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CLERK, U.S. DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

BY: *J-H* DEPUTY

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

vs.

PRESTO TELECOMMUNICATIONS, INC.;
ALFRED LOUIS VASSALLO, JR. aka
BOBBY VASSALLO,

Defendants.

CASE NO. 04-CV-0163-IEG (WMC)

**ORDER AUTHORIZING
RECEIVER TO SELL
DEFENDANT'S HOUSE ON THE
CONDITION THAT DEFENDANT
FAILS TO PAY THE CONTEMPT
FINE**

[Doc. No. 641]

Presently before the Court is Thomas Lennon's ("the Receiver") motion for an order authorizing the sale of residential property belonging to Alfred "Bobby" Vassallo, Jr. (hereinafter "defendant" or "Vassallo"). The Receiver claims that the sale of the property is necessary to satisfy defendant Vassallo's current contempt fine of \$13,228, as well as other costs incurred by the Receiver.

BACKGROUND

A. Factual Background

In October 2002, Vassallo and his wife purchased the residential property located at 1329

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1 West Muirlands Drive in La Jolla, California ("the property"). Thereafter, in November 2002,
2 defendant and his wife transferred title to the property to the Vassallo Family Trust. Although the
3 form of property ownership changed when defendant placed the property in trust, the liens
4 currently recorded on the property are not attributable to the trust, but rather secure obligations
5 owed by either the defendant, his wife, or both.

6 The residential property is heavily encumbered. Although the purchase price in October
7 2002 was \$2,750,000, the liens on the property currently total \$5,215,946. However, the actual
8 total may be significantly less than \$5,215,946 since the validity of each lien has yet to be tested.
9 Additionally, the actual value of the property is unknown at the present time, since the house has
10 not yet been appraised.

11 **B. Procedural Background**

12 On March 2, 2004, the Court issued a preliminary injunction order, which froze defendant
13 Vassallo's assets and appointed a permanent receiver over Presto Telecommunications, Inc.
14 Additionally, on March 10, 2004, the Court issued a supplemental order directing defendant to
15 perform certain acts pursuant to the preliminary injunction. Subsequently, on August 19, 2004, the
16 Court issued an order imposing a contempt fine on defendant for wilfully disobeying two court
17 orders. The Court ordered defendant to pay the Receiver \$13,228 as compensation for losses
18 sustained by the Receiver due to defendant's non-compliance. Although the Court ordered
19 defendant to pay the fine no later than September 10, 2004, on September 9, 2004, counsel for the
20 Receiver agreed to defer the payment obligation pending the outcome of settlement negotiations.
21 Unfortunately, the settlement negotiations failed, and on September 22, 2004, counsel for the
22 Receiver revoked the temporary deferral, but agreed to limited relief from the asset freeze so that
23 defendant Vassallo could pay the fine. (Declaration of Jeffrey Patterson at Exh. A.) To date,
24 defendant has not paid the fine, nor has he identified a source of liquid assets from which he could
25 pay the fine.

26 In an effort to collect on the outstanding contempt fine, the Receiver filed the instant
27 motion on August 23, 2004, asking the Court to authorize the sale of defendant's residential
28 property. The Receiver argues that he is entitled to sell the property pursuant to the Court's

1 preliminary injunction order. In the preliminary injunction, the Court ordered defendant Vassallo
2 to pay the costs, fees and expenses incurred in connection with the Receiver's duties. The
3 Receiver contends that any capital left in Presto, Inc. after the freeze has already been exhausted.
4 Therefore, the Receiver argues that the residential property must be sold in order to compensate the
5 Receiver for existing costs.

6 On September 28, 2004, defendant Vassallo submitted his opposition to the Receiver's
7 motion to sell the property. Thereafter, on October 4, 2004, both the Receiver and the S.E.C. filed
8 replies to the defendant's opposition. The Court held oral argument on Tuesday October 12, 2004.

