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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEVADA
LAS VEGAS, NEVADA

In re: USA COMMERCIAL MORTGAGE COMPANY,)	JANUARY 3, 2006
)	E-Filed: 01/09/06
)	
Debtor.)	Case No.
)	BK-S-06-10725-LBR
)	Chapter 11
<hr/>		
USA COMMERCIAL MORTGAGE COMPANY,)	
)	
Plaintiff,)	
)	
vs.)	Adversary No.
)	06-01201-LBR
GATEWAY STONE ASSOCIATES, LLC,)	
)	
Defendant.)	
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USA COMMERCIAL MORTGAGE COMPANY, et al.,)	
)	
Plaintiffs,)	
)	
vs.)	Adversary No.
)	06-01256-LBR
HMA SALES, LLC, et al.,)	
)	
Defendants.)	
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PARTIAL TRANSCRIPT OF PROCEEDINGS
OF
JUDGE'S RULING
ON
(06-10725) MOTION TO ENFORCE ORDER
GRANTING DEBTOR'S MOTION TO DISTRIBUTE FUNDS, 1389
AND
MOTION FOR PROTECTIVE OVER, NO. 1843
AND
(06-01201) SCHEDULING CONFERENCE RE: COMPLAINT, NO. 6
AND
(06-10725) OMNIBUS OBJECTION TO CLAIM OF
IN THE AMOUNT OF CLAIMS ON EQUITY
MISFILED AS CREDITOR CLAIMS, NO. 1901
AND

Proceedings recorded by electronic sound recording;
transcript produced by transcription service.

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OMNIBUS OBJECTION TO CLAIM OF
IN THE AMOUNT OF WRONG DEBTOR CLAIMS MISFILED AGAINST
USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC, NO. 1893
AND
STATUS HEARING RE: MOTION FOR APPROVAL
OF PROCEDURES REGARDING ASSIGNMENTS
OF DIRECT LENDERS' INTERESTS IN LOANS, NO. 1806
AND
MOTION TO ALLOW CLAIMS OR INTERESTS, NO. 2175
AND
(06-01256) MOTION FOR PRELIMINARY INJUNCTION, NO. 8
AND
MOTION FOR PRELIMINARY INJUNCTION
CONTINUING ASSET FREEZE
AND MOTION FOR IMMEDIATE WRIT OF ATTACHMENT
WITH NOTICE, NO. 11
VOLUME 1
BEFORE THE HONORABLE LINDA B. RIEGLE
UNITED STATES BANKRUPTCY JUDGE

Wednesday, January 3, 2007

9:30 a.m.

Court Recorder: Helen C. Smith

Proceedings recorded by electronic sound recording;
transcript produced by transcription service.

1 APPEARANCES:

2 For the Debtor and ANNETTE W. JARVIS, ESQ.
 Debtor in Possession: Ray, Quinney & Nebeker, P.C.
 3 36 South State Street
 Suite 1400
 4 Salt Lake City, Utah 84145

5 JEANETTE E. McPHERSON, ESQ.
 Schwartz & McPherson Law Firm
 6 2850 South Jones Boulevard
 Suite 1
 7 Las Vegas, Nevada 89146

8 For the First Trust FRANK A. MEROLA, ESQ.
 Deed Committee: Stutman, Treister & Glatt, P.C.
 9 1901 Avenue of the Stars
 Twelfth Floor
 10 Los Angeles, California 90067

11 For the First Trust CANDACE C. CARLYON, ESQ.
 Deed Equity Committee: Shea & Carlyon, Ltd.
 12 233 South Fourth Street
 Suite 200
 13 Las Vegas, Nevada 89101

14 For the Jones Vargas JANET L. CHUBB, ESQ.
 Objecting Creditors: Jones Vargas
 15 100 West Liberty
 Twelfth Floor
 16 Reno, Nevada 89501

