.App.3d 1212, 1219–1220, fn. 3, 219 Cal.Rptr. 375.) However, courts may also *686 impose the receiver costs on a party who sought the appointment of the receiver or “ ‘apportion them among the parties, depending upon circumstances.’ ” **692 (*Baldwin v. Baldwin* (1947) 82 Cal.App.2d 851, 856, 187 P.2d 429.) Courts are vested with broad discretion in determining who is to pay the expenses of a receivership, and the court's determination must be upheld in the absence of a clear showing of an abuse of discretion. (*Ibid.*; see *Melikian v. Aquila, Ltd.* (1998) 63 Cal.App.4th 1364, 1368, 74 Cal.Rptr.2d 739; *People v. Riverside University* (1973) 35 Cal.App.3d 572, 587, 111 Cal.Rptr. 68.)

B. Analysis

Adams contends the court abused its discretion in refusing to order Wachovia to pay all receivership costs because Wachovia was unjustly enriched by his services. We disagree.

“An individual is required to make restitution if he or she is unjustly enriched at the expense of another.” (*First Nationwide Savings v. Perry* (1992) 11 Cal.App.4th 1657, 1662, 15 Cal.Rptr.2d 173.) “The recipient of the benefit is liable only if the circumstances are such that, as between the two persons, it is unjust for the recipient to retain it.” (*California Federal Bank v. Matreyek* (1992) 8 Cal.App.4th 125, 131, 10 Cal.Rptr.2d 58.)

A court may require one or more parties to pay for receiver fees where the property subject to the receivership is inadequate to compensate the receiver and/or where other equitable circumstances support imposing fees on a party. (*Stanton v. Pratt* (1941) 18 Cal.2d 599, 603, 116 P.2d 609; *Baldwin v. Baldwin*, *supra*, 82 Cal.App.2d at p. 856, 187 P.2d 429.) In considering the appropriate source for the compensation, a relevant factor is whether the party to be charged obtained a benefit from the receiver's services. (See *Stanton*, at p. 603, 116 P.2d 609.)

Here, the trial court found that Wachovia should not personally bear the costs of the receiver's services. Adams relies primarily on *Ephraim v. Pacific Bank* (1900) 129 Cal. 589, 62 P. 177 (*Ephraim*) to assert that it is unjust for a foreclosing bank to retain the value of a receivership without paying the receiver's costs. His

reliance on *Ephraim* is misplaced. In that case, the court concluded that the receiver could seek his fees from “the parties at whose request he had incurred the expenses.” (*Id.* at p. 594, 62 P. 177.) In this case, Wachovia did not seek appointment of the receiver or create the situation that required the receivership; rather, it was the City that initiated the proceedings to cure the dilapidated condition of the property. Further, Wachovia only owned the property for less than four months out of the two-year receivership period, and the majority of Adams's work was performed before Wachovia's ownership.

***687** We are unable to discern from the record what, if any, monetary benefit Adams's services conferred directly on Wachovia. Adams relocated two tenants, boarded up and secured the property, and performed minor landscaping, including mowing the grass and pulling weeds. Thereafter, it appears that Wachovia sustained a financial loss as a result of the foreclosure proceedings and sale to a third party. Further, as Adams informed the court in early 2009, he did not rehabilitate the property because he believed it would be expensive and this was the responsibility of the lender upon foreclosure. Thus, Adams's role was limited to leaving the property “vacant and secured.”

Without any citation to authority, Adams argues that because Wachovia paid \$11,000 to satisfy liens incurred when Gutierrez owned the property and \$6,000 for liens incurred in October 2010, Wachovia admitted that it was responsible for and benefited from the receiver's services. Wachovia asserts that the liens were satisfied ****693** in order to clear the property's title for sale to a third party. We are not convinced that Wachovia's satisfaction of the liens suggests anything in regard to whether Wachovia should be held directly responsible for the receiver's fees.

Thus, on this record, we cannot conclude that the trial court abused its discretion in refusing to make Wachovia responsible for Adams's fees and costs. In reaching this conclusion, we express no opinion regarding whether Adams could have recovered from the City through principles of unjust enrichment or otherwise.

II. SECTION 17980.7

Upon request of an enforcement agency, tenant, or tenant association or organization, the court may appoint

a receiver for a substandard building where the owner failed to correct cited violations that are “so extensive and of such a nature that the health and safety of residents or the public is substantially endangered.” (§§ 17980.6; see 17980.7, subd. (c).) The receiver has the power “[t]o borrow funds to pay for repairs necessary to correct the conditions cited in the notice of violation and to borrow funds to pay for any relocation benefits authorized by [this section] and, with court approval, secure that debt and any moneys owed to the receiver for services performed pursuant to this section with a lien on the real property upon which the substandard building is located. The lien shall be recorded in the county recorder's office in the county within which the building is located.” (§ 17980.7, subd. (c)(4)(G).) “The receiver shall be entitled to the same fees, commissions, and necessary expenses as receivers in actions to foreclose mortgages.” (§ 17980.7, subd. (c)(5).)

***688** Adams contends Wachovia was directly responsible for receivership fees because it was an “owner” of the property for purposes of section 17980.7. In making this assertion, Adams relies on section 17980.7's definition of an “owner,” which states that “[t]he term ‘owner,’ ... shall include the owner, including any public entity that owns residential real property, at the time of the initial notice or order and *any successor in interest who had actual or constructive knowledge of the notice, order, or prosecution.*” (§ 17980.7, subd. (f), italics added.) Wachovia acknowledges that it “became a temporary ‘successor in interest’ to Gutierrez when it took her title through foreclosure,” but argues that section 17980.7 does not mandate direct liability for the receiver's expenses.

In considering these arguments, our fundamental objective is to ascertain the legislative intent of section 17980.7. In so doing, we focus initially on the words of the statute “ ‘ ‘because the statutory language is generally the most reliable indicator of legislative intent. [Citation.] The words of the statute should be given their ordinary and usual meaning and should be construed in their statutory context.’ [Citation.] If the statutory language is unambiguous, ‘we presume the Legislature meant what it said, and the plain meaning of the statute governs.’ ” ’ [Citation.]” (*San Diego County Employees Retirement Assn. v. County of San Diego* (2007) 151 Cal.App.4th 1163, 1174, 60 Cal.Rptr.3d 601.) If the language of the statute does not provide a definitive answer, then we look to extrinsic sources, including the legislative history. (*Ibid.*)

We find nothing in the statute or its legislative history to suggest that it was intended to impose direct liability for a receiver's fees and costs on a foreclosing lender that ultimately acquires the property. To the contrary, the statute specifically states that a receiver can, with court approval, obtain a lien on the real property **694 upon which the substandard building is located. (§ 17980.7, subd. (c)(4)(G).) This is exactly what the trial court in this case authorized Adams to do and, for reasons unknown to us, it appears that it was never done. If the Legislature had intended to impose direct liability or provide the receiver with a priority lien, it would have done so, just as it allowed the court to directly “[o]rder the owner to pay all reasonable and actual costs of the enforcement agency....” (§ 17980.7, subd. (d)(1).)

Simply put, section 17980.7 does not in and of itself allow for the receiver to recover his expenses directly from the

owner; rather recovery should be through a lien on the property. Any change in the law must come from the Legislature, not the courts.

***689 DISPOSITION**

The order is affirmed. Wachovia is entitled to costs on appeal.

Huffman, Acting P.J., and O'Rourke, J., concurred.

All Citations

207 Cal.App.4th 681, 143 Cal.Rptr.3d 689, 12 Cal. Daily Op. Serv. 7729, 2012 Daily Journal D.A.R. 9312

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32 Cal.App.5th 648
Court of Appeal, Second
District, Division 3, California.

CITY OF SIERRA MADRE,
Plaintiff and Respondent,

v.

SUNTRUST MORTGAGE,
INC., Defendant and Appellant;
David J. Pasternak, Real Party
in Interest and Respondent.

B284550

|
Filed 2/26/2019

Synopsis

Background: Following residential landowners' refusal to abate nuisance, 2018 WL 6787331, city brought action against landowners and mortgage lender and sought appointment of receiver to undertake remediation, and receiver sought approval for super-priority lien. The Superior Court, Los Angeles County, No. GC046442, William D. Stewart, J., granted the lien, and mortgage lender appealed.

Holdings: The Court of Appeal, Lavin, J., held that:

receiver appointment statute authorized super-priority lien, and

court appropriately exercised its discretion when authorizing super-priority lien.

Affirmed.

****120** APPEAL from an order of the Superior Court of Los Angeles County, William D. Stewart, Judge. Affirmed. Los Angeles County Super. Ct. No. GC046442.

Attorneys and Law Firms

Wright, Finlay & Zak, Jonathan D. Fink, Newport Beach, and Ruby J. Chavez for Defendant and Appellant.

Dapeer, Rosenblit & Litvak and William Litvak, Los Angeles, for Plaintiff and Respondent.

Pasternak, Pasternak & Alsbrook, David J. Pasternak and Blake C. Alsbrook, Los Angeles, for Real Party in Interest.

Michael N. Feuer, City Attorney (Los Angeles), Wilfredo R. Rivera, Assistant City Attorney, Christina V. Tusan, Jeremy Berzon and Rebecca Morse, Deputy City Attorneys for The People of the State of California as Amici Curiae on behalf of Plaintiff and Respondent and Real Party in Interest.

LAVIN, J.

*651 INTRODUCTION

This is the second appeal before us involving a public nuisance created by Jeffrey ****121** M. and Taryn N. Hildreth (the Hildreths) on their residential property in Sierra Madre. (See ***652** *City of Sierra Madre v. Hildreth* (Dec. 26, 2018, B281729), 2018 WL 6787331 [nonpub. opn.].) Because the Hildreths refused to abate the nuisance, the City of Sierra Madre (City) brought the present action against them and their mortgage lender, appellant SunTrust Mortgage, Inc. (SunTrust), and sought the appointment of a receiver to undertake the remediation. SunTrust did not object to the appointment of the receiver or the remediation plan, but when the receiver borrowed \$250,000 to fund the remediation work, SunTrust objected to the issuance of the lien securing that loan because it had priority over SunTrust's preexisting lien. The receiver and real party in interest in this appeal sought approval for the super-priority lien because no lender would loan funds without it. SunTrust appeals the court's order authorizing the super-priority lien.

