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Thomas P. Jeremiassen, Chapter 11 Trustee

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

NORTHERN DIVISION

In re

ESTATE FINANCIAL, INC.,

Debtor.

THOMAS P. JEREMIASSEN, CHAPTER 11 TRUSTEE,

Plaintiff,

vs.

BRYAN CAVE LLP, a professional limited liability partnership, and KATHERINE M. WINDLER, an individual,

Defendants.

(Continued on next page)

Case No. 9:08-bk-11457-RR

Chapter 11

Adv. No.

COMPLAINT FOR:

1. **PROFESSIONAL NEGLIGENCE - FAILURE TO PROPERLY ADVISE;**
2. **PROFESSIONAL NEGLIGENCE- FAILURE TO PREVENT DEFICIENT DISCLOSURES IN SECURITIES OFFERINGS;**
3. **PROFESSIONAL NEGLIGENCE – FAILURE TO CONDUCT A PROPER AND COMPETENT COMPLIANCE REVIEW AND AUDIT;**
4. **PROFESSIONAL NEGLIGENCE - FAILURE TO COMPETENTLY STAFF AND SUPERVISE THE EFI REPRESENTATION;**
5. **BREACH OF CONTRACT;**
6. **BREACH OF FIDUCIARY DUTY;**
7. **AIDING AND ABETTING BREACH OF FIDUCIARY DUTY;**

8. EQUITABLE SUBORDINATION OF CLAIMS;

9. DISALLOWANCE OF PROOF OF CLAIM; AND

10. AVOIDANCE AND RECOVERY OF PREFERENTIAL TRANSFERS

JURY TRIAL DEMAND

Status Conference:

Date: [refer to summons]
Time: [refer to summons]
Place: Courtroom 201
1415 State Street
Santa Barbara, CA 93101

Plaintiff, Thomas P. Jeremiassen ("Plaintiff" or "Trustee"), solely in his capacity as the Trustee of the chapter 11 bankruptcy estate of debtor, Estate Financial, Inc. ("EFI"), by and through his attorneys, alleges as follows: [1]

I.

INTRODUCTION

I agree that you and Guy [Puccio] need to address the regulatory requirements immediately. I understand that the way to get the DRE to go easy on our clients is for them to admit error and cooperate fully. There is a risk if they do since the DRE could still sanction them, but a greater risk if they don't. These risks, from what you've (Katherine Windler) told me, include losing broker licenses and criminal penalties.

John Amberg, senior partner, Bryan Cave, LLP, ("Bryan Cave") **November 13, 2006**, (**Exhibit 1**) prior to Bryan Cave's completing a compliance review of EFI's business practices and operations.

[1] The EFI bankruptcy proceedings are pending in the United States Bankruptcy Court, Central District of California, Santa Barbara Division, Case No.: 9:08-bk-11457-RR.

> ***If you don't have any investors right now who are complaining, . . . we are fairly confident right now that the DOC or DRE won't look at you while you are in the process of fixing things up – even if you conduct business as usual until then.***

Katherine M. Windler ("Windler") Counsel, Bryan Cave, **December 16, 2006**, (**Exhibit 2**), after completing EFI's compliance audit, knowing that EFI's business practices and securities offerings violated federal and state securities laws, rules and regulations, and California real estate laws, rules and regulations, practices that could subject EFI's principals to criminal liability.

> ***This is a highly confidential document because it* [sic] *it fell into the hands of an investor, it would be the road map on how to attack EFI and the Fund for all contractual and securities issues.***[2]

Windler, **May 10, 2008**, after a year and a half of representing EFI and Estate Financial Mortgage Fund LLC ("EFMF" or the "Fund") as their corporate securities/real estate lawyer. [3]

The misguided and unprincipled legal advice rendered by Bryan Cave and Katherine M. Windler, as presented above, caused a loss of over $100 million to EFI/EFMF and to the over 1500 individuals who invested in EFI/EFMF after Bryan Cave and Windler knew that EFI's business practices violated countless real estate, securities and corporate laws, rules and regulations. Bryan Cave and Windler were retained to advise and help EFI address its legal deficiencies so that EFI/EFMF could continue its business operations in a lawful and appropriate manner. Instead, Bryan Cave and Windler knowingly advised EFI to continue to operate in violation of state and federal securities and real estate laws, rules and regulations, advice which led directly to the destruction of EFI/EFMF's business, and to the incarceration of EFI's officers and directors, all principally because they reasonably and justifiably relied on the advise given to

[2] The "roadmap" is a memorandum Windler prepared, and then sent to David Gould (a proposed receiver) and Lewis Landau (Mr. Gould's counsel) on May 18, 2008. True and correct copies of the memorandum and the email transmitting the same are attached as **Exhibit 3.**

[3] EFMF is a California Limited Liability Corporation formed by EFI's principals as a vehicle to raise money to fund construction loans generated by EFI. EFI was the corporate manager of EFMF. EFMF filed for bankruptcy on July 1, 2008. The case is pending in this Court, Case No. 9:08-bk-11535-RR.

them by Bryan Cave and Windler.

The facts presented in this Complaint tell a tragic story of how one of the most prestigious law firms in the country completely abandoned legal principles and its fiduciary, contractual and ethical obligations in an over-zealous attempt to orchestrate a restructure of a mortgage broker/investment company that was operating in violation of California and federal securities and real estate laws, rules and regulations, without making proper disclosures of its clients' conduct, notwithstanding their knowledge of the same; and of the Firm's failure to properly advise their clients in light of such knowledge. The claims presented herein arise out of the failure of Bryan Cave and Windler to adhere to sacrosanct rules of professional conduct, of their failure to recognize and address obvious conflicts of interests and to appropriately address the same and, in light of the foregoing, of their failure to counsel their clients' properly as to applicable laws, rules and regulations, including but not limited to California Rules of Professional Conduct. As stated the damages caused by Bryan Cave's and Windler's conduct is in excess of $100 million.

II.

REQUIRED PLEADING DISCLOSURE

1. In accordance with the requirements of Local Bankruptcy Rule 7008-1, the Trustee hereby alleges that at least some of the claims for relief asserted in this Complaint constitute core proceedings under 28 U.S.C. § 157(b). The other claims for relief asserted herein are related to this bankruptcy case as the outcome on those claims could have an effect on EFI's bankruptcy estate. Regardless, consent is hereby given to the entry of final orders and judgment by the Bankruptcy Court, except to the extent inconsistent with the Trustee's demand for a jury trial on all issues properly triable by a jury under applicable law.