17 For the Diversified ANNE M. LORADITCH, ESQ.
 Trust Deed Fund Equity Beckley Singleton, Chtd.
 18 Holders Committee: 530 Las Vegas Boulevard South
 Las Vegas, Nevada 89101

19 For the Unsecured ROB CHARLES, JR., ESQ.
 20 Creditors Committee Lewis and Roca, LLP
 of USA Commercial 3993 Howard Hughes Parkway
 21 Mortgage Company: Suite 600
 Las Vegas, Nevada 89109

22 For the Diversified MARC A. LEVINSON, ESQ.
 23 Committee: Orrick, Herrington & Sutcliffe, LLP
 400 Capitol Mall
 24 Suite 300
 Sacramento, California 95814

25

1	APPEARANCES (Cont.)	
2	For Joseph Milanowski	RUSSELL S. WALKER, ESQ.
3	and USA Investment	Woodbury & Kesler, P.C.
4	Partners, LLC:	265 East 100 South
		Suite 300
		Salt Lake City, Utah 84111
5		KENNETH M. BREEN, ESQ.
6		Fulbright & Jaworski, LLP
7		666 Fifth Avenue
		New York, New York 10103
8	For the Direct	GERALD M. GORDON, ESQ.
9	Lenders Committee:	GREGORY E. GARMAN, ESQ.
		Gordon & Silver, Ltd.
		3960 Howard Hughes Parkway
		Ninth Floor
10		Las Vegas, Nevada 89109
11	For the McGimsey	WILLIAM L. MCGIMSEY, ESQ.
12	Claimants and	William L. McGimsey, P.C.
13	Johnny Clark:	601 East Charleston Boulevard
		Las Vegas, Nevada 89104
14	For the Lender	ALAN R. SMITH, ESQ.
15	Protection Group:	505 Ridge Street
		Reno, Nevada 89501
16	For Stanley Alexander,	ROBERT C. LePOME, ESQ.
17	Florence Alexander,	Law Offices of Robert C. LePome
18	and Others Identified:	330 South Third Street
		1100-B
		Las Vegas, Nevada 89101
19	For the United States	AUGUST B. LANDIS, ESQ.
20	Trustee:	Office of the United States Trustee
		300 Las Vegas Boulevard South
		Suite 4300
		Las Vegas, Nevada 89101
21	For USA Commercial	JEFFREY R. SYLVESTER, ESQ.
22	Real Estate Group:	Sylvester & Polednak, Ltd.
23		7371 Prairie Falcon Road
24		Suite 120
25		Las Vegas, Nevada 89128

1	APPEARANCES (Cont.)	
2	For Del Bunch,	RICHARD F. HOLLEY, ESQ.
3	Ernestine Bunch,	Santoro, Driggs, Walch, Kearney,
4	and Hall Financial	Johnson & Thomson
5	Group, Ltd.:	400 South Fourth Street
		Third Floor
		Las Vegas, Nevada 89101
6	For Roland P. Weddell	MATTHEW J. KREUTZER, ESQ.
7	and Spectrum Financial	Hale, Lane, Peek, Dennison
8	Group:	& Howard
		3930 Howard Hughes Parkway
		Fourth Floor
		Las Vegas, Nevada 89109
9	For Compass Partners,	GEORGE A. DAVIS, ESQ.
10	LLC:	Weil, Gotshal & Manges, LLP
11		767 Fifth Avenue
		New York, New York 10153
		(Telephonic)
12	For Douglas Carson:	JEFFREY L. HARTMAN, ESQ.
13		Hartman & Hartman, P.C.
14		510 West Plumb Lane
15		Suite B
		Reno, Nevada 89509
		(Telephonic)
16	For the Plaintiffs:	LENARD E. SCHWARTZER, ESQ.
17		Schwartzter & McPherson Law Firm
18		2850 South Jones Boulevard
		Suite 1
		Las Vegas, Nevada 89146
19	For Salvatore J. Reale:	DOUGLAS D. GERRARD, ESQ.
20		Gerrard, Cox & Larsen
21		2450 St. Rose Parkway
		Suite 200
		Henderson, Nevada 89074
22	For Debt Acquisition	DEAN T. KIRBY, JR., ESQ.
23	Company of America V,	Kirby & McGuinn, P.C.
24	LLP:	600 B Street
25		Suite 1950
		San Diego, California 92101
		(Telephonic)