SunTrust's primary argument is that Health and Safety Code section 17980.7—a statute authorizing the appointment of a receiver in cases involving remediation of substandard buildings—does not explicitly provide that a court may issue a super-priority lien which displaces previously existing liens. We reject this argument because the use of super-priority liens has been approved in California since at least 1915. SunTrust's remaining arguments are without merit. We therefore affirm the order.

FACTS AND PROCEDURAL BACKGROUND

1. Over the course of more than 10 years, the Hildreths undertake several unpermitted construction projects on their residential property.

In July 1998, the Hildreths purchased a small home in Sierra Madre. The home was in substantial disrepair and the Hildreths began a complete remodel—without the benefit of any permits from the City. In October 1998, after the City issued a stop work order due to the absence of permits, the Hildreths requested and obtained permits for plumbing, building, electrical, and mechanical work relating to the renovation. Although the Hildreths eventually completed the work contemplated by the permits and moved into the home, they never notified the City the work was completed or requested a final inspection.

Around the time the Hildreths began the renovation, they decided they wanted to develop the home and the property for commercial use—specifically, a wine tasting and sales business. In September 1999, the Hildreths applied for a conditional use permit describing their proposed business operation, but the City never issued the requested permit. The Hildreths, however, proceeded to develop the property for their proposed wine business. In 2005, the City discovered the Hildreths had excavated a large pit on the eastern side of their property which caused a portion of an adjacent alley to collapse. The City immediately issued a stop work order and *653 required the Hildreths to work with a licensed engineer and a licensed shoring contractor, together with the City Building Department, to install temporary shoring. The Hildreths later constructed an unpermitted cement structure in the pit.

Then, in early 2009, the City discovered the Hildreths had—again without permits—excavated the western portion of their property to a depth of 12 feet below ground level, including the area underneath the western side of the house. The excavated area ran the entire length of the property and extended east to the unpermitted subterranean cement structure. In **122 June 2009, the City issued another stop work order. It appears SunTrust refinanced the Hildreths' mortgage during this time, as a deed of trust evidencing a mortgage loan of \$276,000 was recorded in March 2009.

In 2010, apparently undeterred by the City's prior warnings, the Hildreths erected a large, unpermitted deck in their front yard that extended over the public sidewalk adjacent to their property. In late October 2010, after receiving complaints from City residents, the City inspected the property and issued another stop work order.

2. The City files a nuisance action naming the Hildreths and SunTrust as defendants.

On December 1, 2010, the City filed the present action against the Hildreths and SunTrust seeking declaratory relief and asserting claims for public nuisance, municipal code violations, and state housing law violations. The following month, in January 2011, the court issued a preliminary injunction identifying a minimum of 30 violations of state and local building codes and prohibiting the Hildreths from performing any additional work or residing in the home without required permits, inspections, and approvals by the City. The court also ordered the Hildreths to submit the requisite applications, plans, documents, and fees to the City regarding the outstanding violations and, upon approval by the City, to remediate the home and the property.

3. After the Hildreths fail to remediate the property, the court appoints a receiver. SunTrust does not object to the appointment.

The Hildreths refused to cooperate with the City or comply with the preliminary injunction. In August 2012, more than a year and a half after the court issued the preliminary injunction, the City asked the court to appoint a receiver to take custody and control of the Hildreths' property. SunTrust did not object to the appointment. Citing the Hildreths' continuing obstruction, the court granted the City's request and appointed David J. Pasternak to act *654 as the receiver. Because the Hildreths obstructed the receiver's work, the City and the receiver agreed to postpone the remediation until after the court entered judgment in the nuisance action.

4. Following a lengthy bench trial, the court finds in favor of the City on all claims and enters judgment accordingly. SunTrust does not participate in the trial.

The court conducted a 27-day bench trial during the spring of 2016. SunTrust did not participate in the trial but

reserved the right to challenge the issuance of any lien that would displace its position as first lienholder.

The court issued a lengthy and thorough statement of decision in support of its judgment in favor of the City on all claims. As pertinent here, the court found the unpermitted and unapproved construction constituted a public nuisance under the City's municipal code as well as under state law, and injunctive relief to abate the nuisance was appropriate. The court entered judgment in the City's favor in January 2017.

Also, and as part of the judgment, the court ordered the previously-appointed receiver to oversee remediation of the property. The court found the Hildreths would not be willing or able to remediate the property if given the opportunity to do so. The Hildreths were required to pay the receiver's costs, however.

****123 5. The receiver presents a remediation plan, which the court adopts. SunTrust objects to the proposed super-priority lien for the lender funding the remediation but does not object to the plan.**

In early April 2017, the receiver provided his remediation report to the court. The property needed extensive and costly work performed. Specifically, a contractor would need to fill the excavated portion of the lot with slurry, increase the home's structural support, and remove the large deck encroaching on the public sidewalk. The lowest of the three contractor bids was approximately \$250,000 and the bulk of the expense related to filling in the pit under the Hildreths' home.

The receiver also advised the court that the value of the property after remediation would be \$175,000 to \$200,000 as a vacant lot and \$465,000 to \$495,000 with the rehabilitated home. Because the cost to remediate the home was relatively small and the increase in value was substantial, the receiver recommended rehabilitating, rather than demolishing, the home.

To fund the remediation, the receiver proposed borrowing funds from South County Bank (bank), one of very few institutional lenders willing to *655 provide such funding. The bank would require, however, its loan to be secured by a receiver's certificate with first priority, i.e., a senior lien on the property ahead of all other recorded liens and encumbrances (super-priority lien). The receiver indicated no lender would loan money to the receiver

unless it received a super-priority lien. The property as it then existed had no equity in light of the SunTrust lien. And even after remediation, the property value would be insufficient to satisfy the SunTrust lien, the substantial attorney's fees and cost award to the City (approximately \$875,000), and the receiver's costs of administration. In other words, according to the receiver, a lender would not be repaid unless it had a super-priority lien on the property.

SunTrust objected to the receiver's proposed remediation plan but only to the extent it provided a super-priority lien for the bank that would displace SunTrust as the senior lienholder. SunTrust did not challenge the receiver's approach or the cost of the remediation.

6. The court authorizes the receiver to borrow funds as proposed. SunTrust appeals.

On July 5, 2017, the court granted the receiver's request in large part.¹ Specifically, the court authorized the receiver to borrow \$250,000 from the bank in exchange for a receiver's certificate in the amount of the loan with first priority ahead of all other encumbrances if SunTrust opted not to fund the remediation. SunTrust opted not to do so and appealed from the July 5, 2017 order.

DISCUSSION

SunTrust contends the trial court erred in authorizing the receiver to issue a receiver's certificate with first priority over all other liens and encumbrances.

1. The appeal is not moot.

We first address, and reject, the City's contention that the present appeal is moot.

“ “[W]hen, pending an appeal from the judgment of a lower court, and without any fault of the defendant, an **124 event occurs which renders it impossible for this court, if it should decide the case in favor of plaintiff, to grant him any effectual relief whatever, the court will not proceed to a formal *656 judgment, but will dismiss the appeal.” ’ [Citations.]” (*Panoche Energy Center, LLC v. Pacific Gas & Electric Co.* (2016) 1 Cal.App.5th 68, 95–96, 205 Cal.Rptr.3d 39.) “ ‘The pivotal question in determining if a case is moot is ... whether the court can

grant the plaintiff any effectual relief. [Citations.] If events have made such relief impracticable, the controversy has become “overripe” and is therefore moot.’ [Citation.]” (*Id.* at p. 96, 205 Cal.Rptr.3d 39.)

The City contends SunTrust’s appeal is moot because the receiver, in accordance with the order appealed by SunTrust, obtained a loan from South Coast Bank to fund the remediation of the Hildreths’ property and secured that loan with a super-priority lien. Essentially, the City contends SunTrust forfeited the right to challenge the court’s July 5, 2017 order authorizing the receiver to provide a super-priority lien because SunTrust did not obtain a stay of the order pending appeal. We disagree. Although it appears the remediation is complete at this point, that fact does not prevent us from resolving the issue presented here concerning the relative priority of liens on the Hildreths’ property. And even if the property had been sold and the funds improperly dispersed, SunTrust might still have a remedy in equity against the recipient of those funds.

2. The court did not abuse its discretion in authorizing a super-priority lien to secure the loan taken by the receiver to fund remediation of the Hildreths’ property.

2.1. Legal Principles

The function of the receiver is to aid the court in preserving and managing the property involved in a particular lawsuit for the benefit of those to whom it can ultimately be determined to belong. (*Free Gold Mining Co. v. Spiers* (1901) 135 Cal. 130, 132, 67 P. 61; *City of Santa Monica v. Gonzalez* (2008) 43 Cal.4th 905, 930, 76 Cal.Rptr.3d 483, 182 P.3d 1027 (*Gonzalez*); *City of Chula Vista v. Gutierrez* (2012) 207 Cal.App.4th 681, 685, 143 Cal.Rptr.3d 689 (*Chula Vista*)). A receiver is an officer of the court and is subject to the court’s continuing control; a receiver only has those powers granted to it by statute or an order of the court. (*Gonzalez*, p. 930, 76 Cal.Rptr.3d 483, 182 P.3d 1027; Code Civ. Proc., § 568.) The receiver, acting for the court, is not the agent of any party but acts for the benefit of all holding an interest in the receivership property. (*Gonzalez*, p. 930, 76 Cal.Rptr.3d 483, 182 P.3d 1027; Cal. Rules of Court, rule 3.1179(a).)

A receiver has the power, with court authorization, to take possession of property, receive rents, collect debts, borrow money, and sell real or personal property in receivership pursuant to court order. (Code Civ. Proc., §§ 568, 568.5.)

The receiver acquires no title in the property but instead acts as an officer of the court, and title remains vested in those persons or entities in *657 whom it was vested when the receiver was appointed. (*North v. Cecil B. De Mille Productions, Inc.* (1934) 2 Cal.2d 55, 58, 39 P.2d 199; *Kaura v. Stabilis Fund II, LLC* (2018) 24 Cal.App.5th 420, 433, 234 Cal.Rptr.3d 265.)