9 DISCUSSION

10 A. Legal Standard

11 The Ninth Circuit has repeatedly held that district courts have broad power and wide
12 discretion in fashioning relief and protective measures in S.E.C. actions involving receiverships.
13 S.E.C. v. Hardy, 803 F.2d 1034, 1037 (9th Cir. 1986); S.E.C. v. American Capital Inv., Inc., 98
14 F.3d 1133, 1143-44 (9th Cir., 1996); In re San Vicente Med. Partners Ltd., 962 F.2d 1402, 1406
15 (9th Cir. 1992); Sec S.E.C. v. Safety Fin. Serv. Inc., 674 F.2d 368, 373 (a court overseeing a
16 receivership is accorded "wide discretionary powers" in light of "the concern for orderly
17 administration"). The basis for such discretion arises from the fact that most receiverships involve
18 multiple parties and complex transactions. S.E.C. v. Hardy, 803 F.2d at 1037. Additionally, the
19 Ninth Circuit has acknowledged that the primary purpose of equity receiverships is to promote the
20 orderly and efficient administration of assets for the benefit of investors and creditors. Id.; see also
21 S.E.C. v. Wencke (Wencke II), 783 F.2d 829, 837 n.9 (9th Cir. 1986). Thus, the Ninth Circuit has
22 generally upheld reasonable procedures to promote the orderly administration of assets, including
23 the sale of property. S.E.C. v. Hardy, 803 F.2d at 1038.

24 B. Analysis

25 On August 23, 2004, the Receiver filed the instant motion for a court order authorizing the
26 sale of defendant's residential property. Subsequently, on September 28, 2004, defendant filed his
27 opposition. Defendant argues that the Receiver's motion should be denied on two independent
28 grounds: 1) an order authorizing the sale of defendant's home at this stage of the litigation would

1 be tantamount to a prejudgment writ of execution, and would thereby violate his due process
2 rights; and 2) the Court does not have the authority to order the sale of the property because
3 defendant's wife retains a separate property interest in the house. The Court addresses each of
4 defendant's arguments in turn.

5 1. Defendant's Claim that an Order Authorizing the Sale of Property would
6 Amount to a Pre-Judgment Writ of Execution and Violate his Due Process
7 Rights

8 In his opposition, defendant argues that the motion to authorize the sale of his residential
9 property amounts to a pre-judgment writ of execution because it punishes him before any of the
10 S.E.C.'s allegations have been proven at trial. As such, defendant argues that any such motion
11 would deprive him of his due process rights. However, the motion authorizing the sale of
12 defendant's house is not made in an effort to repay shareholders for defendant's alleged securities
13 fraud. Rather, the Receiver's motion is made in an effort to collect the court-imposed contempt
14 fine of \$13,228, as well as other costs. Thus, defendant's current obligations to the Receiver are
15 independent of the outcome of the S.E.C.'s case. Because defendant owes the Receiver \$13,228
16 regardless of whether the S.E.C. ultimately prevails against defendant at trial, the Receiver's
17 attempt to collect the fine does not violate defendant Vassallo's due process rights.

18 In its reply brief, the S.E.C. acknowledges that selling a house in order to collect on a debt
19 totaling \$13,228 seems "unusual." (S.E.C. Reply Brief at 2.) However, defendant has not
20 submitted to the Court any documents identifying another source of funds with which to pay the
21 fine. Although counsel for the Receiver tentatively agreed to partially lift the asset freeze in order
22 to allow defendant to pay the contempt fine, defendant apparently has no assets or income with
23 which to pay the fine, even if the freeze were lifted. (Def.'s Opp. at 1 n.1.) As a result, Receiver's
24 motion to order the sale of defendant's property appears to be the only option.

25 2. Defendant's Claim that the Motion to Sell the Property Should be Denied
26 Due to his Wife's Separate Property Interest in the House

27 Defendant also argues that the instant motion should be denied because his wife retains a
28 separate property interest in the house. As a result, defendant contends that Mrs. Vassallo is
entitled to have her separate property—and any appreciation resulting therefrom—returned to her in

1 any post-judgment sale. The Receiver does not refute defendant's claim, but rather argues that the
2 Court does not need to address Mrs. Vassallo's alleged property interest in the house at this time.
3 Specifically, the Receiver argues that the Court may order a sale of the property notwithstanding
4 the fact that other, non-debtor parties (such as Mrs. Vassallo) may hold an ownership interest.