1 APPEARANCES (Cont.)

2 For Frank Snopko: KEVIN A. DARBY, ESQ.
3 Downey Brand, LLP
4 427 West Plumb Lane
Reno, Nevada 89509
(Telephonic)

5 Also Present: DON WALKER (phonetic)
6 Committee Chair
Unsecured Creditors Committee
7 of USA Commercial Mortgage Company

8 WILLIAM BULLARD
9 Member of Direct Lenders Committee

10 THOMAS J. ALLISON
11 Mesirow Financial Interim
12 Management, LLC
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1 (Court previously convened at 09:44:50 a.m.)

2 (Partial transcript of Judge's ruling at 03:46:42 p.m.)

3 THE COURT: Okay. All right. Now, dealing first
4 and putting aside the issue about the funds, I'm going to
5 disallow the claim for voting purposes, and let me go
6 through the analysis of that.

7 The first step is the Ninth Circuit case of
8 K.F. Diaries (sic) -- Dairies -- excuse me -- tells us that
9 under 502(d) a claim may be disallowed -- let me read
10 502(d).

11 It says, "Notwithstanding any subsection, the Court
12 shall disallow any claim of any entity from which property
13 is recoverable or is a transferee of a transfer avoidable
14 under 547 unless such entity has paid the amount or turned
15 over any such property of which this entity or transferee is
16 liable under this title."

17 And K.F. Dairies tells us that notwithstanding the fact
18 that no preference action was timely brought" -- and this is
19 a case in which objection to claim was made after the
20 preference Statute of Limitations had expired -- that
21 notwithstanding that fact the claim could not be allowed
22 until that money was paid back, and the Court recognized
23 that was in the sense of recoupment.

24 So we already know that you don't have to first file
25 the preference claim to disallow a claim in its entirety.

1 Now, how does that relate to voting?

2 Under the voting rule, we know that once a claim is
3 objected to the party is not entitled to vote, and there's
4 no place in the rules that says if objected to \$1 or \$100 or
5 \$1,000,000.

6 It does say that the Court shall temporarily upon a
7 motion of hearing shall -- let me grab that -- "may
8 temporarily allow the claim in an amount which the Court
9 deems proper for purposes of accepting or rejecting a plan,
10 so that's when you go back to 502(d). We know under 502(d)
11 that even if the preference is \$1 the claim is not allowed.

12 Now, the reason I said I think it's too late for you to
13 pay the money is 502(d) has been there this whole time, and
14 it has always said that it is disallowed unless you pay back
15 the money, and there was no offer to do so, no suggestion,
16 and I told you at the last hearing what I thought 502(d)
17 meant.

18 Now, the next step is why do I believe there's a
19 preference. I believe there's a preference at least more
20 likely rather than less likely for temporary allowance of
21 voting because of the nature of the transaction, and let me
22 go through the elements.

23 We know now the elements are that -- there really isn't
24 any serious dispute that the trustee has met the initial
25 burden of showing that there was a transfer that meets

1 547(b), and the next question is there a defense, and it's
2 the creditor's burden to show a defense.

3 Now, to establish the defense, the transfer must be in
4 payment of a debt incurred by the debtor in the ordinary
5 course of business or financial affairs of the debtor and
6 the transferee.

7 I have a serious question here whether we can say this
8 was a debt incurred by the debtor in the ordinary course of
9 the debtor's business. The debtor's business was making and
10 brokering mortgage loans and servicing loans.

11 Now, arguably, you can say that it was in the ordinary
12 course of its financial affairs to borrow money. Well, how
13 about the flip side, the transferee's ordinary course of
14 business?