Most matters related to receiverships rest in the sound discretion of the trial court. As our Supreme Court noted in *Gonzalez*, for example, considerable deference is afforded to “court decisions that are drastic enough to extinguish an owner’s interest in property” and to decisions regarding the demolition or rehabilitation **125 of substandard structures. (*Gonzalez, supra*, 43 Cal.4th at p. 931, 76 Cal.Rptr.3d 483, 182 P.3d 1027.) Similarly, the amount of compensation paid to a receiver is within the court’s discretion. (*People v. Riverside University* (1973) 35 Cal.App.3d 572, 587, 111 Cal.Rptr. 68 [“It is settled that fees awarded to receivers are in the sound discretion of the trial court and in the absence of a clear showing of an abuse of discretion, a reviewing court is not justified in setting aside an order fixing fees.”].) And although the receiver’s compensation is typically paid from the receivership estate, the court has considerable discretion to determine who must ultimately bear the cost of the receivership. (See, e.g., *Ephraim v. Pacific Bank* (1900) 129 Cal. 589, 592, 62 P. 177 [noting “the general rule that the costs of a receivership are primarily a charge upon the fund in his possession” but that “it may sometimes happen that a direct liability is imposed upon the parties to the action, or upon some of them, for the remuneration of the receiver” due to “irregularity of the appointment, or from the insufficiency of the fund, or out of the agreement between the parties’ ”]; *Baldwin v. Baldwin* (1947) 82 Cal.App.2d 851, 855, 187 P.2d 429 [“As a general proposition the costs of a receivership are primarily a charge upon the property in the receiver’s possession and are to be paid out of said property. However, this is not an invariable rule. In many cases a direct liability is imposed upon the parties to the action, or upon some of them, for the remuneration of the receiver.’ ”].) Here, as noted, the court imposed the cost of the receivership on the Hildreths. SunTrust has not challenged that determination.

Courts also have substantial discretion to authorize a receiver to borrow money to fund the preservation and management of property in the receivership estate,

particularly where, as here, the estate does not produce income. In that circumstance, the receiver may ask the court to authorize the issuance of a receiver's certificate to the lender as security for money loaned to the estate. Typically, such a receivership certificate will have priority over all other liens—even preexisting liens. (See, e.g., 12 Miller & Starr, Cal. Real Estate (4th ed. 2018) § 41.12, p. 41-33 [“Receivership certificates are then issued as evidence of the indebtedness and become liens on the subject property when issued under the direction and control of the court, usually with priority over all other liens, including preexisting liens.”].) This too is a matter committed to the sound discretion of the court. (*Title Ins. & Trust Co. v. California Development Co.* (1915) 171 Cal. 227, 233, 152 P. 564 [“The questions here *658 involved, i.e., whether receiver's certificates should be issued and whether those certificates when issued should be given priority over the other indebtedness of the defendant, rested largely in the discretion of the court below. That court, upon a consideration of all the facts, determined that the certificates should equitably be given priority over the bonds, and we think its conclusion should not be interfered with.”]; 12 Miller & Starr, *supra*, pp. 41-33 to 41-34 [“Whether receiver's certificates should be issued, and whether those certificates when issued should be given priority over the other indebtedness already of record against the property, are decisions that rest largely in the discretion of the court.”].) But as the receiver points out, use of super-priority liens should be infrequent because the disturbance of preexisting liens may bring harsh consequences. (See 2 Clark on Receivers (3d ed. 1959) § 463, pp. 760–761 [“The authority to disturb existing liens should be exercised with great caution, and should be carried **126 no further than actually necessary to attain the desired protection to the res.”].)

2.2. SunTrust's arguments are without merit.

Notwithstanding the well-settled authority just discussed, SunTrust claims the court had no authority to give the bank a super-priority lien, thereby displacing SunTrust as the senior lienholder. SunTrust's arguments are not persuasive.

SunTrust first argues no statute authorizes the issuance of a super-priority lien. Here, the receiver was appointed under Code of Civil Procedure section 564 (a generally applicable receivership statute) and Health and Safety Code section 17980.7 (authorizing appointment of receivers to remedy building code violations). SunTrust's

primary argument is that Health and Safety Code section 17980.7 does not explicitly authorize the issuance of a super-priority lien. That section specifically identifies the powers of a receiver appointed under the Health and Safety Code and provides, in pertinent part, that a receiver appointed to take control of a substandard building² has the power “[t]o borrow funds to pay for repairs necessary to correct the conditions cited in the notice of violation and to borrow funds to pay for any relocation benefits authorized by paragraph (6) and, with court approval, secure that debt and any moneys owed to the receiver for services performed pursuant to this section with a lien on the real property upon which the substandard building is located. The lien shall be recorded in the county recorder's office in the county within which the building is located.” (Health & Saf. Code, § 17980.7, subd. (c)(4)(G).) As SunTrust notes, that section makes no mention of a super-priority lien. And SunTrust urges us to infer from the plain language of the statute (i.e., the absence of language authorizing a super-priority lien) and the legislative history of section 17980.7 that the *659 Legislature intended to *prohibit* super-priority liens when it adopted this statute in 1990 and amended it in 2001.

We conclude it is unnecessary to engage in a lengthy statutory analysis of Health and Safety Code section 17980.7 because, as noted, the receiver was also appointed under Code of Civil Procedure section 564. Section 568 of the Code of Civil Procedure—first enacted in 1872—gives a receiver appointed under section 564 very broad powers: “The receiver has, under the control of the Court, power to bring and defend actions in his own name, as receiver; to take and keep possession of the property, to receive rents, collect debts, to compound for and compromise the same, to make transfers, and generally to do such acts respecting the property as the Court may authorize.” (Code Civ. Proc., § 568.) As already noted, the California Supreme Court long ago concluded a court may authorize a receiver to issue a super-priority lien in appropriate circumstances. (*Title Ins. & Trust Co. v. California Development Co.*, *supra*, 171 Cal. at p. 233, 152 P. 564.) And Health and Safety Code section 17980.7, subdivision (c)(4)(H),³ specifically gives a receiver appointed under that section the powers of a receiver appointed under Code of Civil Procedure section 564.

SunTrust also contends *Chula Vista*, *supra*, does not support the issuance of a **127 super-priority lien. (207 Cal.App.4th at p. 681, 143 Cal.Rptr.3d 689.) Specifically,

SunTrust argues “courts may impose the costs [of the receiver] on the party who sought the appointment of the receiver or apportion them among the parties.” That is true, as noted *ante*. And here the court has assigned the costs of the receivership to the Hildreths. That issue is distinct, however, from SunTrust’s apparent concern that it might be unable to collect the debt owed by the Hildreths if it is not paid from the proceeds of sale of the property due to the new super-priority lien created by the receiver.

In any event, *Chula Vista* is of no assistance to SunTrust. There, a receiver was appointed under Health and Safety Code section 17980.7 to cure code violations in a residential building. (*Chula Vista, supra*, 207 Cal.App.4th at p. 684, 143 Cal.Rptr.3d 689.) The court approved the receiver’s request for a lien to secure his fees, but the receiver never recorded the lien. (*Id.* at p. 685, 143 Cal.Rptr.3d 689.) Eventually, the lender (and senior lienholder) foreclosed and conveyed the property to a bona fide purchaser. (*Ibid.*) Several years later, the receiver filed an action against the lender seeking payment of his fees under a theory of unjust enrichment. (*Ibid.*) The issue on appeal was whether the lender “benefited” from the receiver’s services. (*Id.* at pp. 685–687, 143 Cal.Rptr.3d 689.) As that issue is not remotely relevant to the present proceeding, we address it no further.

***660** Finally, SunTrust points out that under the Health and Safety Code, the receiver may look to numerous sources for payment of receivership costs. For example, SunTrust notes the receiver could create a junior lien to secure a loan under Health and Safety Code section 17980.7, subdivision (c)(4)(G). Further, a receiver may look to the rents and profits produced by a property to pay for the cost of the receivership. (Health & Saf. Code, § 17980.7, subd. (c)(4)(E), (F).) Alternatively, the court could have appointed as receiver a nonprofit organization or community development corporation which would have been eligible to apply for grants to assist in the rehabilitation of the property. (Health & Saf. Code, § 17980.7, subd. (c)(2).) SunTrust also suggests the Hildreths, as owners, or the City, as the party that requested the receiver, should pay the costs of the receivership.

SunTrust correctly states the provisions of the statute at issue. But the fact that the court had a variety of options to choose from when it authorized the receiver to obtain funding for the needed remediation is beside

the point. SunTrust cites no authority suggesting—and doesn’t even argue—the court abused its discretion by authorizing a super-priority lien after considering all the facts and balancing the equities.

In any event, we would find no abuse of discretion on this record. The Hildreths refused to abate the nuisance they created on their property. SunTrust chose to take no action against the Hildreths, despite the fact the Hildreths were plainly in breach of the deed of trust.⁴ Accordingly, the court properly appointed a receiver to abate the nuisance and, notably, SunTrust did not object. Because neither the Hildreths nor SunTrust was willing to fund the costly remediation and the property did not produce any income, the receiver had to borrow money in order to proceed with the remediation. And as no ****128** lender would loan money to the receiver unless the loan was secured with a super-priority lien on the property, the only way to effect the remediation was to authorize the receiver’s request to issue such a receiver’s certificate. In short, the court did not abuse its discretion.

In closing, we note SunTrust repeatedly argues its interest in the Hildreths’ property was inequitably displaced by the lender’s super-priority lien. For example, SunTrust urges “[i]t is inequitable to allow [its] lien to be essentially stripped to nothing for a receivership that it did not request and which, as it will eat up most if not all the equity in the property, offers little to no benefit to [SunTrust]. It was not [SunTrust]’s duty to protect against and monitor the Hildreths’ use of the property that they owned subject to a loan [t]hat was current or the City’s related neglect. Therefore, [SunTrust]’s priority lien should not be sacrificed to pay for the remediation.”