III.

JURISDICTION AND VENUE

2. This action is a civil proceeding related to a case under Title 11 of the United States Code. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 151,

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157 and 1334, as well as the Local Bankruptcy Rules of the United States Bankruptcy Court and the United States District Court for the Central District of California.

3. Venue is proper in this Court, including venue pursuant to 28 U.S.C. §§1408 and 1409, because, among other things, this is the district in which the bankruptcy action is pending. Pursuant to 28 U.S.C. § 1391, venue is also appropriate as defendants are authorized to and regularly carry out substantial business in this district and the acts and conduct complained of herein took place within this district. Accordingly, this Court also has personal jurisdiction over the defendants.

IV.

THE PARTIES

4. Plaintiff Thomas P. Jeremiassen is the duly appointed chapter 11 trustee for the bankruptcy estate of EFI.[4]

5. Defendant Bryan Cave is a limited liability law partnership conducting business in the State of California, with offices in Santa Monica, California. Bryan Cave is an international law firm with more than 1,000 attorneys, and at least 19 offices worldwide. Bryan Cave holds itself out to the public as competent to provide broad based legal services, with specializations in various practice areas, including but not limited to corporate and securities laws, rules and regulations, real estate laws, rules and regulations, creditors' rights, bankruptcy, and legal ethics.

6. Defendant Windler is a resident of the County of Los Angeles, State of California. At all times relevant, Windler was and is an attorney licensed to practice law in the State of California and is "Counsel" to Bryan Cave. Windler is based in Bryan Cave's Santa Monica office and holds herself out as a bankruptcy specialist. Windler and Bryan Cave are collectively referred to hereinafter collectively as the "Firm".

[4] The Trustee is authorized to bring the instant action on behalf of EFI and its creditors. EFI, a California corporation doing business in the County of San Luis Obispo, State of California, became subject to the jurisdiction of the bankruptcy court on or about July 16, 2008 after the Court entered an order for relief (the "Order for Relief") in the involuntary bankruptcy case filed against EFI. Because the Trustee was not appointed as the chapter 11 Trustee until after the occurrence of the facts alleged in this Complaint, he has no personal knowledge of such facts. Accordingly, the Trustee alleges all such facts on information and belief based on a review of business records of EFI and other documents produced by Bryan Cave, some of which records and documents are exhibits to this Complaint.

7. At all times asserted in this Complaint, Windler was the agent, servant and/or employee of Bryan Cave, and in doing the acts and things herein mentioned and alleged was acting within the course and scope of her agency and/or employment.

V.

TOLLING OF THE STATUTE OF LIMITATIONS

8. At all times between October 2006 and the entry of the Order for Relief, Bryan Cave and Windler continuously represented EFI as its attorneys as to all of the matters upon which this action is based. On June 29, 2010, the Trustee, the Chapter 11 Trustee for EFMF, counsel for the EFI and EFMF Creditors' Committees, Bryan Cave and Windler entered into a written agreement tolling the running of the statute of limitations on the claims asserted in this Complaint (the "Tolling Agreement"). The Tolling Agreement was amended from time to time further tolling the running of the statutes of limitations to and including May 16, 2011.

VI.

STATEMENT OF FACTS COMMON TO ALL CLAIMS FOR RELIEF

A. BACKGROUND ALLEGATIONS, AND SUMMARY OF FACTS AND CLAIMS

9. Prior to its bankruptcy, EFI was a mortgage brokerage company engaged in the business of funding, servicing, and managing real estate construction loans. EFI funded its loans from money obtained from individual investors ("Investors" or "Fractionalized Note Holders") or from EFMF. EFI formed (and managed) EFMF for the purpose of investing in construction loans, and land acquisition and development loans, secured by first deeds of trust that were to be recorded against commercial and residential real estate located exclusively in California. EFI solicited Investors for its loans and for EFMF through offering circulars and placement memoranda ("offering materials") pursuant to permits issued by the California Department of Corporations.

10. EFI loaned money to real estate developers and contractors at high interest rates. EFI attracted Investors by promising them that their investments would be evidenced by a promissory note secured by first deeds of trust and that each Investor would have a fractionalized

interest in the Promissory Note and Deed of Trust. EFI also promised its Investors a 12% annual return on their investment. At the time of its bankruptcy, EFI had approximately 544 outstanding loans under management. As to those loans, approximately 42 already were foreclosed upon or the properties were deeded to EFI in lieu of foreclosure. Virtually all of the remaining loans were in default. At the time of EFI's bankruptcy, the 544 loans had an outstanding balance of approximately $318 million, of which approximately $151 million was funded by EFMF and the remainder (roughly $167 million) was funded by direct Investors. There are approximately 1,500 individuals who invested with EFI, either individually or by purchasing membership interests in EFMF, or both. As further set forth in this Complaint, at the time of the investment each Investor or EFMF member became a creditor of EFI.

11. EFI's bankruptcy was triggered in part from an order issued by the California Department of Corporations' Commissioner on May 28, 2008, "Revoking the Effectiveness of (EFI/EFMF's) Permit(s)" to solicit investors for EFMF (the "Revocation Order"). The Revocation Order was issued based upon a determination, among other things, that EFI's permit application failed to make certain material disclosures; including failing to disclose that as of December 31, 2006 more than 5% of the EFMF's outstanding loans were to affiliated companies to EFI. The DOC had issued the permit on May 21, 2007 based upon an application and offering materials prepared by the Firm. A true and correct copy of the Revocation Order is attached as **Exhibit 4**, and is incorporated herein by this reference.

12. Subsequent to the issuance of the Revocation Order, creditors of EFI filed a petition for an involuntary bankruptcy as to EFI, which was followed by EFMF's bankruptcy filing and the entry of the Orders for Relief. Thereafter, EFI's officers and directors, Karen Guth ("Guth") and Joshua Yaguda ("Yaguda") were charged with, and pled guilty to, 26 counts of fraud and five enhancements. The charges were based in large part upon Guth's and Yaguda's business activities that took place between December 2006 and May 2008, all during which time Bryan Cave and Windler were counsel to EFI and EFMF.