15 First of all, if he's a lender, is it his business? I
16 mean, he's not -- while he may make loans for investments,
17 is it his business?

18 I mean, if he's a lender, see, I think he has to be
19 licensed under Nevada law. He doesn't hold the license, so
20 is that his business?

21 And then, secondly, is it his business to make these
22 loans which go into an investor trust account which under
23 Nevada law can only be used if you're making loans to direct
24 investors, but it's not used for that, and he knows that.

25 Secondly, is it his ordinary course of business to make

1 loans, unsecured loans, to mortgage companies as opposed to
2 be an investor in things like a direct lender and
3 consolidated which broker's loans, et cetera.

4 Also, I am not sure whether since these tests were sort
5 of conflated together before whether or not you wouldn't
6 have to show an industry standard as to this test. I will
7 assume that you don't.

8 I will also assume that -- notwithstanding my doubts, I
9 will assume unlike Mr. Schwartzner that the creditor has met
10 his burden on this test because of the ordinary course of
11 the debtor's business needing money, to borrow money from
12 time to time, and then Mr. Bunch's habit of making loans
13 back and forth. I expressed my doubts about that, but I
14 will find in your favor.

15 But where you fail is -- certainly, as everybody
16 acknowledges, you fail under ordinary-business terms
17 because, A, there's no expert testimony.

18 And I recognize you were short on time in responding,
19 but there's no way you could get expert testimony that says
20 that this kind of a loan would be in the ordinary course of
21 business.

22 Also, we know that Ponzi schemes are not ordinary
23 course of business. Now, whether or not this is a Ponzi
24 scheme I think fits in the next test.

25 While Mr. Schwartzner conceded that you could say that

1 the transfer was made in the ordinary course of business or
2 financial affairs of the debtor and the transferee, I don't
3 think that's the case, and I think that's where the creditor
4 fails.

5 Importantly, we have to look to the statutes in Nevada
6 in this regard, and I think my analogy about the attorney
7 trust fund is right on if I do say so myself.

8 Hey, somebody's got to tell you you're smart, you know,
9 I mean, if even you do it yourself, you know. You've really
10 got to pat yourself on the back.

11 In seriousness, though, you look at 645B.175(4). "All
12 money paid to a mortgage broker and his mortgage agents by a
13 person in full or in partial payment of the loan secured by
14 a lien on the real property must be kept separate from money
15 belonging to the mortgage broker in an account appropriately
16 named to indicate that it does not belong to the mortgage
17 broker."

18 Importantly, then subdivision 9 says, "If a mortgage
19 broker receives any money pursuant to this section, the
20 mortgage broker shall not release the money to" -- subpart B
21 -- "any person who has a contractual right to receive the
22 money if the mortgage broker knows or in light of all the
23 surrounding facts and circumstances reasonably should know
24 that the person's contractual right to receive the money
25 violates any provision of this chapter or a regulation

1 adopted pursuant to this chapter." It's illegal.

2 And as we know as -- and, now, this is not a case where
3 Mr. Bunch was a direct lender, and the property became so
4 mingled that that's how it became property of the estate.
5 It became commingled, and so he's receiving money from
6 ostensibly a trust account, and whether or not he knew it is
7 beside the point. The point is it is illegal under Nevada
8 law.

9 So it seems to me that unless he is in the business of
10 receiving money illegally he fails to meet the test that
11 says the transfer is made in the ordinary course of the
12 transferee's business, and that's the problem, and that's
13 why I think more likely rather than less likely this is a
14 preference.

15 Now, I still think you say, well, let me talk to my
16 client, and maybe I'll now put in the half-a-million
17 dollars.

18 I tend to think it's too late because I've ruled it's
19 disallowed until you put the money in, so I just think
20 it's -- I mean, you know, I'm not attempting to do a gotcha.