***661** The critical point, unmentioned by SunTrust, is that its lien on the Hildreths’ property was worthless (or nearly so) well before the court authorized the receiver to issue a super-priority lien.⁵ The Hildreths persisted with unpermitted excavation and construction on the property and created the public nuisance which required remediation so costly it exceeded the value of the unimproved land. As a result, SunTrust had an inadequately secured loan and, due to California’s anti-deficiency statutes, also had an extremely limited ability to obtain payment from the Hildreths directly.⁶ Stated differently, the imposition of a super-priority lien by the receiver did not substantially prejudice SunTrust

because prior to the remediation, SunTrust was the senior lienholder on a property with minimal (or perhaps negative) value and was unlikely to be repaid in any event. SunTrust’s contention that it should remain the senior lienholder—and benefit from the increased property value provided by the remediation while bearing none of the cost—is simply untenable.

WE CONCUR:

EDMON, P. J.

EGERTON, J.

All Citations

32 Cal.App.5th 648, 244 Cal.Rptr.3d 118, 19 Cal. Daily Op. Serv. 1764, 2019 Daily Journal D.A.R. 1591

DISPOSITION

The July 5, 2017 order authorizing the receiver to issue a receiver’s certificate with first lien priority is affirmed. The City of Sierra Madre shall recover its costs on appeal.

Footnotes

- 1 The July 5, 2017 order substantially modified a June 2, 2017 order authorizing the receiver to proceed as he proposed. The court reconsidered that order, however, and the July 5, 2017 order is the court’s final ruling.
- 2 A substandard building is defined in Health and Safety Code section 17920.3.
- 3 That portion of the statute states a receiver appointed under Health and Safety Code section 17980.7 has the power “[t]o exercise the powers granted to receivers under Section 568 of the Code of Civil Procedure.”
- 4 We note, for example, that under the deed of trust, the Hildreths agreed to preserve, maintain, and protect the property, not to allow it to deteriorate, and not to commit waste on it.
- 5 As noted, the receiver concluded the property remediation would cost at least \$250,000 and the value of the property after remediation would likely be \$175,000 to \$200,000 as a vacant lot and \$465,000 to \$495,000 with the rehabilitated home.
- 6 Although a mortgage lender is generally barred from suing its borrower to recover the balance of a mortgage loan when the value of the property is inadequate to satisfy the loan (see Code Civ. Proc., § 580b), a lender may bring an action against a borrower for “ ‘bad faith’ ” waste in appropriate circumstances. (*Cornelison v. Kornbluth* (1975) 15 Cal.3d 590, 604, 125 Cal.Rptr. 557, 542 P.2d 981.) As Miller & Starr explains: “To the extent that there has been a reduction in the value of the property by depressed market conditions, the trustor or other person liable on the debt cannot be held personally liable. However, when the reduction in value resulting from bad-faith waste is the result of intentional or malicious action by the owner or person in possession, they can be held personally liable despite the limitations against personal liability on a purchase-money obligation.” (5 Miller & Starr, Cal. Real Estate, *supra*, § 13:313, p. 13-1322.)

“RECEIVERSHIP” ABATE DILAPIDATED PROPERTIES, INCREASE HOUSING STOCK, AND RECOVER FEES

Almost every City has an abandoned, fire damaged, or otherwise dilapidated properties. These Properties sit abandoned and dilapidated for years with no solution in sight. However, Receiverships solve the dilapidated property issue by utilizing California Health and Safety Code (“HSC”) section 17980.7.

HSC section 17980.7 allows cities obtain judicial approval to appoint a Receiver over a dilapidated property. The Receiver is then authorized to borrow funds to rehabilitate the Property with court oversight, and then sell the rehabilitated Property to a responsible owner approved by the Court, pursuant to California Code of Civil Procedure (“CCP”) section 568.5. (*Santa Monica v. Gonzalez* (2008) 43 Cal. 4th 905, 933)

Abating dilapidated properties is great for communities, and the City recovers all its attorney’s fees, enforcement costs, and outstanding City liens on the Property. These fees and costs are paid by selling the Property. (See HSC 17980.7(c)(11) & (d)(1). In addition to improving communities by abating dilapidated properties, and recovering money for the City, the receivership process has two positive collateral effects.

The first collateral effect is adding new housing stock to the City. Almost every City is dealing with limited housing stock in California, but dilapidated Properties can be brought into a productive use, and provide additional housing.

The second collateral effect is increasing Property tax revenue. We know Prop 13 limits Property Taxes on homes owned for a long time. However, when a property is sold the assessed value becomes the new basis for the tax. Therefore, when these dilapidated properties are sold a new tax base is established.

Receivership solves the dilapidated property issue, recovers money for cities, adds housing stock to cities, and increases Property Tax Revenue. Our presentation will explain the positive impacts Receiverships has on cities, as well as the receivership process.

Kasey J. Curtis (SBN 268173)
Direct Phone: +1 213 457 8089
Email: kcurtis@reedsmith.com

Reed Smith LLP
355 South Grand Avenue
Suite 2900
Los Angeles, CA 90071-1514
Tel +1 213 457 8000
Fax +1 213 457 8080
reedsmith.com

April 26, 2019

By E-Filing

Chief Justice Cantil-Sakauye and Associate Justices
California Supreme Court
350 McAllister St.
San Francisco, CA 94102

Re: Request for Depublication
City of Sierra Madre v. SunTrust Mortgage, Inc.
California Court of Appeal Second District, Division Three, Case No. B284550
Supreme Court Case No. S255087

Dear Chief Justice Cantil-Sakauye and Associate Justices:

Pursuant to Rule 8.1125 of the California Rule of Court, I write on behalf of Nationstar Mortgage, LLC d/b/a Mr. Cooper ("Nationstar") to respectfully request that the Court depublish the Court of Appeal's opinion in *City of Sierra Madre v. SunTrust Mortgage, Inc.* (2019) 32 Cal.App.5th 648 (*Sierra Madre*), issued by the Second District, Division Three, on February 26, 2019.

The opinion should be depublished because it not only conflicts with the applicable case law, statutes, and constitutional considerations, but will also wreak havoc on the well-defined law of liens and lien priorities that existed prior to the issuance of the opinion. The opinion holds that when a receiver is appointed at the behest of a municipality for code enforcement pursuant to Health and Safety Code § 17980.7, trial courts have the equitable discretion to alter statutory lien priority. Specifically, the opinion holds that trial courts have equitable discretion to authorize such a receiver to borrow funds secured by a "super-priority" lien (i.e., a lien with priority over all preexisting liens) to fund the receiver's efforts to bring the property into compliance with applicable building codes—thereby permitting the municipality to pass the cost of code enforcement off on lienholders.

Prior to the Court of Appeal's opinion in this case, California case law held that lien priority was a creature of statute creation. As a result, municipalities and courts lacked the power to alter lien priority in a manner not authorized by the Legislature. And, while Health and Safety Code § 17980.7(c)(4)(G) authorized receivers to borrow funds for remediation and to secure the amounts borrowed with a lien on receivership property, that provision did not purport to grant receivers the power to alter existing rules of lien priority. To the contrary, the relevant legislative history reflected that although the Legislature had considered giving receivership liens priority over other liens in enacting § 17980.7, it ultimately decided against doing so. What is more, the proposition that a receiver appointed at the behest of the government for code enforcement would have the power to abrogate a lienholder's lien priority would have presented grave constitutional concerns. Such abrogation of lien

priority in the name of the “public interest” would amount to a taking of the lienholder’s interest in the property without providing just compensation.

Yet, in concluding that a court has equitable discretion to alter lien priority, the Court of Appeal’s opinion does not address any of the above considerations. Instead, relying almost exclusively on a one-hundred-year-old decision involving a fundamentally different kind of receivership (one undertaken at the request of creditors to preserve the subject property), the opinion concludes that a trial court’s equitable discretion to subordinate liens is well-settled and it finds no abuse of discretion on the record before it. In so doing, the opinion binds trial courts to a flawed interpretation of the scope of a trial court’s equitable powers that disrupts otherwise is at odds with case law, statutes, and both the California and United States Constitutions.

Because the opinion substantially alters the state of California law without addressing the conflicting case law, statutes, and constitutional considerations, and has the potential to reach havoc on California lenders and homeowners, it should be depublished.

Statement Of Interest

Nationstar is one of the largest mortgage servicer in the United States, with a servicing portfolio that involves millions of loans. As a large mortgage servicer conducting business in California, Nationstar has recently found itself defending against litigation spearheaded by private attorneys and receivers who specialize in what they market as “zero cost” code enforcement. Essentially, these professionals have seized on the fact that local governments often have limited resources devoted to code enforcement and have attempted to devise ways to get third-parties (typically, homeowners or lienholders) to bear both the cost of bringing properties into compliance, as well as their associated professional fees.

The receivership remedy authorized by Health and Safety Code § 17980.7 is the most common type of such zero cost code enforcement litigation in which Nationstar has become involved. In the majority of the § 17980.7 receivership actions in which Nationstar has been involved, the municipality charged with code enforcement seeks appointment of a receiver (typically an attorney) who specializes in this area. Once appointed, the receiver takes control of the litigation and asks the trial court to give the receiver permission to fund the receivership by borrowing money secured by a “super-priority” lien on the property. When successful, this super-priority lien enables the municipality to shift the economic burden associated with the receivership (which includes payment of the receiver’s fees) to the lienholder.

The Law Before The Court Of Appeal’s Opinion

Prior to the Court of Appeal’s opinion in this case, California cases held that lien priority was a matter of statutory creation and had generally rejected the notion that municipalities or the courts have the power to override the Legislature’s policy determinations about which liens should enjoy priority over others. (See *Isaac v. City of Los Angeles* (1998) 66 Cal.App.4th 586, 599-601 (*Isaac*) [because lien priority is a creature of statutory creation that “reflects a legislative intent to favor certain types of charges against real property,” municipalities lack the power to alter lien priority by local ordinance];

Behniwal v. Mix (2007) 147 Cal.App.4th 621, 635-636 (*Behniwal*) [courts are not free to craft remedies that disregard statutory lien priority based upon their view of the equities of a particular case.] As these decisions explained, to do so would wreck absolute “havoc” on the otherwise well-settled and clearly defined rules of lien priority upon which lenders rely to effectively operate. (See *Isaac, supra*, 66 Cal.App.4th at pp. 601-602; *Behniwal, supra*, 147 Cal.App.4th at pp. 635-636.)