13. This action presents claims against Bryan Cave and Windler, who had primary responsibility for and controlled the EFI/EFMF representation, for, among others, professional malpractice, breach of contract, breach of fiduciary duty and aiding and abetting breach of fiduciary duty. The claims presented are premised upon, among other things, the Firm's failure to properly advise and counsel EFI and its officers and directors as to EFI's business activities and affairs between November 2006 and June 2008. More specifically, in or around November 2006, EFI retained the Firm to conduct a "compliance review and audit" ("Compliance Review") of EFI's business practices. The purpose of the Compliance Review was for the Firm to determine whether EFI's offering circular materials and business practices were in compliance with state and federal laws, rules and regulations; and for the Firm to advise and counsel EFI on how to address and correct any deficiencies relating thereto, so as to enable EFI to continue its business in full compliance with applicable laws and its contractual and fiduciary obligations to the Investors and to EFMF.

14. The Firm's Compliance Review, conducted in or around November-December 2006, revealed that EFI's offering materials and business practices in fact violated various state and federal laws, rules and regulations, including that EFI was misusing trust funds in the administration of its loans, and that its loan brokering activities and solicitation of, and acceptance of, funds from perspective lenders (individuals and EFMF) violated federal and state securities laws. Notwithstanding this knowledge, in or about December 2006, the Firm counseled EFI to continue its current business activities and practices without modification or disclosure, which business practices included the solicitation of new investors, until such time as the Firm could prepare new management and operating documents and file a new application for an offering permit with the DOC. In so doing, the Firm:

a. failed to advise EFI to stop any and all business activities that violated state and federal laws, rules and regulations,

b. failed to advise EFI to stop soliciting investors using offering materials that the Firm knew contained false and misleading statements and omissions of material facts.

c. failed to advise EFI as to the implications, both civil and criminal, of failing to immediately stop its current business practices.

d. failed to advise EFI as to the implications, both civil and criminal, of following the Firm's advice to continue its current business activities without modification, while the Firm was preparing new management and real estate documents and a new application for an offering permit with the Department of Corporations.

e. failed to advise EFI, as the manager of EFMF, of its obligations to abide by California Corporations Code §17656 ("Liability of limited liability company for civil penalty for failure to notify Attorney General or appropriate government agency and shareholders or investors with respect to knowledge of certain enumerated acts") and of its repurchase/rescissions obligations and rights under California Corporations Code § 25507 ("Limitation of actions to enforce liability created under section 25503; effect of offer to repurchase security or to pay damages; irrevocable consent.")

15. The Firm's knowledge of EFI's business practices in December 2006 presented an issue as to whether or not the Firm's representation of EFI, and through EFI, EFMF, and indirectly Guth and Yaguda, as officers and directors of EFI, presented a conflict of interest as to any continuing or concurrent representation by the Firm. The Firm failed to disclose this potential or actual conflict of interest to EFI, and to advise Guth and Yaguda of the need for EFI or EFMF to retain independent counsel and management so as to appropriately address any conflicts that existed or may have existed as a result of the Firm's findings *vis a vis* the Compliance Review. The Firm also failed to advise EFI of the implications raised as a result of the conflict of interest as to the relationship as between EFI and EFMF and EFI's Investors. Instead, the Firm continued to represent EFI and EFMF well after the Firm knew that there were actual and potential conflicts of interest and conflicting fiduciary considerations without disclosure of the same.[5] The Firm's

[5] As demonstrated *infra*, the Firm had evidence that EFI/EFMF's offerings and real estate practices violated state and federal laws, rules and regulations and had potential criminal consequences by no later than November 2006. Upon obtaining this evidence, Bryan Cave had an obligation to advise EFI of the consequences of its conduct, and should have advised EFI to obtain independent management for EFI and EFMF, at least until a determination was made as to Guth and Yaguda's criminal liability. The Firm failed to render such advice.

continuing representation was contrary to the interests of EFI and EFMF. Further, in continuing its dual representation, and in failing to recommend independent counsel and management for EFI and EFMF, the Firm:

a. failed to identify each past and continuing violation of state and federal laws, rules and regulations,

b. failed to counsel EFI to cease and desist its unlawful business operations,

c. failed to recommend an immediate plan to remedy the violations,

d. failed to advise EFI to report the violations to the DOC or SEC with a plan to fix the violations and protect EFI's Investors and creditors,

e. failed to advise EFI and EFMF, as well as Guth and Yaguda, to obtain separate independent counsel,

f. failed to withdraw from the representation after knowing of the conflicting interests, and

g. failed counsel EFI disaffirm any opinion, document or affirmations or the like related to EFI's business activities after it had knowledge that the offering materials it prepared violated state and federal laws, rules and regulations, and to discontinue the sale of memberships in light of the known violations of law.

16. In the spring of 2007 the Firm prepared and submitted an application to the DOC for the issuance of a permit that would allow EFI to continue soliciting investors for EFMF. The application and offering materials submitted to the DOC were based upon Windler's due diligence and previous Compliance Review, and were prepared almost exclusively by Windler, with only limited review by Bryan Cave lawyers with securities law expertise. The application and the submitted offering materials contained material misstatements of fact and omissions of material fact, including but not limited to failing to disclose EFI and EFMF's prior and continuing business practices that violated state and federal laws, rules and regulations. The violations were known to the Firm at the time of the submission to the DOC as a result of the Firm's Compliance Review. Notwithstanding, Bryan Cave/Windler encouraged EFI to use the permit that was issued in

conjunction therewith, and later failed to disaffirm any opinion, document or affirmations or the like related to the 2007 application and offering materials after it had knowledge that the offering materials it prepared violated state and federal laws, rules and regulations.

17. In addition to failing to disclose the violations in the application or the offering materials, the Firm failed to properly counsel EFI and its officers and directors on their obligations to disclose the violations to the Investors, the members of EFMF, to the DOC, the California Attorney General, or to the United States Securities & Exchange Commission ("SEC"), all as required by various laws, rules and regulations, and further failed to timely provide EFI with a plan for addressing the violations and for protecting EFI, EFI's investors and Creditors.

18. The conduct of the Firm as described in paragraphs 13 through 17, and as more specifically set forth throughout this Complaint, demonstrates a pervasive failure of good faith on the part of Bryan Cave and Windler and that the Firm's conduct was continuous throughout its representation of EFI/EFMF.