21 But, you know, that's what 502(d) says from the
22 beginning, so, you know, that's where I think we end up on
23 that, and let me make a comment about the voting.

24 On one hand, it would seem unfair to disallow
25 somebody's voting rights for \$1 when they've got 1,000,000,

1 for example, in entirety.

2 But the converse is why should everybody else's rights
3 be skewed by somebody who owes the estate in this case a
4 half-a-million dollars and has not yet done anything to do
5 this.

6 So I think the harm is on one hand you're taking away
7 the person's right to vote. But on the other hand, I
8 think -- and that's why I think the code recognizes that you
9 disallow, and that's for all purposes as well as a temporary
10 allowance as well. You can't have a temporary allowance and
11 say you can vote part of the claim and still have 502(d).

12 I think they work in tandem in that regard. I think
13 that's the only logical way of weighing everybody's rights
14 and liabilities. Okay. Thank you on that.

15 Should we take a break, and then we'll do the
16 attachments?

17 MR. SCHWARTZER: Your --

18 MR. GERRARD: Please --

19 MR. SCHWARTZER: Your Honor --

20 MR. GERRARD: Please, no, your Honor. I have a
21 settlement conference I was supposed to be at --

22 MR. SCHWARTZER: And we --

23 MR. GERRARD: -- at 4:00.

24 MR. SCHWARTZER: And we have a settlement, and we
25 have a stipulated --

1 THE COURT: Oh, I'm sorry. Okay.

2 MR. SCHWARTZER: Okay. Your Honor --

3 THE COURT: I apologize, Mr. Gerrard.

4 MR. SCHWARTZER: -- Lenard Schwartzter on behalf of
5 the plaintiffs.

6 MR. GERRARD: Douglas Gerrard on behalf of
7 Mr. Reale.

8 MR. SCHWARTZER: Your Honor, Mr. Walker's here,
9 but he's not representing (indiscernible) at this point.

10 Are you?

11 MR. WALKER: No. (Indiscernible).

12 MR. SCHWARTZER: Okay. Okay. What we have agreed
13 to is a stipulated temporary restraining order that
14 Defendant Reale as agents, officers, members, whatever will
15 be enjoined from disposing of the disbursing or expending of
16 the moneys or noncash proceeds from the sale of the
17 Royal Hotel until further order of this Court.

18 And then it is ordered that Mr. Reale shall provide the
19 plaintiffs' counsel -- and this is not to be put on the
20 public record -- the --

21 THE COURT: Well, now wait.

22 MR. SCHWARTZER: -- to put --

23 THE COURT: Oh.

24 MR. SCHWARTZER: No.

25 THE COURT: Oh, the stipulation --

1 MR. SCHWARTZER: The --

2 THE COURT: -- is on --

3 MR. SCHWARTZER: This in the --

4 THE COURT: -- a public record.

5 MR. SCHWARTZER: -- public record.

6 THE COURT: What you're saying is --

7 MR. SCHWARTZER: But the --

8 THE COURT: Okay.

9 MR. SCHWARTZER: -- next part is where the
10 6.7 million dollars is --

11 THE COURT: Got it.

12 MR. SCHWARTZER: -- at what bank, the bank of
13 that, where at least 6.7 million dollars is in a financial
14 institution in Clark County, Nevada which shall be
15 identified by name, address, and account number.

16 And it is ordered that a copy of this order shall be
17 served on said financial institution, and said financial
18 institution shall not transfer any of the funds that are on
19 deposit until further order of the Court.

20 And it is agreed that there will be depositions both of
21 the plaintiff with regard to their information concerning
22 how the money went from the debtor's various entities into
23 HMA Sales, LLC and of Mr. Reale with regard to this
24 litigation during the last week of January, and then we'd
25 need to have a continued hearing.