As a result, while it was the responsibility of municipalities to enforce building codes, they were required to do so in a manner that honored a lienholder’s lien priority. The Legislature had never authorized municipalities to force private third-parties to finance public enforcement efforts, such as by siphoning off the value of deeds of trust guaranteed first priority by statute. Instead, if municipalities wanted to remediate a property, they would invoke statutes like Government Code §§ 25845, 38773.1, 38773.5 and 54988, which authorized them to recoup abatement expenses as liens against substandard property, but subject to the standard “first in time, first in right” lien priority rules codified in Civil Code §§ 2897 and 2898.

Further, although Health and Safety Code § 17980.7 authorized municipalities to seek appointment of a receiver to achieve code enforcement, that statute did not purport to authorize the use of the value associated with the lienholder’s lien to fund the receiver’s work. To the contrary, while Health and Safety Code § 17980.7(c)(4)(G) provided an exhaustive list of the powers of the receiver and authorized the receiver to borrow funds secured by a lien on the subject property, it did not purport to authorize the subrogation of existing liens. (Health & Saf. Code, § 17980.7, subd. (c)(4)(G); see also *City of Chula Vista v. Gutierrez* (2012) 207 Cal.App.4th 681, 688 [“[i]f the Legislature had intended to impose direct liability or provide the receiver with a priority lien, it would have done so”].) What is more, the legislative history of § 17980.7 reflected that the Legislature had considered, but decided against, giving a receiver the authority to borrow funds on a super-priority basis. (Compare Assem. Bill No. 3492 (1989-1990 Reg. Sess.) as introduced Feb. 28, 1990 [“the receiver may borrow funds and secure the debt with an encumbrance on the real property upon which the substandard building is located which shall constitute a lien upon that property, superior to all prior liens and encumbrances, except taxes”] with Assem. Bill No. 3492 1989-1990 Reg. Sess.) as amended in Senate Aug. 24, 1990 [removing that language].)

All of this made perfect sense given the constitutional concerns with forcing third-parties to finance public code enforcement. After all, a lien on real property securing a debt is a protected property interest. (*D & M Financial Corp. v. City of Long Beach* (2006) 136 Cal.App.4th 165, 176 [“We find that the beneficiary of a deed of trust on property has a sufficient ownership interest to be entitled to just compensation in inverse condemnation”].) Permitting a receiver to subordinate a senior lien to provide funds to achieve code enforcement without providing the lienholder with just compensation, would violate the Takings Clauses of the California and United States Constitutions. (See Cal. Const., art. I, § 19; U.S. Const., 5th Amend.)

The Court Of Appeal’s Opinion

Unfortunately, the Court of Appeal’s opinion does not address any of the foregoing. Instead, relying almost exclusively on a one-hundred-year-old decision, the opinion holds that a trial court has

the equitable discretion in to alter statutory lien priority and pass the economic burden of code enforcement off on lienholders.

Relevant Factual And Procedural Background

In July 1998, the Hildreths purchased a home in Sierra Madre and began to remodel it. (Slip Op. at p. 3.) They did not obtain the required permits and improperly developed the property in violation of various building codes. (*Id.* at pp. 3-4.) The City discovered the Hildreths' unauthorized work and warned them that they needed to comply with permitting laws. (*Ibid.*) In March 2009, SunTrust refinanced the Hildreths' mortgage and recorded a deed of trust for \$276,000. (*Id.* at p. 4.)

In December 2010, the City of Sierra Madre filed an action seeking to resolve the building code violations on the Hildreths' property. (Slip Op. at p. 4.) The court issued a preliminary injunction and ordered the Hildreths to show how they intended to rehabilitate the property, but the Hildreths did not comply with the court's orders. (*Id.* at pp. 4-5.) The City then sought the appointment of a receiver to take custody and control of the Hildreths' property, and the court granted this request and appointed a receiver. (*Id.* at p. 5.)

In the meantime, the trial court held a bench trial and found that the Hildreths' unauthorized construction was a public nuisance under municipal and state law. (Slip Op. at pp. 5-6.) It also determined that the Hildreths were not willing to remediate the property. (*Id.* at p. 6.) It ordered the receiver to remediate the property and required the Hildreths to pay the receiver's costs. (*Ibid.*)

Pursuant to the court's order, the receiver obtained three contractor bids to rehabilitate the property, and the lowest of the estimates was for \$250,000. (Slip Op. at p. 6.) The receiver also determined that "the value of the property after remediation would be \$175,000 to \$200,000 as a vacant lot and \$465,000 to \$495,000 with the rehabilitated home." (*Ibid.*) Based on these estimates, the receiver decided to rehabilitate the property. (*Ibid.*)

To fund the rehabilitation, the receiver sought permission to obtain a loan for \$250,000, and he requested that the loan be secured by a receiver's certificate with priority over all other liens, including SunTrust's deed of trust. (Slip Op. at pp. 6-7.) The receiver asserted that without this super-priority lien, he would not be able to obtain funding. (*Id.* at p. 7.) SunTrust objected to this request, but the trial court ruled in favor of the receiver and authorized the receiver to borrow funds on a super-priority basis. (*Ibid.*) SunTrust appealed. (*Ibid.*)

The Opinion's Holding Courts Have Equitable Discretion To Alter Statutory Lien Priority

The primary issue decided within the opinion is whether the trial court had the legal power to grant the receiver a "super-priority" lien notwithstanding the lack of any express statutory authorization for that type of lien. Relying upon the proposition that "[m]ost matters related to receiverships rest in the sound discretion of the trial court" and this Court's one-hundred-year-old decision in *Title Insurance*

& Trust Co. v. California Development Co. (1915) 171 Cal. 227 (*Title Insurance*)¹ the opinion concludes that such equitable power exists and finds no abuse of the trial court's equitable discretion in altering lien priority. (Slip Op. at pp. 10-11, 15-17.) In particular, the opinion concludes that it was not inequitable for the trial court to give the receiver a super-priority lien because SunTrust was aware of the issues but "chose" not to take any action against the Hildreths and was later unwilling to fund the remediation itself. (*Id.* at pp. 15-16.)

With respect to SunTrust's arguments about why the trial court lacked the legal power to subordinate its interest, the opinion summarily rejected all of them. (Slip Op. at pp. 12-15.) Although SunTrust had argued that the plain language of Health and Safety Code § 17980.7 and relevant legislative history suggested the Legislature did not intend to authorize the receiver to obtain a super-priority lien, the opinion concludes "it is unnecessary to engage in a lengthy statutory analysis of Health and Safety Code section 17980.7 . . ." (*Id.* at pp. 13-14.) Instead, relying on *Title Insurance*, the opinion concludes a receiver in such situations can authorize super-priority liens. (*Ibid.*) Likewise, while SunTrust also argued that the remediation could have been funded through other means, such as by the city or the owners, the opinion concludes that fact was irrelevant because the use of a super-priority lien was just one of many acceptable options. (*Id.* at p. 15.)

Because The Opinion Substantially Alters California Law, And Will Wreck Havoc On Otherwise Well-Defined Lien Priority Rules, It Should Be Depublished

As noted above, prior to the issuance of the opinion in this case, the relevant case law, statutes, legislative history, and constitutional considerations all suggested trial courts lack the power to alter statutory lien priority. Yet, the Court of Appeal's opinion fails to address any of that. It does not address: (i) cases like *Isaac* and *Behniwal* that hold that lien priority is a matter of statutory creation that municipalities and courts lack the power to change; (ii) the statutes that permitted municipalities to enforce building codes in a manner that respected lien priority; (iii) the text and legislative history of Health and Safety Code § 17980.7 that made clear although the Legislature considered giving receivers the ability to borrow funds on a super-priority basis, it ultimately declined to do so; or (iv) the grave constitutional concerns presented by interpreting the law in a manner that enables municipalities to force lienholders to bear the costs of code enforcement. The opinion instead relies almost exclusively on a one-hundred-year-old decision to bind trial courts to a flawed construction of the scope of a trial court's equitable powers that conflicts with all of the forgoing.

Isaac and *Behniwal* both thoughtfully explain precisely why this result is untenable and should not stand. (See *Isaac, supra*, 66 Cal.App.4th at pp. 601-602; *Behniwal, supra*, 147 Cal.App.4th at pp. 635-636.) Those decisions stress there can be "no ad hoc creation of 'super-liens'" because of the absolute "havoc" that would result from disturbing the existing, well-settled, rules of statutory lien

¹ *Title Insurance* involved a fundamentally different kind of receivership: One established at the behest of creditors to preserve the property in which the creditors claim an interest. (*Title Insurance, supra*, 171 Cal. at pp. 229-231.) This is significant because, at common law, a receiver's expenditures were limited to those undertaken for the benefit of creditors—specifically those "necessary care and preservation of the property during the receivership." (*Id.* at p. 231.) It may be that it is "equitable" to require lienholders to bear the economic burden of a receivership undertaken for the benefit. There is, however, nothing equitable about requiring lienholders to fund the cost of municipal code enforcement and, prior to the Court of Appeal's opinion in this case, no reported California decision had ever suggested otherwise.

priority upon which lenders rely. (*Behniwal, supra*, 147 Cal.App.4th at pp. 635-636, citing *Isaac, supra*, 66 Cal.App.4th at p. 601.) They explain how this type of tinkering, while driven by the understandable compulsion to ensure a certain expense is paid from the equity of the property, is an example of the law of unintended consequences. (*Behniwal, supra*, 147 Cal.App.4th at pp. 631, 635-636.) It not only creates untenable results that destroy the expectations of lenders, but also risks putting the availability of lending in jeopardy. (See *Isaac, supra*, 66 Cal.App.4th at pp. 601-602 [“The potential ramifications of this anomalous lien include the reticence of lenders to underwrite master-metered apartment buildings and increased information costs relating to properties in the County, as potential lenders or purchasers must undertake additional investigations to determine the existence of such liens.”].)

The opinion should be depublished.

Very truly yours,


Kasey J. Curtis

KJC/hv

PROOF OF SERVICE

City of Sierra Madre v. SunTrust Mortgage, Inc.