19. Further, Bryan Cave allowed Windler to control and supervise the EFI representation without proper supervision and guidance by Bryan Cave partners with expertise in the areas of securities and real estate laws, rules and regulations. Windler was hired by Bryan Cave following her employment by a former international and now defunct law firm, Coudert Brothers. Her hiring followed a malpractice claim prosecuted against Coudert Brothers arising out of a representation of a bankrupt community hospital that involved Windler as one of the primary attorneys. The malpractice claim accused Coudert Brothers (i.e. Windler) of failing to disclose critical and vital information about the financial condition of the company to the hospital's board of directors. This failure resulted in the appointment of a Trustee, and a multi-million malpractice claim against Coudert Brothers. Yet, Bryan Cave not only hired Windler, but then failed to supervise her actions, decisions and conduct in regard to the representation of EFI, allowing her to conduct and supervise the Compliance Review, and to be primarily responsible for the drafting of the EFI and EFMF's 2007 offering applications, offering materials and real estate contracts and forms, notwithstanding that she lacked the expertise in real estate, corporate and securities laws to

render professional and competent advice on the complex issues presented by the EFI representation without appropriate supervision and oversight. This is particularly so since the Firm had knowledge that Windler had a history of being involved in representations in which her integrity, honesty and professional ethics had been called into question. [6]

20. The loss caused to EFI from the Firm's conduct is significant and is in excess of $100 million. The Firm's advice and its failure to act upon its conflict of interest are the substantial and contributing factors to the damages sustained by EFI. Without question, as set forth *infra*, EFI hired the Firm to evaluate EFI's business practices, and to counsel EFI on how to address any and all deficiencies EFI had with its business operations and practices, including but not limited to addressing any securities and real estate legal issues presented by its past operations and practices. Bryan Cave is an international law firm with attorneys specializing in real estate and securities laws and regulations. By engaging Bryan Cave as its attorneys, EFI reasonably and justifiably believed that it was engaging highly competent attorneys with the skills and expertise to identify and address all potential issues and shortcomings of EFI's business practices.

21. When EFI was advised by the Firm as to the nature of the legal issues involving its business practices, EFI specifically requested that the Firm advise EFI as to how to conduct its business during the time the Firm was addressing EFI's deficiencies. The Firm's advice was for EFI to continue with its business operations as usual, without modification or change, and without appropriate disclosures or other actions as required by law, until the Firm had obtained a new

[6] See *In re Asset Resolution, LLC*, U.S. Bankruptcy Court, District of Nevada, Case No. BK-S-09-32824, in which the District Court entered an order imposing sanctions of several hundred thousand dollars against Bryan Cave (Windler being the lead lawyer) pursuant to Rule 9011 for filing and prosecuting chapter 11 cases for improper purposes and which were frivolous. In so doing, the District Court found Bryan Cave should be sanctioned because it caused their clients to engage in improper forum shopping solely in an attempt to evade the Court's jurisdiction and adverse rulings and to unnecessarily delay the proceedings in a related case. *See* ECF Docket No. 884, Order entered May 5, 2010, p. 13, 14-17. The Order is subject to a pending appeal before the 9th Circuit Court of Appeals. *See* ECF Doc. No. 940. In a related action, the same District Court issued an order for an attorney to file a motion for an "Order to Show Cause Why Katherine Windler Should Not Be Held In Contempt of Court re $375,112.43 in Unlawfully Transferred Direct Lender Proceeds From the Sale of the Anchor B Property." See, *In Re: USA Commercial Mortgage Company*, Debtor, *3685 San Fernando Lenders, LLC et al v. Compass USA SPE, LLC et al*, United States District Court, District of Nevada, Case No. 2:07-cv-00892-CJ, ECF Doc. No. 2123. Further, Windler's had EFI pay Bryan Cave's fees with a cashier's check, after the involuntary petition was filed against EFI. Windler, a lawyer who practices in the bankruptcy field certainly knew that the payment could be a preference and or post petition transfer, see, Bankruptcy Code §§ 547 and 549. *See*, *infra*, Tenth Claim for Relief.

offering permit for EFMF in the spring of 2007. Given the highly complex and specialized nature of the legal issues facing EFI, EFI had no other choice but to rely upon the advice and counsel of the Firm, and accordingly, reasonably and justifiably relied on the advice of the Firm that continuing with previous business operations was an acceptable and legal course of action until a new permit could be obtained. The Firm then prepared the new application, offering circular and other materials (the "2007 Application") submitted to the DOC in order to obtain a permit that would allow EFI to continue to solicit members/investors in EFMF. Again, given the highly complex and specialized nature of the legal issues facing EFI, EFI reasonably and justifiably relied on the Firm's advice and counsel that the 2007 Application made adequate disclosures and complied with state and federal laws, rules and regulations. Having obtained the new permit, EFI then reasonably believed and justifiably relied upon the Firm's counsel and advice that EFI could continue with its business operations as guided by the Firm including the solicitation of Investors and prospective members in EFMF. Accordingly, as set forth herein, EFI and its officers and directors reasonably and justifiably relied on the advice provided by the Firm, which advice was at all times directly contrary to the interests of EFI, EFMF, and EFI's Investors and creditors, and was directly contrary to state and federal laws rules and regulations. The advice provided by the Firm led EFI to reasonably and justifiably believe that the legal and regulatory issues with EFI's business practices were being addressed properly and correctly, while, in actuality, the advice directly led to, or was a substantial factor in leading to, further violations of state and federal laws, rules and regulations, breaches of fiduciary duty and the charges against and the guilty pleas of EFI's officers and directors. For the legal advice provided by the Firm, EFI incurred legal fees in an amount in excess of $800,000.

22. Had the Firm properly advised EFI, EFI would not have been able to solicit investors after November 2006 through 2008 for EFI or for EFMF, during which time Investors and EFMF members placed over $95 million with EFI either individually or in obtaining membership interests in EFMF all of which occurred during the time of the Firm's representation and during a time EFI was insolvent. Nor would EFI have continued its business operations in

violation of state and federal laws, rules and regulations. Indeed, when the Firm did provide advice and recommendations to EFI, EFI generally followed that advice and recommendations. Had the Firm proffered appropriate advice, EFI would have stopped its illegal activities, and would have taken appropriate actions to address its impaired business practices and offering materials. In the process EFI would have had to make full and complete disclosures to its Investors, the California Department of Real Estate ("DRE"), the DOC and the California Attorney General all as required by law; and, would have made offered rescission rights to its Investors, as propounded for by California law, the practical effect of which would have resulted in the liquidation of EFI's assets and a possible restructuring of its business. The failure to proffer this advice at the time EFI was insolvent (December 2006) extended the life of EFI, during which time EFI's liabilities increased by at least $95 million.

