

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. SACV 15-01746-PA (KESx) Date December 2, 2016
Title Securities and Exchange Commission v. Diverse Financial Corporation, et al.

Present: The Honorable Karen E. Scott, United States Magistrate Judge

Jazmin Dorado

n/a

Deputy Clerk

Court Reporter / Recorder

Attorneys Present for Plaintiffs:

Attorneys Present for Defendants:

n/a

n/a

Proceedings: (In Chambers) re TENTATIVELY GRANTING Defendants' Motion to Quash Subpoena (Dkt. 85)

I. The Complaint

Plaintiff Securities and Exchange Commission ("SEC") filed this civil enforcement action against Defendants Diverse Financial Corporation ("DFC") and DFC's owners Roy Dekel and David Kandell on October 28, 2015. (Dkt. 1.) The Complaint alleges that "Defendants raised at least \$3.29 million from at least 16 U.S. investors over a two-and a half year period, falsely claiming they would use investor proceeds exclusively to invest in premium finance lending or 'short term cash type investments' pending such investment, when in fact, they misappropriated investors' money" (*Id.* ¶ 5.) A stipulated judgment was entered against Defendant Kandell in February 2016. (Dkt. 37.)

DFC and Dekel ("Defendants") are represented by the law firm of Wilson Keadjian Browndorf LLP ("WKB"). (Dkt. 89 ¶ 1.)

II. The Subpoena

On Friday, October 14, 2016, three days before the discovery cutoff date (*see* Dkt. 45 at 2), SEC subpoenaed MinowCPA, a Professional Corporation ("MinowCPA"), a non-party, to produce the following documents:

1. Request A: "All agreements between You and any other person or entity regarding DFC."
2. Request B: "All Communications between You and any person, besides DFC, regarding DFC."
3. Request C: "All other non-privileged Documents regarding DFC."

(Dkt. 110-1 at 22.) The subpoena required production on or before October 28, 2016. (*Id.* at 16.)

II. The Motion to Quash and Related Briefing

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On October 26, 2016, Defendants moved to quash this subpoena arguing that these requests are overly broad, unduly burdensome and seek privileged and confidential information. (Dkt. 85.) With regard to burden, Defendants argued that “Defendants have already provided similar responses and produced documents pertaining to the Requests for production served on non-party MinowCPA.” (Id. at 4.) Defendants also argued that locating responsive documents would “require MinowCPA to unreasonably halt its day-to-day operations.” (Id. at 5.)

With regard to privilege, Defendants argued that “Many of the documents requested by the Subpoena are subject to various privileges and protections, including the attorney work product doctrine and attorney-client privilege.” (Id. at 6.) Defendants also argued that “The Requests require MinowCPA to produce documents from a broad range of topics, all of which may be subject to the attorney-client, attorney work product, or accountant-client privilege.” (Id. at 7.)

Defense counsel did not file a supporting declaration with their motion to quash, but subsequently filed one at the Court’s request. (Dkt. 89 [Stec Decl].) In that declaration, Mr. Stec explains that he spoke with someone at MinowCPA about the subpoena on October 26, 2016, and learned that it would “require hours to search for and compile” responsive documents. (Id. ¶ 3.) Mr. Stec also declares that MinowCPA “is a forensic accountant and expert witness for Defendants” and “any communications between Defendants and MinowCPA would have been through counsel for Defendants.” (Id. ¶ 5.) In his October 5, 2016 deposition, Michael Keadjian, a corporate transactional attorney at WKB, identified Scott Minow, CPA, as the forensic accountant who was retained by WKB in or around August 2014, to assist with Diverse Financial’s proposed investor workout “following the noisy withdrawal of one of defendants’ salespeople, who alerted investors to the misuse of their funds.” (Dkt. 110 at 11.) Mr. Minow’s role was to “help [WKB] ... understand the [] financials as represented in the QuickBooks files” of DFC. (Id. at 6.) “The output of WKB and Minow’s collaboration with Diverse Financial during this time period culminated in a letter to investors dated October 15, 2014, where defendants outright denied any misuse of funds.” (Id. at 11.)

On November 14, 2016, the parties participated in a telephonic conference with the Court. During the conference, Defendants’ counsel orally proffered certain additional information regarding the subpoena, stating that Mr. Minow is a consulting expert and apparently emailed defense counsel, Marc Lazo, concerning the burden of responding to the subpoena, with an estimate of 4 hours, at a cost between \$800-\$1,200. The parties also discussed that MinowCPA was likely to have at least two kinds of responsive documents: (1) DFC financial records sent to it for analysis, and (2) communications between KWB and MinowCPA about its analysis. Defendants did not assert that merely sending DFC records to MinowCPA rendered them privileged, but did assert that such documents have likely already been produced by DFC. No party raised the issue of timing.