California Court of Appeal Second District, Division Three, Case No. B284550
Supreme Court Case No. S255087

I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is REED SMITH LLP, 355 South Grand Avenue, Suite 2900, Los Angeles, CA 90071. On April 26, 2019, I served the following document(s) by the method indicated below:

APRIL 26, 2019, LETTER REQUESTING DEPULICATION

E-Service via TrueFiling

William Litvak
Dapeer, Rosenblit & Litvak, LLP
11500 W. Olympic Boulevard, Suite 550
Los Angeles, CA 90064

*Attorneys for Plaintiff
and Respondent City of
Sierra Madre*

Ruby J. Chavez
Jonathan D. Fink
Wright, Finlay & Zak, LLP
4665 MacArthur Court, Suite 200
Newport Beach, CA 92660-5704

*Attorneys for Defendant
and Appellant Suntrust
Mortgage, Inc*

David J. Pasternak
Blake Corby Alsbrook
Pasternak Pasternak & Alsbrook
1875 Century Park East, #2200
Los Angeles, CA 90067

*Attorneys for Real Party
in Interest and
Respondent David J.
Pasternak*

by placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California addressed as set forth below. I am readily familiar with the firm's practice of collection and processing of correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after the date of deposit for mailing in this Declaration. *Courtesy copy sent via email as noted.*

Clerk, Second Appellate District, Division 3
Ronald Reagan State Building
300 S. Spring Street
2nd Floor, North Tower
Los Angeles, CA 90013

Case No. B284550

I declare under penalty of perjury under the State of California that the above is true and correct. Executed on April 26, 2019 at Los Angeles, California.


Heather Valencia

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ORIGINAL FILED
AUG 20 2012
LOS ANGELES
SUPERIOR COURT

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

CITY OF SIERRA MADRE, a municipal corporation,)	CASE NO. GC046442 [<i>Assigned to Hon. Edward C. Simpson, Dept. R</i>]
)	
Plaintiff,)	[Related to Case No. GC048533]
)	
vs.)	[Proposed] ORDER APPOINTING RECEIVER
)	
JEFFREY M. HILDRETH, individually and d/b/a THE STERLING OAK;)	Hearing Date: July 31, 2012
TARYN N. HILDRETH, individually and d/b/a THE STERLING OAK;)	Department: R
SUNTRUST MORTGAGE, INC., a Virginia Corporation; and Does 1-50, inclusive,)	Time: 1:30 p.m.
)	
Defendants.)	
)	
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1 The Motion by Plaintiff CITY OF SIERRA MADRE for the Appointment of a
2 Receiver came on for hearing before the above-entitled court, on July 31, 2012, in
3 Department R, located at 300 E. Walnut Street, Pasadena, California 91101.

4 Upon consideration of the Notice of Motion and Motion, the Declarations
5 submitted by the City and the Exhibits attached thereto, the Memorandum of Points and
6 Authorities in support thereof, the Request for Judicial Notice, the Order for Preliminary
7 Injunction issued by this Court on January 24, 2011, and the pleadings and records on file
8 in this matter, and the arguments of counsel and the Defendants, and it appearing
9 therefrom to the satisfaction of this court that this is a proper matter for the Appointment
10 of a Receiver pursuant to Health & Safety Code § 17980.7 and CCP §564(b)(9), and that
11 unless the relief prayed for be granted, a public nuisance will continue to exist at the
12 property located at 187 E. Montecito Avenue, City of Sierra Madre, in the County of Los
13 Angeles, California, and identified by Assessor's Parcel Number 5767-014-005,
14 (hereinafter "Subject Property"), and it further appearing that irreparable harm will result
15 if the requested relief is not granted and there being no adequate remedy at law,

16
17 **1. THE COURT HEREBY FINDS AS FOLLOWS:**

18 1.1 On January 24, 2011, this Court, issued an Order for Preliminary
19 Injunction, finding that unless granted, a public nuisance will exist at real property
20 located at 187 E. Montecito Avenue, City of Sierra Madre, in the County of Los Angeles,
21 California, and identified by Assessor's Parcel Number 5767-014-005, (hereinafter
22 "Subject Property"), which is unlawful and dangerous to the public health and general
23 welfare, and thereby ordering Defendants JEFFREY M. HILDRETH and TARYN N.
24 HILDRETH (together, "Defendants"), among other things, to immediately abate all
25 unlawful conditions on the Subject Property;

1 1.2 Defendants JEFFREY M. HILDRETH and TARYN N. HILDRETH have
2 failed to comply within a reasonable time with the terms of the Order for Preliminary
3 Injunction issued by this Court on January 24, 2011 (“Order for Preliminary Injunction”);

4 1.3 Unless further action is taken by the Court, a public nuisance will
5 continue to exist at the Subject Property in violation of the Sierra Madre Municipal Code
6 and the laws of the State of California and pose a threat to the public health and general
7 welfare;

8 1.4 The appointment of a receiver to take custody and control of the Subject
9 Property pursuant to Health & Safety Code §17980.7 and CCP §564(b)(9) is necessary to
10 abate the substandard conditions on the premises and to preserve the Subject Property and
11 the rights of the City.

12
13 **ACCORDINGLY, GOOD CAUSE HAVING BEEN SHOWN, THE COURT**
14 **HEREBY ORDERS AS FOLLOWS:**

15 **2. APPOINTMENT OF RECEIVER**

16 2.1 IT IS ORDERED that David J. Pasternak, Esq. (hereinafter “Receiver”) is
17 appointed Receiver of the real property commonly known as 187 E. Montecito Avenue,
18 City of Sierra Madre, in the County of Los Angeles, California, and identified by
19 Assessor’s Parcel Number 5767-014-005 (“Subject Property”) for the purpose of abating
20 and correcting all unlawful and substandard conditions on the Subject Property and
21 bringing it into full compliance with the Sierra Madre Municipal Code, Health & Safety
22 Code and all other local and state laws. The Subject Property is legally described as
23 follows:

24 THE SOUTHERLY 9205 FEET OF LOT 4 OF THE LONG
25 BEACH TRACT NO. 2, IN THE CITY OF SIERRA MADRE,
26 COUNTY OF LOS ANGELES, STATE OF CALIFORNIA, AS
27 PER MAP RECORDED IN BOOK 10, PAGE 117 OF MAPS, IN
28 THE OFFICE OF THE COUNTY RECORDER OF SAID
COUNTY.

1 2.2. IT IS FURTHER ORDERED that the Receiver shall execute an
2 acknowledgement that he accepts the appointment as Receiver and shall tender his oath or
3 affirmation that he will faithfully perform the duties as Receiver to the clerk of the court;

4 2.3. IT IS FURTHER ORDERED that the Receiver shall file a bond in
5 Department R with surety thereon approved by this Court, in the sum of \$7,500.00,
6 conditioned upon the faithful performance of the Receiver's duties and that the cost of the
7 surety bond shall be assessed as a cost in this action in accordance with California Code of
8 Civil Procedure § 567(b).

9 2.4. Pending further instructions from this Court, the Receiver is authorized and
10 requested to submit a proposal ("Receiver's Proposal") to the Court and all parties by no
11 later than August 20, 2012, that shall include the following:

12 2.4.1. Proposal for how the Receiver will devise a remediation plan that will
13 bring the Subject Property into full compliance with all applicable
14 Municipal Codes, the Health & Safety Code and/or other laws;

15 2.4.2. Proposed provisions on the nature and extent of the Receiver's
16 powers and duties as are necessary to bring the Subject Property into
17 full compliance with all applicable Municipal Codes, the Health &
18 Safety Code, and/or other laws and for the Receiver to undertake all
19 actions necessary to abate all substandard, hazardous, and/or
20 unlawful conditions at the Subject Property;

21 2.4.3. A preliminary appraisal report for the Subject Property; and,

22 2.4.4. Discussion of how and in what manner the Receiver will be
23 compensated for his services.

24 2.5. All parties may file a response to the Receiver's Proposal no later than
25 August 31, 2012. A hearing on the Receiver's Proposal is set for September 12, 2012 at
26 8:30 a.m. in Department R. The parties and the Receiver may stipulate to continue the
27 aforementioned dates based upon availability of the parties and their respective counsel.
28

1 2.6. IT IS FURTHER ORDERED THAT the Receiver and the parties to this
2 case may at any time apply to this Court for further or other instructions or orders, and for
3 further powers necessary to enable the Receiver to perform the Receiver's duties properly,
4 as ordered by this Court, and that the receivership shall be ongoing until further order of
5 the Court.

6
7 **3. FURTHER ORDERS AS TO DEFENDANTS JEFFREY M. HILDRETH**
8 **and TARYN N. HILDRETH DURING THE PENDENCY OF THE**
9 **RECEIVERSHIP:**

10 3.1 Defendants, upon execution of this order, shall permit the Receiver, and
11 any and all persons acting on his behalf, including but not limited to the receiver's staff,
12 City officials, licensed contractors, engineers, and other service providers, to enter onto
13 the Subject Property at any time between the hours of 8:00 a.m. and 6:00 p.m., with
14 reasonable notice to the Defendants, for the purpose of conducting inspections of all areas
15 of the property, without a warrant, in order to obtain cost estimates, prepare for and
16 implement remediation plans necessary to bring the Subject Property into compliance
17 with the Sierra Madre Municipal Code and all other local and state laws, to fulfill the
18 Receiver's duties as will be determined by the Court, and to ensure compliance with the
19 terms of this order, and any other orders issued by the Court pursuant to Section 2.5
20 herein. ("Reasonable notice" shall be defined as forty-eight (48) hours notice or more
21 prior to any inspection date. Defendants may waive the forty-eight (48) hours notice
22 requirement at any time).