1 MR. GERRARD: Actually, that would be the second
2 to the last week of January because you're going to be gone
3 part of the last week of January, right --

4 MR. SCHWARTZER: Well, I'm --

5 MR. GERRARD: -- the week --

6 MR. SCHWARTZER: I'm going --

7 MR. GERRARD: -- of the 22nd?

8 MR. SCHWARTZER: Right. During the week of the
9 22nd --

10 MR. GERRARD: Right.

11 MR. SCHWARTZER: -- we'll do the depositions.

12 MR. GERRARD: And, your Honor, what we're going to
13 need is -- I mean, obviously, there needs to be some
14 discovery done --

15 THE COURT: Right.

16 MR. GERRARD: -- before this hearing takes place,
17 and so we need a continued date, but what we need is access,
18 and this is very important.

19 We need access to the records of Investment Partners.
20 We've got to have -- you know, I came in this morning, and
21 I'm new to this, obviously.

22 But I heard some discussion about a protective order
23 and some language about a protective order related to
24 Investment Partners' records.

25 My client made loans in excess of \$13,000,000, and the

1 majority of the checks that he wrote out went to Investment
2 Partners.

3 And it's important for us to show that Investment
4 Partners then, in turn, took that money and put it into
5 various entities that Investment Partners had an interest in
6 including HMA which shows a direct benefit and goes to
7 reasonably-equivalent value.

8 We need those records, and we need to be able to serve
9 a subpoena, so we can have access to those or just be
10 allowed to go into wherever those records are currently
11 being maintained and review them. I don't care who else is
12 there.

13 THE COURT: Well, the point is under ordinary
14 discovery you serve your subpoena, and you are entitled to
15 the records until somebody comes in and moves for a
16 protective order.

17 MR. GERRARD: Well, and that's fine. What we're
18 requesting here is that you waive the requirements of
19 Rule 26, so that we can start discovery --

20 THE COURT: Yes.

21 MR. GERRARD: -- immediately, and that we shorten
22 the timing on any deposition notices --

23 THE COURT: (d) (3).

24 MR. GERRARD: -- to maybe five days --

25 THE COURT: Sure.

1 MR. GERRARD: -- so that we can then get moving
2 and get this accomplished.

3 THE COURT: Yeah. That's no problem. And if the
4 parties agree to it, especially --

5 MR. SCHWARTZER: And we --

6 THE COURT: -- there's no problem.

7 MR. SCHWARTZER: And we understand this is an
8 order that we could have a hearing on a preliminary
9 injunction in a relatively short time, the problem then
10 being that I have foolishly planned this vacation in Europe
11 for the first two weeks of February.

12 So I won't be back until the evening of the 14th, so
13 what I don't want is the hearing on the morning of the 15th,
14 your Honor.

15 THE COURT: Do you want to do it the last week of
16 February? Is that --

17 MR. SCHWARTZER: That would be fine --

18 THE COURT: Because that's --

19 MR. SCHWARTZER: -- with me.

20 THE COURT: All right.

21 MR. SCHWARTZER: If the Court would have time, I
22 would expect that we'll need a couple of hours for this.
23 And since it's in a separate adversary, it doesn't have to
24 be on the date of --

25 THE COURT: Right.

1 MR. SCHWARTZER: -- an omnibus hearing.

2 MR. GERRARD: And, you know, obviously, we want it
3 as soon as Mr. Schwartz's back that you have an available
4 date, your Honor.

5 THE COURT: Okay. Is that Flamko-Otter?
6 Aren't you in that one, Mr. Garman?

7 MR. GARMAN: In what case, your Honor?
8 (Colloquy not on the record.)

9 THE COURT: Flamko-Otter?
10 (Colloquy not on the record.)

11 MR. GARMAN: I don't believe so.

12 MR. HOLLEY: That's --

13 THE CLERK: That's not --

14 MR. HOLLEY: Your Honor, that's --

15 THE COURT: Somebody here --

16 THE CLERK: That's not --

17 THE COURT: -- is in that one.

18 THE CLERK: -- (indiscernible).

19 (Colloquy not on the record.)