On November 21, 2016, SEC filed an opposition to the motion to quash. (Dkt. 110.) SEC contends that its demands are not overly broad and seek only relevant information, because “Information

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exchanged among Diverse Financial and Minow during this time period could easily prove probative of the SEC's claim—for example if Minow questioned Diverse Financial's use of funds or its commingling of investors' monies." (Id. at 12.)

With regard to burden, the SEC argues that (1) Defendants lack standing to quash the subpoena based on the burden to MinowCPA of responding, and (2) Defendants have failed to provide adequate evidence of any undue burden to MinowCPA. With regard to the allegation that many responsive documents were already produced by DFC, SEC argues that "it has received, to its knowledge, only a single document that actually mentions Minow, and that document has been heavily redacted." (Id. at 13.)

With regard to privilege, SEC points out that there is "no confidential accountant-client privilege under federal law." (Id. at 14.) However, as the Court noted in its October 27, 2016, minute order, privilege may reach "communications to an accountant, in confidence, for the purpose of obtaining legal advice from a lawyer." (Dkt. 86 at 1.) SEC argues that "Defendants do not describe any documents purportedly exchanged with Minow for the purpose obtaining legal advice, the attorneys who provided the advice, the recipients of the advice, the subject of the advice, or its confidential nature. Instead, defendants assert a blanket privilege" (Dkt. 110 at 14.) SEC also argues implied waiver (i.e., "to the extent defendants seek to rely on advice from Minow for their defense, no privilege applies.") (Id. at 5.)

On December 1, 2016, Defendants filed a Reply. (Dkt. 112.) Defendants argues that "since defense counsel retained and directed Minow in order to understand Defendants' financials for the purpose of advising Defendants, all communications and any other documents requested are necessarily protected by the attorney-client and/or work product doctrines" (Id. at 3.)

With regard to waiver, Defendants argue that they are not asserting an affirmative defense of reliance on advice of counsel. (Id.) Rather, they intend to present evidence at trial that they relied on advice of counsel to try to negate any finding of scienter. (Id.) The only counsel whose advice they will claim to have relied upon, however is Loeb & Loeb, Defendants' counsel when the subject loan notes were prepared. (Id.) Defendants do not intend to present evidence at trial that they relied on advice from WKB (and thus Minnow), and have not identified anyone from WKB as a trial witness. (Id. at 4.)

While this discovery dispute was unfolding, on November 3, 2016, the Court granted SEC's motion for summary judgment. (Dkt. 87.) The Court subsequently ordered that the parties' pretrial documents "should be limited to the proper scope of injunctive relief and amount of monetary damages, including disgorgement and civil penalties." (Dkt. 92.) SEC seeks civil penalties under Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d) and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3). (Complaint at 15.) Both sections authorize three "tiers" of potential penalties, with tiers two and three only applying to violations that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement."

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The final pretrial conference is set for December 2, 2016, and a bench trial is set for December 20, 2016. As part of its pretrial preparations, SEC has moved *in limine* to preclude evidence of any reliance on advice of counsel, based on Defendants' assertions of privilege over and failure to disclose any such advice during discovery. (Dkt. 98.)

IV. Disposition

The subpoenas seek information relevant to civil penalties, and the evidence concerning burden does not show that responding would impose an undue burden on MinowCPA. It appears likely that some responsive documents would be privileged, i.e., communications between MinowCPA and WKB for the purpose of WKB advising Defendants, a privilege that has not been waived if Defendants do not claim that they are less culpable because they relied on WKB's advice. The responsive documents have not yet been collected by MinowCPA, such that no privilege log has been drafted.

Beyond the issues briefed by the parties, the fundamental problem is that that the discovery cutoff date was October 17, 2016, and the motion cutoff date was October 24, 2016. (Dkt. 47.) The discovery cutoff date "is the last date to complete discovery, including expert discovery, and the resolution of any discovery motions before the magistrate judge." (*Id.*) The Order Setting Scheduling Meeting of Counsel and Scheduling Conference further explains that the discovery cutoff date "is not the date by which discovery requests must be served; but the date by which all discovery is to be completed. Any motion challenging the adequacy of discovery responses must be filed timely, served and calendared sufficiently in advance of the discovery cutoff date to permit the responses to be obtained before that date, if the motion is granted." (Dkt. 43, n.2.)

Here, SEC did not serve the instant subpoena until October 14, 2016. (Dkt. 110-1 at 2, ¶ 4.) This left only three days (from Friday to Monday) for MinowCPA to respond before the discovery cutoff date, which is insufficient to constitute reasonable notice for the production of documents. Indeed, the subpoena did not even direct MinowCPA to respond until October 28, 2016, a date after the discovery and motion cutoff dates.

The subpoena was not timely served, which excuses MinowCPA from any obligation to respond.

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