23 3.2 Defendants are ordered to provide the Receiver with any and all
24 information, documents, records, or other information that he shall request, including
25 without limitation all books, records, books of account, ledgers, operating statements,
26 budgets, real estate tax bills, and all other business records, wherever located, and in
27 whatever mode maintained, including information contained on computers and any and
28 all software relating thereto, as well as any banking records, statements, and cancelled

1 checks and all documents which pertain to all licenses, permits, or government approvals
2 relating to the Subject Property, and Defendants shall immediately advise the Receiver of
3 any Federal Taxpayer Identification Number used in connection with the operation of the
4 Subject Property, and any insurance coverage of the Subject Property;

5 3.3 Defendants shall notify, in writing, any prospective purchaser, lessee,
6 agent, or other successor in interest that any person who obtains an ownership interest in
7 the Subject Property shall be subject to any order to correct a violation of any applicable
8 Municipal Codes, and/or State laws issued and/or recorded with the County Recorder;
9 and shall provide a copy of said notification to the City and this Court.

10 3.4 Defendants, each of them, and their agents, employees, servants, successors
11 or assigns, or anyone acting on their behalf or in concert with them, are prohibited from
12 the following:

13 3.4.1 Interfering with or obstructing in any manner, directly or indirectly,
14 the discharge of the Receiver's duties as will be determined by the
15 Court and as set forth in this order and any other order of the Court;

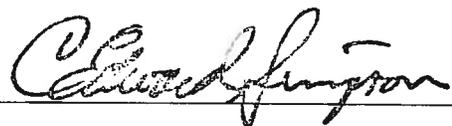
16 3.4.2 Interfering with or obstructing in any manner, directly or indirectly,
17 the Receiver's possession, custody, control, operation or
18 management of the Subject Property;

19 3.4.3 Encumbering or transferring the Subject Property or any portion
20 thereof; and,

21 3.4.4 Interfering in any manner whatsoever with the objectives of this
22 order or any other order of the Court.

23 **IT IS SO ORDERED.**

24 ISSUED at Pasadena, California, on the 20 day of August 2012.

25
26 

27 Judge of the Superior Court

28 C. Edward Simpson

6 Judge of the Superior Court

PROOF OF SERVICE

1 STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

2
3 I am employed in the county of Los Angeles, State of California. I am over
4 the age of 18 and not a party to the within action; my business address is 11500
5 W. Olympic Blvd., Suite 550, Los Angeles, CA 90064-1524.

6 On August 10, 2012, I served the foregoing document described as
7 **[Proposed] ORDER APPOINTING RECEIVER** on interested parties in this action by
8 placing a true copy thereof enclosed in a sealed envelope addressed as follows:

9
10 SEE ATTACHED SERVICE LIST

11 I am "readily familiar" with the firm's practice of collection and processing
12 correspondence for mailing. Under that practice it would be deposited with U.S.
13 postal service on that same day with postage thereon full prepaid at Los Angeles,
14 California in the ordinary course of business. I am aware that on motion of the
15 party served, service is presumed invalid if postal cancellation date or postage
16 meter date is more than one day after date of deposit for mailing in affidavit.

17
18 Executed on August 10, 2012, at Los Angeles, California. I declare under
19 penalty of perjury under the laws of the State of California that the above is true
20 and correct.

21
22
23 
24 Camille Smith, Declarant

SERVICE LIST

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David E. Rosenbaum, Esq.
484 So. Euclid Ave., Suite 105
Pasadena, CA 91101
Tel. No.: (626) 432-7422
Fax No.: (626) 792-5433
e-mail: davider484@sbcglobal.net

Attorney for Defendants Hildreth

Eric J. Troutman, Esq.
Benjamin A. Eilenberg, Esq.
Severson & Werson
A Professional Corporation
The Atrium
19100 Von Karman Ave., Suite 700
Irvine, CA 92612
Tel. No.: (949) 442-7110
Fax No.: (949) 442-7118

Attorney for Suntrust Mortgage, Inc.

David J. Pasternak, Esq.
Pasternak, Pasternak & Patton
1875 Century Park East
Suite 2200
Los Angeles CA 90067-2523
Tel. No.: (310) 553-1500
Fax No.: (310) 553-1540

Receiver

CYNTHIA F. PASTERNAK
DAVID J. PASTERNAK
BLAKE C. ALSBROOK

FREDMAN LIEBERMAN PEARL LLP
GREG YARIS
OF COUNSEL

PASTERNAK, PASTERNAK & ALSBROOK

A LAW CORPORATION
1875 CENTURY PARK EAST, SUITE 2200
LOS ANGELES, CALIFORNIA 90067-2523

TELEPHONE
(310) 553-1500

FACSIMILE
(310) 553-1540

AUTHOR'S E-MAIL
hca@prslaw.com

May 6, 2019

BY E-FILING

Chief Justice Cantil-Sakauye and the Honorable
Associates Justices of the California Supreme Court
California Supreme Court
350 McAllister Street
San Francisco, CA 94102

Re: **Response to Request for Depublication**
City of Sierra Madre v. SunTrust Mortgage, Inc.
California Court of Appeal Second District, Division Three, Case No. B284550
Supreme Court Case No. S255087

Dear Chief Justice Cantil-Sakauye and Associate Justices:

I am the Receiver and real party in interest in this case. I write in response and opposition to Nationstar Mortgage, LLC's ("Nationstar") April 26, 2019 Request for Depublication.

In urging this Court to depublish the unanimous Opinion below, Nationstar falsely asserts that the Opinion "conflicts with the applicable case law, statutes, and constitutional considerations, [and] will also wreak havoc on the well-defined law of liens and lien priorities that existed prior to the issuance of the opinion." (Request for Depublication "Req. Dep." at p. 1.) In truth, the Opinion provides needed guidance for trial courts that are repeatedly given similar misstatements of the law by lenders, while California receivership law has in fact permitted such priority liens for the last century without any disruption to mortgage lending in this state during that lengthy period of time.

The Opinion Below is not Based on the Health and Safety Code

Nationstar not only mistakenly characterizes the Opinion below as based on Health and Safety Code §17980.7, it repeatedly and improperly relies on the Health and Safety Code throughout its Request for Depublication. (Req. Dep. at p. 1 ["The opinion holds that when a receiver is appointed at the behest of a municipality for code enforcement pursuant to Health and Safety Code § 17980.7 . . ."; "the relevant legislative history

Chief Justice Cantil-Sakauye and Associate Justices
May 6, 2019
Page 2

reflected that although the Legislature had considered giving receivership liens priority over other liens in enacting § 17980.7 . . ."; at p. 2 "[t]he receivership remedy authorized by Health and Safety Code §17980.7 . . ."; at p. 3 extensive discussion of §17980.7; at p. 5 providing misleading and incomplete quote of Court of Appeal opinion regarding §17980.7].)

Tellingly, Nationstar fails to explain to this Court that the Opinion below, in plain terms, *was not based on the Health and Safety Code*:

We conclude it is unnecessary to engage in a lengthy statutory analysis of Health and Safety Code section 17980.7 because, as noted, the receiver was also appointed under Code of Civil Procedure section 564. . . . *As already noted, the California Supreme Court long ago concluded a court may authorize a receiver to issue a super-priority lien in appropriate circumstances.* [Citing *Title Ins. & Trust Co. v. California Development Co.* (1915) 171 Cal. 227, 233.]

(February 26, 2019 Court of Appeal Opinion in this matter at p. 13, emphasis added.) Nationstar's reason for misleading the Court is clear: as opposed to the Health and Safety Code, the general receivership law arising out of Code of Civil Procedure §564, et seq., and the great body of equity jurisprudence in this state has recognized the ability of receivership courts to authorize the issuance of priority receiver's certificates for more than a century.

Nationstar's Depublication Request Is Based On Inapposite Case Law

In addition to misstating the basis for the Court of Appeal's Opinion, Nationstar relies *entirely* on two cases – repeatedly referenced throughout the Request for Depublication – that are irrelevant here. In setting forth what it asserts was the law "[p]rior to the Court of appeal's opinion in this case," Nationstar points to *Isaac v. City of Los Angeles* (1998) 66 Cal.App.4th 586, 599-601 and *Behniwal v. Mix* (2007) 147 Cal.App.4th 621, 635-636 for its feigned horror that the Court of Appeal's Opinion will "wreck [*sic*] absolute 'havoc' on the otherwise-settled and clearly defined rules of lien priority upon which lenders rely to effectively operate." (Dep. Req. at pp. 2- 3.)

First, in *Isaac*, the Los Angeles City Council thought it wise to pass a local ordinance that allowed the City to collect past-due utility payments by creating a super priority lien on certain real properties with payment first before all other creditors. (66 Cal.App.4th at p. 591.) Applying a typical preemption analysis, the Court of Appeal found that California had "occupied the field" by passing laws concerning lien priority, and that the

Chief Justice Cantil-Sakauye and Associate Justices
May 6, 2019
Page 3

City was therefore without power to enact a law in conflict with that statewide regulatory scheme, as "[e]very California city may enact and enforce within its limits local ordinances not in conflict with general laws. (Cal. Const., art. XI, § 7.)" *Id.* at p. 599.)

Unlike *Isaac*, this case does not concern a municipality attempting to pass legislation that conflicts with state law. Instead, this case concerns the longstanding practice of *receivership courts*, sitting in equity, authorizing the issuance of priority receiver's certificates based on the individual circumstances of the case. *Isaac* has no application here.

Second, in *Behniwal*, the trial court ignored the California statute regarding creation of judgment liens and attempted to award contractual attorney's fees to a prevailing party in a specific performance case "off the top of the sales price," thereby "effectively circumvent[ing] the statute." (*Behniwal v. Mix* (2007) 147 Cal.App.4th 621, 636.) The *Behniwal* court was concerned about the general application of super-priority attorney's fee awards, asking the reader to "consider the havoc that would follow if the idea of deducting an attorney fee award were a general rule that a court might apply in any specific performance case." (*Id.*)

Unlike *Behniwal*, the Court of Appeal below considered the issuance of priority receiver's certificates, not an attorney's fee award properly falling within California's law concerning judgment liens. Moreover, unlike the concerns raised by the *Behniwal* court, the issuance of priority receiver's certificates is not a new practice that might find general application in the lower courts and disrupt the priority of liens as envisioned under California law. To the contrary, the Court of Appeal pointed out that "use of super-priority liens should be infrequent because the disturbance of preexisting liens may bring harsh consequences." (Citing 2 Clark on Receivers (3d ed. 1959) §463, pp. 760-761 ["The authority to disturb existing liens should be exercised with great caution, and should be carried no further than actually necessary to attain the desired protection to the res."].) Moreover, as noted by the Court of Appeal and California law more generally, priority receiver's certificates are only to be issued in order to protect and preserve the real property in receivership. (*Title Ins. & Trust Co.*, *supra*, 171 Cal. at p. 231 [citing High on Receivers, 4th ed., sec. 312b; 34 Cyc. 297].) The underlying justification for the rule is that preserving the property at issue will in fact assist any lienholders. (*Id.*) (Indeed, it is hard to imagine how Suntrust would have benefited from the City of Sierra Madre allowing the real property, including its single family residential security, to collapse into a hole.)