5 **a) Under California Law, Cynthia Vassallo Retains a Separate**
6 **Property Interest in the House**

7 At the outset, defendant correctly points out that California law controls the determination
8 of Mrs. Vassallo's interest in the Vassallo home. The Ninth Circuit has held that while federal law
9 determines what constitutes "property of the estate," state law determines what interest a debtor
10 has in the property." In re Summers, 278 B.R. 808, 811 (9th Cir. 2002); see also In re Mantle, 153
11 F.3d 1082, 1084 (9th Cir. 1998) (holding that bankruptcy courts are required to look to state
12 property law to determine the property which is to be included in the estate). Importantly, the
13 principle that federal courts must look to state law in determining individual property rights and
14 interests is not specific to bankruptcy cases, but also applies in S.E.C. actions. See e.g. United
15 States v. Lester, 85 F.3d 1409 (9th Cir. 1996). Thus, in this case, the Court must assess Mrs.
16 Vassallo's property interest under California law.

17 Although Mr. and Mrs. Vassallo acquired the property during their marriage, they held the
18 property as joint tenants. (Grant Deed, Patterson Decl. at Exh. B.) Under California law, when a
19 husband and wife use community funds to take title to property as joint tenants, the form of
20 conveyance destroys the presumption that the property belongs to the community. In re Summers
21 278 B.R. at 811-12. The joint tenancy stands, with the interest of each spouse being that spouse's
22 separate property, unless the spouses intend for the property to remain community property. Id. In
23 creditor proceedings not resulting from the dissolution of the marriage, the title of the property is
24 determinative. Id. at 812.

25 By holding title to the house as joint tenants, Mr. and Mrs. Vassallo are presumed to have
26 separate property interests in the house. Additionally, defendant correctly argues that the Receiver
27 has not provided evidence to overcome this presumption. Instead, the Receiver focuses on the fact
28 that defendant has not submitted admissible evidence that the funds contributed by Mrs. Vassallo

1 to the purchase of the property were, in fact, her separate property. (See Receiver Reply Brief at
2 4.) Receiver contends that defendant's assertions are based on the mere hearsay statement of his
3 former attorney. (Id.) However, the presumption that title reflects the parties' intent may not be
4 overcome simply by evidence as to the source of funds used to purchase the property. In re
5 Summers, 278 B.R. at 812. Because defendant has demonstrated that the property was held in
6 joint tenancy, and that its division does not arise from the dissolution of the marriage, Mrs.
7 Vassallo retains a separate property interest in the house.

8 **b) Defendant's Claim that Mrs. Vassallo's Separate Property**
9 **Interest in the House Prohibits the Sale of the Property**

10 Defendant argues that because Cynthia Vassallo retains a separate property interest in the
11 house, the Receiver's motion must be denied. Specifically, defendant contends that in receivership
12 cases, the Court may only exercise its equitable power over property that is causally related to the
13 alleged wrongdoing. Here, neither the S.E.C. nor the Receiver have provided proof that the La
14 Jolla property was obtained through the fraudulent acts of Mr. Vassallo. Accordingly, defendant
15 Vassallo argues that the court must deny the motion to sell the house.