B. EFI'S CORPORATE HISTORY AND PRIOR LEGAL REPRESENTATION

23. Guth and her former husband, Charles Applebaum ("Applebaum"), incorporated EFI as a California corporation in 1991. In October 2003, Guth and Applebaum divorced. As of January 2005, EFI was owned by Guth (85%), Joshua M. Yaguda (10%) and Isabella W. Yaguda, a minor (5%). Guth was EFI's President and a director. Joshua Yaguda served as EFI's Vice President and Secretary. He was also a director. EFI operated under Yaguda's real estate license issued by the DRE. Isabella Yaguda was neither an officer nor a director.

24. In or about 2002, Guth and Yaguda formed EFMF as a funding vehicle for the loans made and brokered by EFI. Membership interests were sold pursuant to and subject to California Corporations Code Sections 25113 *et seq.* EFI was the corporate manager of EFMF, pursuant to a management agreement entered into between the two entities.

25. From about 2000 through late 2006, EFI was represented by the law firm Stein & Lubin, LLP ("Stein & Lubin"). Stein & Lubin's representation included assisting EFI in the formation of EFMF and acting as securities counsel to EFI and EFMF regarding the intrastate sale of EFMF's membership interests. In conjunction therewith, Stein & Lubin prepared the permit applications for EFI and EFMF's offerings for the years 2003-2006 and the offering materials

used in conjunction therewith. At all times during Stein & Lubin's representation of EFI/EFMF, EFI/EFMF reasonably and justifiably relied on that law firm to properly advise them concerning their respective business operations. EFI followed the advice provided by that law firm. [7]

C. THE LOCATI LITIGATION AND BRYAN CAVE'S INITIAL RETENTION AS COUNSEL TO EFI

26. In or around 2005-2006, a dispute arose between EFI and one of its borrowers, Mathew Locati, as trustee of his family trust ("Locati"). The dispute arose in relation to a $9.949 million loan EFI made in July 2004 to finance Locati's purchase and development of an 18 lot subdivision known as "Creekside Estates." Locati claimed that EFI made an improper and excessive beneficiary demand for payment regarding the sale of Creekside Estates Lot 12, and that EFI illegally made commission payments to a third party who allegedly was not a licensed real estate broker or agent. The dispute was referred to arbitration (the "Locati Arbitration"). EFI retained Stein & Lubin to represent its interests in the Locati Arbitration, which Stein & Lubin did up to August 2006. In August 2006, Stein & Lubin disclosed to EFI a potential conflict with regard to its representation. Stein & Lubin requested EFI waive the conflict. EFI refused to do so and Stein & Lubin advised that EFI would have to obtain new counsel.

27. On or about October 13, 2006, EFI retained Bryan Cave as its counsel for the Locati Arbitration. A true and correct copy of the retention agreement is attached as **Exhibit 5** and incorporated herein by this reference. Windler signed the retention agreement on behalf of Bryan Cave. As part of its representation of EFI, the Firm retained the services of Guy Puccio, a former DRE commissioner.

28. Windler also involved Bryan Cave partner John W. Amberg ("Amberg") as Bryan Cave's litigation partner for the Locati Arbitration.[8] Shortly after the retention, Amberg noted

[7] In November 2006, EFI notified Stein & Lubin that EFI was terminating all legal services of the law firm. Thereafter, in March 2007, Stein & Lubin notified EFI that Stein & Lubin was terminating the attorney-client relationship with EFI in all matters, including those relating to EFMF.

[8] At the time, Amberg had been practicing law in California for approximately 23 years, had been a partner at Bryan Cave for many years and had extensive experience in and his practice focused on, among other things, litigation and legal ethics and malpractice. In 2006, Amberg was the associate risk manager partner for Bryan Cave, an advisor to the California State Bar's Committee on Professional Responsibility and Conduct, a member of the Los Angeles County Bar Association's Professional Responsibility and Ethics Committee and a member of the Association of

several issues involving the Locati Arbitration that raised the specter that EFI's operating documents were contradictory to EFI's business practices and could result in allegations of fraud against EFI. In an email to Windler dated October 18, 2006, Amberg notes:

> Regarding information that EFI has no money in the deal: If we can make the legal arguments you have articulated - - L [Locati] could not legally refinance or sell Lot 12 because he did not have public report or approval of transaction documents so no damage - - ***I don't want to also argue that the investors are indispensable parties because they are the true lenders, not EFI. While this is true, some of our own documents contradict this . . . . We may also cause Locati to claim fraud.*** [Emphasis added.]

A true and correct copy of this email is attached as **Exhibit 6** and incorporated herein by this reference.

29. On November 2, 2006, Windler sent Guth and Yaguda a memorandum recommending settlement of the Locati Arbitration with a restructuring of the promissory note and the issuance of an amended public report. In her memorandum, Windler notes that the issues in the Locati Arbitration presented DRE licensing problems for EFI:

> [W]e are concerned . . . the Department of Real Estate ("DRE") could issue a cease and desist order for the project, prohibiting any future sales, refinances or transfers of interests in the property. ***The DRE could further look to take action against any licensees who were involved in the prior transfers or financing on the property.*** Further, ***any final determination in the pending arbitration that Locati's efforts to sell or refinance Lot 12 constituted violations of the Subdivision Lands Law and the securities laws could be detrimental to defensive***

Professional Responsibility Lawyers and the American Bar Association's Center for Professional Responsibility. Amberg also had been a managing partner of Bryan Cave's Los Angeles office, a former Chair of the California State Bar's Committee on Professional Responsibility and Conduct and a former Chair of the Los Angeles County Bar Association's Professional Responsibility and Ethics Committee. He also lectures and writes frequently on professional responsibility, ethics and risk management, and has coauthored the annual review of ethics developments for the Los Angeles Lawyer for approximately seven years.

positions that either Locati or EFI may wish to take with regard to the DRE. [Emphasis added.]

A true and correct copy of the memorandum is attached as **Exhibit 7** and is incorporated herein by this reference.

D. THE FIRM'S COMPLIANCE REVIEW AND AUDIT RETENTION, AND KNOWLEDGE OF EFI'S AND EFMF'S BUSINESS AFFAIRS

30. On or about November 2, 2006, Windler, on behalf of Bryan Cave, and EFI entered into a second engagement agreement whereby the Firm was retained to conduct a Compliance Review of EFI's business operations and its securities offerings (the "Compliance Review Engagement Agreement"). A true and correct copy of the Compliance Review Engagement Agreement is attached as **Exhibit 8** hereto and is incorporated herein by this reference. The purpose of the Compliance Review was for the Firm to fully assess EFI's business practices, determine the extent, if any, which of those practices did not comply with applicable laws, rules and regulations any contractual and fiduciary requirements or obligations or representations made to borrowers, lenders, investors or EFMF's members; and, to provide proper advice and counsel to EFI concerning any potential consequences of, and the means of correcting any such non-compliance. In addition, the Firm was to counsel and assist EFI in bringing its and EFMF's business practices into full compliance with applicable law, and with its contractual and fiduciary requirements, obligations and representations including those made to EFI's borrowers, Investors and to EFMF and its members.