Chief Justice Cantil-Sakauye and Associate Justices
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California Courts Have Consistently Afforded Great Deference To Receivership Courts, Including With Respect To Lien Issues

Contrary to Nationstar's assertion that the Opinion below is radical and somehow alters California law, this Court has approved of priority receiver's certificates for a century: "there can be no question of the right of the court to give priority to certificates issued to enable the receiver to carry out the primary object of his appointment, viz., the care and preservation of the property." (*Title Ins. & Trust Co. v. California Development Co.* (1915) 171 Cal. 227, 231.)

Nationstar attempts – and fails miserably– to distinguish or delegitimize this Court's *Title Ins. & Trust Co.* holding as a "one-hundred-year-old decision" or a "different kind of receivership" – an effort that is notable as being relegated to a footnote in its Request for Depublication. (Req. Dep. at p. 5.) As should be clear from this Court's words above, however, there was no limitation to the language of *Title Ins. & Trust Co.* Coincidentally, the leading California treatises on the subject do not share Nationstar's confusion:

With court authorization, a receiver may be authorized to issue receivership certificates as security for cash loaned to the receivership estate. Receivership certificates are then issued as evidence of the indebtedness and become liens on the subject property when issued under the direction and control of the court, usually with priority over all other liens, including preexisting liens. Whether receiver's certificates should be issued, and whether those certificates when issued should be given priority over the other indebtedness already of record against the property, are decisions that rest largely in the discretion of the court.

(Miller & Starr, Cal. Real Est. (4th Ed. 2017) §41:12 [citing *Dorn v. Crank* (1892) 96 Cal. 381, 382-384; *Title Ins. & Trust Co.*, supra, 171 Cal. at pp. 229-233; 3 Powell on Real Property, §492].)

Nationstar's attempts to paint this Court's *Title Ins. & Trust Co.* holding as somehow antiquated or irrelevant also fail in light of recent California receivership decisions. In 2014, the Court of Appeal in *City of Riverside v. Horspool* (2014) 223 Cal.App.4th 670, 684 confirmed that a receivership court "has the power to order the sale of property *free and clear of liens and encumbrances.*" (Emphasis added, citing *Miners' Bank of Wilkes-Barre v. Acker* (3d Cir.1933) 66 F.2d 850, 853; *Spreckels v. Spreckels Sugar Corp.* (2d Cir.1935) 79 F.2d 332, 334 [Proper for court to "strike a balance between the conflicting interests" of various creditors when stripping liens].) This provision of broad

Chief Justice Cantil-Sakauye and Associate Justices
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Page 5

powers to receivership courts is nothing new: "rulings on receivership matters are afforded considerable deference on review." (*Lesser & Son v. Seymour* (1950) 35 Cal.2d 494, 503 [confirmation of receiver's sale of partnership assets and real property]; *Golden State Glass Corp. v. Superior Ct.* (1939) 13 Cal.2d 384, 393 [appointing or refusing to appoint a receiver]; *People v. Riverside University* (1973) 35 Cal.App.3d 572, 582 [confirmation of receiver's sale of personal property].) Deference on the part of the reviewing court is the rule even where the court below approves extraordinary action on the part of its receiver. (See, e.g., *Lesser & Son, supra*, 35 Cal.2d at p. 503; *People v. Stark* (2005) 131 Cal.App.4th 184, 199, 207–208 [dealership assets and real estate]; *City of Santa Monica v. Gonzalez* (2008) 43 Cal.4th 905, 931 [California Supreme Court affirmed receivership court's authorization of receiver demolishing (over defendant's objection) rather than repairing defendant's residence to remedy Health and Safety Code violations].)

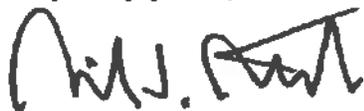
The Court of Appeal's Opinion Should Not Be Depublished Because It Reaffirms Important Law

While the undersigned is confident that priority receiver's certificates have been authorized by receivership courts for the past four decades of his practice, and that they are authorized by California law, this fact might not be so obvious to trial courts without receivership expertise. More and more often, large institutional lenders such as Nationstar and SunTrust are attempting to mislead the trial courts in receivership matters as they have attempted to mislead this Court.

Black letter California law provides discretion to the lower courts to fashion equitable remedies based on the often drastic circumstances involved in the receiverships before them, including authorizing priority liens to protect property. And that is exactly what happened in this case: based on the evidence before it, the trial court determined that there was a nuisance and dangerous condition on the property before it, and it allowed the receiver to borrow funds to correct the condition before the structure collapsed. The Court of Appeal's Opinion does an important job of clarifying the law and reaffirming the *Title Ins. & Trust Co.* holding in light of arguments like the ones presented in Nationstar's Request for Depublication and the ones made to the Courts below by the lender in this case.

Chief Justice Cantil-Sakauye and Associate Justices
May 6, 2019
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Very truly yours,

A handwritten signature in black ink, appearing to read "David J. Pasternak". The signature is stylized and cursive, with a prominent initial "D" and a long, sweeping underline.

David J. Pasternak
Receiver

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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

At the time of service, I was over 18 years of age and **not a party to this action**. I am employed in the County of Los Angeles, State of California. My business address is 1875 Century Park East, Suite 2200, Los Angeles, CA 90067-2523.

On May 6, 2019, I served true copies of the following document(s) described as **Letter-Response to Request for Depublication** on the interested parties in this action as follows:

SEE ATTACHED SERVICE LIST

- BY MAIL:** I enclosed the document(s) in a sealed envelope or package addressed to the persons at the addresses listed in the service list. The envelope or package was mailed with postage thereon fully prepaid. I am "readily familiar" this firm's practice of collection and processing correspondence for mailing. It is deposited with the U.S. Postal Service on the same day in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than 1 day after date of deposit for mailing in affidavit.
- BY ELECTRONIC FILING:** I electronically filed the document(s) with the Clerk of the Court.

Executed on May 6, 2019, at Los Angeles, California.



C. German

1 Kasey J. Curtis, Esq.
Reed Smith LLP
2 355 South Grand Avenue, suite 2900
Los Angeles. CA 90071-1514
3
4 Clerk, Second Appellate District, Division 3
Ronald Regan State Building
300 s. Spring Street
5 2nd Floor, North Tower
Los Angeles. CA 90013
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Biographies

Blake Alsbrook

Mr. Alsbrook is a Shareholder with Pasternak, Pasternak & Alsbrook, a boutique Century City law firm specializing in receiverships, partition actions, provisional directorships, and real estate litigation. Mr. Alsbrook acts as a receiver and counsel for prominent receivers throughout California appointed to general equity, Family Code, rents and profits, Health and Safety Code, and regulatory receiverships. Mr. Alsbrook also acts as and represents partition referees around the state and advises provisional directors of myriad businesses with compromised boards of directors.

Among other receivership matters, Mr. Alsbrook has provided counsel to (1) the receiver of a low income housing developer alleged to have perpetrated a \$100mm+ fraud against California cities and banks, (2) the receiver in a regulatory matter brought by the California Department of Corporations against an internet company alleged to have illegally issued shares, and (3) a rents and profits receiver responsible for completing multiple multi-million dollar development projects. In addition to advising receivers and provisional directors on the impact of California and federal law on their practice, Mr. Alsbrook has significant civil litigation experience defending and prosecuting actions on behalf of receivers and businesses, and regularly practices and argues before the California Court of Appeal and the United States Bankruptcy Court on behalf of receivers and other fiduciaries.

Rocky Delgadillo

Rockard "Rocky" Delgadillo has more than 30 years of experience in litigation, economic development transactions, and government law and public policy.

Rocky served an eight-year tenure, the term limit, as the City of Los Angeles City Attorney. As the city's chief lawyer and chief criminal prosecutor, he led more than 550 attorneys who comprise the second largest municipal law firm in the nation. Rocky was the first Latino to win citywide office in more than 100 years when he was elected in 2001. Running unopposed, he was re-elected in 2005 to a second four-year term.

During his tenure as City Attorney, Rocky implemented a number of innovative programs to further his vision of a better and safer Los Angeles. His top priorities included fighting crime, improving the quality of life in local neighborhoods and reducing the city's civil liabilities. In his first term, Rocky more than tripled the number of gang injunctions, contributing to a steep decline in crime in affected areas. Throughout his tenure, he helped make neighborhoods safer by implementing the neighborhood

prosecutor program and by reducing the city's liability costs to free up millions of dollars to help pay for police and other crucial city services.

Prior to his election as Los Angeles City Attorney, Rocky was the Deputy Mayor of Los Angeles for Economic Development, where he attracted new jobs to emerging neighborhoods. He created an efficient neighborhood-friendly approach to business development through the creation of the LA Business Team and, in four years, helped bring in billions in private investment to the city.

Gerard Keena

Gerard F. Keena is an experienced professional with over 13 years of asset management experience with specialties in property management and business transactions. Consulting services have been completed on a wide variety of asset types. This includes the day-to-day oversight of large residential, commercial and industrial real estate portfolios originated from major financial institutions, private equity and hedge fund clients.

Gerard has been responsible for numerous types of real property management, including office buildings, unfinished apartment and condominium complexes as well as industrial facilities. Additionally, Gerard has sold numerous types of real property ranging from single family homes to multi-million dollar commercial properties. Gerard is experienced in real estate and business evaluations, negotiations as well as financial and market analysis.

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ERIC S. PEZOLD | 714.427.7414 | ERIC.PEZOLD@SWLAW.COM

PLAZA TOWER | 600 ANTON BOULEVARD | SUITE 1400 | COSTA MESA, CALIFORNIA 92626

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