16 To support his argument, defendant cites three decisions rendered by three different federal
17 courts of appeals. (Def.'s Opp. at 9 (citing S.E.C. v. First City Fin., 890 F.2d 1215 (D.C. Cir.
18 1989), Wellman v. Dickinson, 682 F.2d 355 (2d Cir. 1982), and S.E.C. v. Colello, 139 F.3d 674
19 (9th Cir. 1998)). However, all three of the cases cited by defendant involve court-directed action
20 designed to reimburse victim shareholders and/or investors for losses incurred due to securities
21 fraud. For example, in S.E.C. v. First City Financial, the D.C. Circuit allowed the disgorgement of
22 profits, as long as the amount of disgorgement was a reasonable approximation of profits causally
23 related to the securities violation. 890 F.2d at 1232. Additionally, in Wellman v. Dickinson, the
24 Second Circuit held that a court may only award damages to shareholders for losses that proceed
25 directly and proximately from the securities law violation. 682 F.2d at 368. Lastly, in S.E.C. v.
26 Colello, the Ninth Circuit held that before a district court may order the disgorgement of assets
27 from an innocent third party, the plaintiff typically must show that the innocent third party
28 possesses ill-gotten funds, and that he has no legitimate claim to those funds. 139 F.3d at 677.

1 Based on the cited case law, if the instant motion to sell defendant's property was made in
2 an effort to disgorge profits gained through alleged securities fraud, then defendant Vassallo might
3 have a strong argument for denying the motion based on his wife's separate property interest in the
4 house. Indeed, because the Receiver has not submitted evidence that the property was acquired
5 through illegal or fraudulent means, an attempt to use the property to reimburse losses sustained by
6 shareholders would run contrary to well-established authority.

7 However, defendant fails to recognize that the instant motion is not brought with the
8 purpose of reimbursing shareholders. Instead, the Receiver's motion is brought only to collect the
9 \$13,228 contempt fine, as well as any other costs, fees and expenses owed by defendant pursuant
10 to the Court's preliminary injunction order. (See Preliminary Injunction at ¶ 12.) As a result, the
11 case law cited by defendant is inapplicable, because it only involves the disgorgement of profits at
12 the conclusion of trial, rather than the pre-trial payment of outstanding debts. Importantly,
13 defendant cites no authority for the principle that a court is prohibited from ordering the sale of
14 property to satisfy a debt, even when a non-debtor party may hold an ownership interest in the
15 property. In fact, the Receiver points to well-established bankruptcy law suggesting the exact
16 opposite conclusion (i.e. that a district court *may* order the sale of property to satisfy a debt, even
17 when a non-debtor party retains some ownership interest).

18 **c) Using Bankruptcy Law, the Court May**
19 **Authorize the Sale of Defendant's Property Because the Benefits**
20 **of the Sale to the Receiver Outweigh the Detriment Sustained by**
 Cynthia Vassallo

21 In the absence of controlling authority, district courts supervising equity receiverships have
22 often looked to bankruptcy law for guidance. S.E.C. v. American Capital Inv., Inc., 98 F.3d 1133,
23 1140 (9th Cir. 1996); Commodity Futures Trading Com'n v. Topworth Int'l, 205 F.3d 1107, 1116
24 (9th Cir. 1999). Specifically, in Commodity Futures Trading Commission v. Topworth
25 International, the Ninth Circuit affirmed a district court's discretion to adopt a receivership's
26 distribution plan based in part on bankruptcy law policy, signaling that bankruptcy law is an
27 appropriate analogy in receivership cases. 205 F.3d at 1116.

28 As mentioned above, the Receiver argues that the court may order the sale of property,

1 notwithstanding the fact that non-debtor parties may hold an ownership interest in the property.
2 (Receiver's Reply Brief at 4.) As support for this claim, the Receiver points to section 363(h) of
3 the Bankruptcy Code, which provides in pertinent part:

4 (h) Notwithstanding subsection (f) of this section, the trustee may sell both the
5 estate's interest, under subsection (b) or (c) of this section, and the interest of any co-
6 owner in property in which the debtor had, at the time of the commencement of the case,
an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only
if—

- 7 (1) partition in kind of such property among the estate and such co-
8 owners is impracticable;
- 9 (2) sale of the estate's undivided interest in such property would realize
10 significantly less for the estate than sale of such property free of the
11 interests of such co-owners;
- 12 (3) the benefit to the estate of a sale of such property free of the
13 interests of co-owners outweighs the detriment, if any, to such co-owners;
and
- 14 (4) such property is not used in the production, transmission, or
15 distribution, for sale, of electric energy or of natural or synthetic gas for
16 heat, light or power.