31. Windler recognized she was not competent to represent EFI with respect to the securities and real estate work that needed to be addressed as part of the Compliance Review, even though she did not disclose that lack of competence and expertise to EFI or to its officers or directors. On November 2, 2006, Windler wrote to Therese Pritchard, a partner in Bryan Cave's Washington D.C. office asking for help on this project.[9] In her email to Ms. Pritchard she states:

[9] Therese Pritchard is a member of Bryan Cave's Securities Enforcement, Compliance and Litigation Client Service Group and of the firm's Executive Committee. For over 25 years, she has specialized in the areas of securities and financial institutions enforcement and litigation. Ms. Pritchard has represented major public companies, banks,

> I have accepted an engagement to do a compliance review and audit for an existing client named Estate Financial Inc. . . . I would like to have a securities lawyer join me on this project. . . . Because the client is in CA, the loans are made to CA borrowers and secured by CA property, a CA lawyer would be best, but I don't know anyone who does real estate transactions in CA that might know the securities side.

A true and correct of the email is attached as **Exhibit 9** and incorporated herein by this reference.

32. Ms. Pritchard recommended a lawyer in Bryan Cave's St. Louis office, Jim Levey. Mr. Levey did not participate in the engagement. Further, Ms. Windler did not engage any other securities lawyer to assist her with the Compliance Review or with the preparation of the 2007 Offering Materials until March 2007, when she involved Mr. Randolf Katz for the limited purpose of reviewing her draft of the offering circular she prepared.[10]

33. On November 2, 2006, Windler wrote to Guth and Yaguda that she and Puccio would be at EFI's offices on November 14, 2006 to commence the Firm's Compliance Review and requested that Guth and Yaguda provide certain documents and information for review. Her request included but was not limited to sample files of refinances, purchase loans, loan files secured by income producing properties, land loans, construction loans, copies of the wholesale lending agreement with funding lenders or investors, copies of offering memoranda, whether

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broker-dealers, investment advisors, mutual funds, hedge funds and individuals under investigation by the SEC, the NYSE, the NASD and the federal banking agencies. Ms. Pritchard was with the Division of Enforcement of the Securities and Exchange Commission from 1982 to 1991, serving as an assistant director from 1986 to 1991. From 1991 to 1994, she was deputy chief counsel of the Office of Thrift Supervision, in charge of its Washington, D.C. enforcement program, directing and managing many high-profile fraud cases brought by the government resulting from the savings and loan crisis. Ms. Pritchard then co-managed the Professional Liability Section of the Resolution Trust Corporation from 1994 to 1995, where she directed and resolved more than 300 cases against officers, directors and other professionals associated with failed savings and loan institutions. Notwithstanding her expertise, Ms. Pritchard had no further involvement in the EFI representation other than making a recommendation to another lawyer in the firm.

[10] Mr. Katz is a 1978 graduate of UCLA law school and purports to have securities laws experience having served as outside general counsel and special securities counsel to both public and private companies in matters relating to corporate finance, mergers and acquisitions, and corporate governance. Mr. Katz has handled numerous private

issued in the context of private placements or permitted or qualified and registered offerings, copies of loan origination and loan servicing documents, copies of trust fund records for loan funding, escrow and loan servicing trust accounts and copies of reports filed with the DRE, DOC, or to any other federal or state agency. A true and correct copy of the letter is attached as **Exhibit 10** and incorporated herein by this reference.

34. On or before November 6, 2006, the Firm became aware that EFI was using loan funds in an inappropriate manner and in violation of EFI's trust obligations. At that time, Windler received an email from Yaguda relating to the Locati litigation, subject: "Matt's slush fund concept." In this email, Yaguda admits to using funds that were designated for a particular lot in the Creekside development other than Locati's Lot # 12 for the benefit of Locati's lot # 12. As presented in the email: "I think if you look at Matt's testimony you'll see that he knew that the funds were coming from all the loans for the benefit of lot 12. Let me know if you need more." A true and correct copy of the November 6, 2006 email is attached as **Exhibit 11** and incorporated herein by this reference.

35. By no later than November 13, 2006, the Firm knew that EFI's business operations violated California state law with criminal implications. As presented in the introduction, in an email to Windler, Amberg states:

> I agree that you and Guy [Puccio] need to address the regulatory requirements immediately. ***I understand that the way to get the DRE to go easy on our clients is for them to admit error and cooperate fully***. There is a risk if they do since the DRE could still sanction them, but a greater risk if they don't. ***These risks, from what you've told me, include losing broker licenses and criminal penalties.*** [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 1** and incorporated herein by this reference. Given Amberg's experience and expertise in legal ethics, Amberg knew that the possible imposition of criminal liability for a firm client was a very serious matter that

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placements, initial public offerings, follow-on public offerings, and alternative public offerings of domestic and

required specialized attention, created conflict issues as to the Firm's representation of EFI and EFMF, and that all relevant details needed to be communicated to the client and to the Firm's management.

36. On November 14, 2006, Windler and Puccio met with Guth and Yaguda at EFI's offices and commenced the Firm's compliance review. Windler spent 6.4 hours reviewing EFI's business model, files and offering documents. Windler then spent additional time on November 15, 2006 reviewing the EFI materials and documents she previously requested.[11]

37. Windler, Guth, Yaguda and Puccio also met in December 2006, as part of Windler's Compliance Review. As a result of this meeting and her document review, Windler determined that most of what EFI was doing violated securities laws and disclosure rules.[12]

38. As a result of the November 14th meeting, and her review of EFI's records, contracts, files and documents as set forth above, and the discussions in December, 2006, in or around November/December 2006, Windler concluded, among other things that:

i. EFI's offering circulars then in use were inadequate;

ii. EFI's standard form transactional documents and borrower disclosures were internally inconsistent and insufficient to meet minimum legal standards that EFI was required to comply with in order to issue securities;

iii. EFI's business practices violated the Subdivided Lands Law, which was another form of securities offering;

iv. EFI lacked adequate controls and measures in place to conduct its business in a proper and lawful manner;

v. EFI was not handling its trust funds in a proper and lawful manner;

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foreign entities. Mr. Katz is now a partner with the law firm Baker Hostetler (Costa Mesa, California).