20 THE COURT: Oh, okay.

21 MR. HOLLEY: No. Mr. Fell represents the
22 petitioning creditors in that case.

23 THE COURT: Is that going to go forward --

24 MR. HOLLEY: At this point --

25 THE COURT: -- for two days you think?

1 MR. HOLLEY: -- it is going forward, yes.

2 THE COURT: Okay. Thanks.

3 (Colloquy not on the record.)

4 THE COURT: I know we've moved it once.

5 THE CLERK: What about --

6 THE COURT: All right.

7 THE CLERK: -- March 1st (indiscernible)?

8 (Colloquy not on the record.)

9 THE COURT: Let's do it March 2nd.

10 March 2nd work for you?

11 Oh, sorry --

12 MR. WALKER: That's fine.

13 THE COURT: -- Mr. Walker.

14 MR. WALKER: Sorry, your Honor. Russell Walker on
15 behalf of Investment Partners. Our only concern is with
16 regard to the protective order.

17 We have requested the right to do a privilege review
18 prior to disclosure of documents. That's part of the
19 stipulation we think we have reached with the various
20 parties, but we will need to do that prior to Mr. Gerrard
21 having access to those records.

22 So there may be some timing issues there, but I think
23 it's the hearing's on March 2nd. That should give us
24 adequate time to do what we need to do.

25 MR. GERRARD: Well, again, your Honor, we can't

1 afford to really wait around for a lot of time for this to
2 happen. We need to know where the records are, and we need
3 to be able to go through them.

4 MR. WALKER: Well, and our protective order is
5 pending right now. We're hoping to submit, hopefully, by
6 Monday or Tuesday of next week the stipulated protective
7 order. But until that's done --

8 THE COURT: Well, let's have Mr. Gerrard review
9 it, and then if you have any concerns, then maybe we could
10 have a conference to excise out -- you could work it out, so
11 that he's got the right to review --

12 MR. GERRARD: And --

13 THE COURT: -- whatever.

14 MR. GERRARD: And I apologize for asking this. I
15 would find out, normally, in the normal course, but who has
16 custody of those records now? Is it the debtor entities or
17 is it --

18 THE COURT: Yes.

19 MR. GERRARD: It's --

20 THE COURT: The debtor entities.

21 MR. WALKER: They are held --

22 MR. GERRARD: Okay.

23 MR. WALKER: -- in an office.

24 MR. GERRARD: I (indiscernible) to serve the
25 subpoena.

1 MR. WALKER: They're held in an office at the
2 debtor's location, but both parties have agreed that those
3 are basically off limits to both sides until we resolve the
4 protective-order issue.

5 MR. SCHWARTZER: I missed this morning,
6 your Honor. I --

7 THE COURT: We had --

8 MR. SCHWARTZER: So --

9 THE COURT: We got continued until the 17th.

10 MR. SCHWARTZER: Okay. So --

11 THE COURT: So they're physically at the debtor's
12 location.

13 MR. SCHWARTZER: Yes.

14 THE COURT: They're physically safe if you will
15 held by the restructuring officer.

16 MR. SCHWARTZER: Yeah.

17 (Colloquy not on the record.)

18 MR. GERRARD: Well, and, again, your Honor, we
19 need to serve a subpoena, be able to get access to those
20 records, see what happened to the money after it was lent,
21 where it went to make sure that we can --

22 THE COURT: Yeah. I --

23 MR. GERRARD: -- verify that.

24 THE COURT: Mr. Walker, I would be hard-pressed to
25 see anything that would have attorney/client that has to do

1 with financial records. It's where the money went.

2 MR. WALKER: Well, no. We're just concerned that
3 we be able to review that to find those documents that are
4 privileged before they're wholesale turned over. I mean, we
5 have that right, and we have that responsibility.

6 And so we're willing to move as quickly as the debtors
7 are in getting that protective order entered that provides
8 us the right to do that prior to turning anything over with
9 regard to this litigation.