17 The Receiver correctly argues that elements (1), (2) and (4) are easily met in the instant
18 case. With regard to element (1), the property is a single family residence which cannot be
19 partitioned in kind between Mr. and Mrs. Vassallo, with Mr. Vassallo's half to be sold to a third
20 party. Additionally, with regard to element (2), a sale of a 50% interest in the house would
21 undoubtedly yield significantly less than a sale of the entire property. Finally, with regard to
22 element (4), it is clear that the single family residence is not being used in the gas and electric
23 business.

24 Element (3) requires the Court to perform a balancing test to weigh competing interests.
25 Specifically, in determining whether to sell the property, the court must determine whether the
26 benefit to the estate of the sale of such property free of the interests of the co-owner outweighs the
27 detriment, if any, to such co-owner. In this case, the obvious benefit to the receivership estate
28 would be the potential ability to collect on defendant Vassallo's outstanding debt of \$13,228.
Because the property will likely garner a higher bid if sold without Mrs. Vassallo's interest, the
benefit to the receivership is higher if the property is sold free and clear of her ownership interest.

The Receiver contends that the only detriment to Mrs. Vassallo will be the forced

1 relocation of her and her family. While this result seems dramatic at first blush, both the Receiver
2 and the S.E.C. argue that because the preliminary injunction stays all foreclosures and credit claims
3 against Mr. Vassallo, the Vassallo family has been living in the La Jolla house without making any
4 mortgage payments for the past several months. (S.E.C. Reply Brief at 2.) To circumvent this
5 unjust arrangement, both the S.E.C. and the Receiver argue that the property should be sold.

6 In support of this argument, the Receiver cites In re Roswick, 231 B.R. 843 (S.D.N.Y.
7 1999). In that case, the district court held that under section 363(h) of the Bankruptcy Code, a non-
8 debtor cotenant must show that the detriment to her from the sale of jointly owned property
9 exceeds the inconvenience ordinarily attendant in having to change one's residence or live in an
10 adequate but more modest abode. Id. at 853-54. In Roswick, the court found non-economic
11 arguments such as emotional attachment to the residence, and the desire to remain in the same
12 neighborhood, to be unconvincing in light of the benefit received from selling the property. As a
13 result, the court determined that the trustee was authorized to sell the home under section 363(h).

14 In the instant case, Mrs. Vassallo has thus far not provided the Court with any arguments
15 relating to the possible detriment she may suffer if forced to relocate. Because Mrs. Vassallo has
16 not demonstrated that the sale of the property would be so detrimental as to outweigh the clear
17 benefit to the estate of satisfying an outstanding debt to the Receiver, the Court hereby authorizes
18 the Receiver to sell the property.

19 CONCLUSION

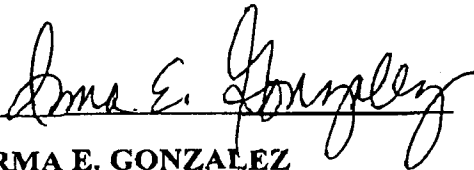
20 Although the Court recognizes the potential hardship involved in the forced sale of one's
21 home, defendant alleges that he has no other source of funds with which to pay the outstanding
22 contempt fine. The Court therefore **GRANTS** the Receiver's motion for an order authorizing the
23 sale of defendant Vassallo's residential property. However, Mr. Vassallo shall have thirty days
24 from the date of this order to pay the amount of \$13,228 owed to the Receiver. If payment is made
25 within this time period, the Court will vacate its order. If payment is not received within the
26 specified period, the Court hereby **AUTHORIZES** the Receiver to implement procedures for the
27 sale of the property.

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IT IS SO ORDERED.

Dated: 10/18/04


IRMA E. GONZALEZ
United States District Judge

cc: Magistrate Judge McCurine
all parties