[11] As part of the Compliance Review, Bryan Cave/Windler also prepared numerous transactions forms and documents that EFI used in the ordinary course of its business, including but not limited to: a form of a Construction Loan Agreement, Blanket Security Agreement; Partial Funding Agreement; Environmental Indemnity Agreement; and a Continuing Guaranty.

[12] See fn. 2, Exhibit 3.

vi. EFI's business operations violated EFI's legal obligations under California's Real Estate Laws, Real Estate Commissioner's regulations pertaining thereto, the California Corporate Securities Law of 1968 and the Corporations Commissioner's regulations pertaining thereto, all as set forth in Business and Professions Code § 10130 *et seq.* and 10 C.C.R. Chapter 6, 2705 *et seq.*, Corporations Code § 25000 *et seq.*, and 10 C.C.R., Chapter 3, 250.9 *et seq.*;

vii. EFI's then outstanding offering circular did not authorize the raising of "risk capital" for the purpose of financing borrowers like Locati and did not authorize partial funding of loans;

viii. EFI's business operations and practices failed to comply with the trust fund handling requirements imposed by the Real Estate Law, Business and Professions Code § 10145 *et seq.*, and 10 C.C.R. Chapter 6, § 2830.1 *et seq.*;

ix. EFI's transactional documents and disclosures were inconsistent with applicable existing law and the form and intent of the transaction, particularly for disbursements during the course of land development or construction of residential building and site improvements, as required by Cal. Fin. Code § 17005.1;

x. Each offering circular used by EFI did not adequately address the loan products upon which EFI was relying for almost its entire loan origination activities, did not address investor suitability, left unanswered how trust funds were to be properly maintained, failed to describe how partial funding was to be appropriately accomplished and did not discuss how loans were to be secured within subdivision properties in advance of compliance with the requirements of the Subdivided Lands Law and the Real Estate Commissioner's regulations pertaining thereto.

39. Windler's findings and conclusions as set forth above are presented in a memorandum Windler prepared in May 2007. A true and correct copy of the email transmitting the memorandum to Yaguda and the memorandum itself are attached as **Exhibit 12** and are

incorporated herein by this reference. As presented in Windler's email to Yaguda: "I believe this is factually accurate based upon what I understand from our first compliance review in your office."

40. That the Firm had actual knowledge that EFI's business practices created significant and material legal issues is further presented in a December 7, 2006 memorandum from Puccio, in which he cautioned Windler that EFI should not continue partial funding with fractionalized notes and deeds of trust as the investment vehicle. As presented in the memorandum:

> I am aware that Karen is concerned about how to restructure EFI to allow her to continue with construction and land acquisition development loans relying on partial funding. ***What she cannot do is to continue partial funding with fractionalized notes and deeds of trust as the investment vehicle. The investment vehicle must be pooled funds such as an LLC, an LLP, or a CMO.*** Further, she will face an investor suitability issue. On the other hand, it is not impossible. Let's discuss, at your convenience. Also, your securities counsel will want to consider my thoughts and advice. [Emphasis added.]

A true and correct copy of the memorandum is attached as **Exhibit 13** and incorporated herein by this reference. Windler never discussed the "investor suitability" issue with "securities counsel" as recommended by Puccio.

41. EFI's violations of California securities and real estate laws, rules and regulations, as presented by Windler and as confirmed by Puccio, triggered certain obligations of EFI and rights of the Investors including but not limited to the right of each Investor to receive a repayment of his or her Investment under California Corporations Code §25507 as of December 2006. These "Rescission" claims exceeded $200 million as of December 2006. As a result, EFI became insolvent in that EFI's liabilities exceeded its assets by tens if not hundreds of millions of dollars.

42. Notwithstanding Windler's knowledge that EFI's current business practices violated state and federal laws, rules and regulations, and could result in criminal sanctions, and

notwithstanding Puccio's admonition that EFI should not continue partial funding with fractionalized notes and deeds of trust as the investment vehicle, the Firm advised EFI to continue to conduct its business as "usual" because Windler felt that the DOC and DRE would not take notice. As presented in the introduction, on December 13, 2006, Windler sent the following email to Guth responding to her request for advice on how to proceed with EFI's business operations:

> ***If you don't have any investors right now who are complaining,*** or you don't have any loans that are in default that you are having to roll over because of defaults, ***this is not yet urgent for you.*** I'd prefer that we file the CFL and business plan together. . . The entire process . . . takes about 4 months, and during this time I am expecting that you will continue conducting business as you have in the past . . .***we are fairly confident right now that the DOC or DRE won't look at you while you are in the process of fixing things up – even if you conduct business as usual until then.*** [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 2** and is incorporated herein by this reference.

43. Puccio also urged that EFI file a complaint with the DRE regarding the Locati transaction as to the acts and conduct of Locati in regard to the sales for the subdivision. Ignoring her own expert's advice, Windler advised against such a filing. Windler's email to Guth and Yaguda (with a copy to Amberg) dated January 10, 2007 evidences her knowledge that EFI business practices involved violations of the securities laws:

> . . . . ¶ . . . . In contrast [to Puccio's recommendation that EFI file a complaint with the DRE against Locati], John and I believe that the filing of a DRE complaint would not be recommended at this point. Locati could argue that we are trying to improperly influence the outcome of the arbitration and could still amend his complaint. We continue to be concerned about the potential that filing an affirmative complaint before the arbitrator issues his ruling could give Locati new

> grounds to file claims against EFI. . . ¶ EFI can still file a complaint on this project if it wishes to do so at some date after the arbitration is finished. . . . Filing a complaint at a later date still might assist EFI in reforming the notes and TDs***. It might also permit EFI to issue beneficiary demands without engaging in further securities violations***, . . . [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 14** and incorporated herein by this reference.

44. The Firm knew that EFI's solicitation of investors (whether as investors in fractionalized notes or in EFMF) was in violation of state and federal laws, rules and regulations since at least November 14, 2006, the date of the Compliance Review meeting in Paso Robles. Puccio was in accord with this view, and offered that the Firm could accomplish a business plan and model that would bring EFI into statutory and regulatory compliance. In a memorandum dated January 23, 2007 to Guth and Yaguda (copy to Windler) Puccio wrote:

> I am confident we can accomplish a business plan and model that will suit your objectives while at the same time bring you into substantial compliance with the statutory and regulatory scheme we discussed when KW (Katherine Windler) and I were at your office on November 14 and 15.