10 (Colloquy not on the record.)

11 MR. WALKER: I don't think this litigation is that
12 critical that it should forfeit our right --

13 THE COURT: Well --

14 MR. WALKER: -- to our --

15 (Colloquy not on the record.)

16 THE COURT: -- it is --

17 MR. WALKER: -- privileged review.

18 THE COURT: -- in the sense that the money's held
19 up --

20 MR. WALKER: That's --

21 THE COURT: -- by all these people --

22 MR. WALKER: That's true.

23 THE COURT: -- in the meantime.

24 (Colloquy not on the record.)

25 MR. WALKER: That's true.

1 (Colloquy not on the record.)

2 MR. WALKER: But then maybe the injunction --

3 (Colloquy not on the record.)

4 MR. WALKER: I mean, it's difficult to try a case
5 quickly, and a preliminary-injunction hearing is I guess
6 what's going to happen.

7 (Colloquy not on the record.)

8 MR. WALKER: But we do need the right to review
9 the documents for privilege.

10 THE COURT: So why --

11 MR. SCHWARTZER: Your --

12 THE COURT: -- can't they --

13 MR. SCHWARTZER: Your Honor, as long as that issue
14 is decided on January 17th with regard to the litigation,
15 we'll be okay because you're saying the trial will be on
16 March 2nd.

17 So that would mean that Mr. Gerrard would be able to
18 get the documents sometime after January 17th. I physically
19 don't have to be here for him to get --

20 THE COURT: Right.

21 MR. SCHWARTZER: -- the records, so --

22 THE COURT: So you could issue your subpoena now
23 for any date after January 17th like even the 18th, and then
24 we can deal with it. If there's --

25 MR. SCHWARTZER: Well, I --

1 THE COURT: -- a problem on the 18th --

2 MR. SCHWARTZER: I would --

3 THE COURT: -- we'll deal with it.

4 MR. SCHWARTZER: -- suggest not doing it exactly
5 on the 18th like maybe having the subpoena due --

6 THE COURT: The 19th --

7 MR. SCHWARTZER: -- the first subpoena, due on --

8 THE COURT: -- or something?

9 MR. SCHWARTZER: -- Monday the 22nd, and that way
10 if there's an issue somebody could raise the issue,
11 appropriately.

12 And then what we would do is we would set our
13 depositions in this case for the week of February 19th for
14 both my client and for his client, and then we would have
15 the hearing on March 2nd. Let's see what time?

16 MR. GERRARD: Well, your Honor, right now, we have
17 a hearing date March 2nd, correct?

18 THE COURT: Correct.

19 MR. GERRARD: And what time's that going to be?

20 THE COURT: 9:30.

21 MR. GERRARD: Okay.

22 MR. SCHWARTZER: Now, your Honor, I have a full
23 panel of --

24 THE COURT: 1:30?

25 MR. SCHWARTZER: Yeah. 1:30 would work.

1 MR. GERRARD: Okay. So, your Honor, if we have
2 that, then if we could -- we'll go along with
3 Mr. Schwartzer's recommendation and make our subpoena
4 returnable by the 22nd, so that we can have those records by
5 the 22nd, and then we'll work with Mr. Schwartzer to get
6 dates for the deposition.

7 THE COURT: Okay. Thank you.

8 MR. SCHWARTZER: Okay. Thank you, your Honor.

9 THE COURT: Thank you. Okay.

10 Is that all the matters that we have?

11 (Colloquy not on the record.)

12 THE COURT: Okay. Thank you.

13 (Colloquy not on the record.)

14 MS. CARLYON: Thank you, your Honor.

15 (Colloquy not on the record.)

16 THE CLERK: All rise.

17 (Court concluded at 04:05:38 p.m.)

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I certify that the foregoing is a correct transcript
from the electronic sound recording of the proceedings in
the above-entitled matter.

/s/ Lisa L. Cline

01/09/06

Lisa L. Cline, Transcriptionist

Date