A true and correct copy of the memorandum is attached as **Exhibit 15** and incorporated herein by this reference.

45. The Firm's advice to EFI that it should not change its business practices, notwithstanding the Firm's knowledge of EFI's substantial and significant regulatory violations, was apparently bolstered by Guy Puccio's opinion that neither the DRE nor the DOC were moving "aggressively to knock on EFI's door." In a memorandum dated February 9, 2007, Puccio writes:

> Please be informed that I believe, in response to my discussions along with KW discussions with them, ***neither the DRE nor the DOC are moving aggressively to knock on EFI's door.*** Each are waiting for EFI, its counsel, and consultant to correct the outstanding issues, structure and implement our mitigation plan, refine

> EFI's business plan/model, and submit an application for a new offering to be permitted by the DOC. [Emphasis added.]

A true and correct copy of the memorandum is attached as **Exhibit 16** and incorporated herein by this reference.

E. THE FIRM'S PREPARATION AND FILING OF EFMF'S 2007 APPLICATION FOR A PERMIT TO SELL EFMF SECURITIES (MEMBERSHIP INTERESTS) AND LEGAL SERVICES BETWEEN MARCH 2007 – JULY 2007

46. EFI/EFMF's permit for selling membership interests for the year 2006 expired on March 29, 2007. On March 12, 2007, Windler again counseled EFI to continue its business operations without modification, expressing her opinion that EFI could get an extension of its current permit, which she previously acknowledged was used in violation of securities laws, pending issuance of a new permit. In an email to "Karen" and "Joshua," Windler states:

> Guy Puccio and I have been working on revising your offering and your loan documents for the securities permit for Estate Financial Mortgage Fund, LLC. ***The current permit expires on 3/29/07.*** Guy has opened discussions with the DOC regarding an extension of that permit until the new documentation can be completed. ***We are waiting (and hoping) for confirmation that EFI can extend its permit for 90 days, without modifications, while the new forms of loan agreement and offering circular are completed.*** The DOC is fully aware of our work with you to revise and amend the offering. In order to get the new permit issued, you will need to be prepared to disclose the following information: [number of nonperforming loans and actions taken to pursue]. [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 17** and is incorporated herein by this reference.

47. During March 2007, Windler prepared the new offering documents that EFI/EFMF was to use for the sale of interests in EFMF and forwarding the same to Guth and Yaguda for their review. In her transmittal email to them dated March 25, 2007 Windler acknowledges that EFI's prior business practices were illegal and violated disclosure rules:

> With the knowledge we gained from you in our meeting in PR [Paso Robles] before Christmas [December 2006], we learned some things about your business and those ideas are reflected here, but the majority of the changes reflect my view on what the DOC will allow in the current market and what the law requires. This draft offering describes practices that are substantially different than your past business practices, ***so we have to schedule some time to discuss the changes and what you can live with and how far you want me to push the DOC.*** I will send you a redline so you can see the changes we made from your last pool offering. ***It might not be very helpful, because most of what you were doing wasn't legal and violated the disclosure rules.*** [Emphasis added.]

A true and correct copy of the email, and the draft Offering Circular for the 2007 permit application is attached as **Exhibit 18** and is incorporated herein by this reference.

48. The Firm knew that EFI/EFMF was violating state and federal securities laws, rules and regulations, by having more than 500 individual investors in EFMF, based upon its Compliance Review. On March 25, 2007, Windler sent an email to a Bryan Cave "corporate" attorney, Randolph Katz, requesting he review the draft offering memorandum Windler had prepared. In her email, Windler acknowledged that EFI had violated federal and state securities laws in its 2006 offering:

> The client is . . . EFI who is the Managing Member and licensed real estate broker acting as a mortgage loan broker for a qualified and registered offering by Estate Financial Mortgage Fund LLC. I have drafted a revised Offering Circular [for EFMF], which is substantially different from what was submitted for last year's permit. . . . ***last year the Commissioner didn't notice that there were 1,064 investors – way beyond the rule of 500 max before SEC compliance. . . . . [T]heir business in the past hasn't been based on strict compliance with the law and this newly revised version of the Offering attempts to put them closer to compliance***

> ***without hoping that the DOC Commissioner will again omit to read it.*** [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 19** and is incorporated herein by this reference. Katz took no action in regard to the federal securities law violation disclosed in Windler's email.

49. On March 29, 2007, EFMF's 2005-2006 Offering Permit expired. The Firm did not obtain an extension. Nor did the Firm advise EFI to cease soliciting investors for EFMF until a new permit issued. The new permit was not issued until May 21, 2007. Between March 29, 2007 and May 21, 2007, EFI sold over $5 million in membership interests in EFMF.

50. At or about the same time, Windler, as part of the Compliance Review, started to revise EFI business forms and loan documents. Windler, who had no expertise in this area, used five-year old outdated documents as her "base" and then had the same reviewed by a Bryan Cave partner, Bryan Turner, who was located in the Firm's Kansas City, Missouri office. Turner was not licensed to practice in California and knew nothing about the specifics of California law as the same pertained to the documents Windler prepared for EFI. In an e-mail dated March 29, 2007, (**Exhibit 20**) Windler writes:

> Bryan – I need some help. . . . [¶] I have been working on a transaction for one of my leading clients, getting their offering circular for the LLC Pool renewed with the Dept of Corporations. In this process, I have come to realize that many of their documents are sorely lacking and do not provide for consistent terms. I am trying to remedy that. [¶] Years ago (in 2002) I prepared a set of construction loan documents for a client along with the Coudert real estate partner. I have used them as my base. I have completed the modifications to the 3 attached . . . . ¶ Do you have time to put your real estate stamp of approval on these?

Mr. Turner agreed to participate in the task of modifying EFI's construction loan documents, with the caveat that he was not a California lawyer and was not going to check state-specific requirements. In an email to Windler dated April 4, 2007, Mr. Turner writes:

> **. . . (. . . of course, I am not a California lawyer, so the state-specific portions I can't check).** (Emphasis added.)

A copy of the email is attached as **Exhibit 21**, and is incorporated herein by reference. The Firm never advised EFI of these facts and later encouraged EFI to use the documents prepared by Windler in the ordinary course of EFI's business.

51. On April 4, 2007, Windler, on behalf of EFI as the manager of EFMF, submitted an application (the "2007 Application") and proposed Offering Circular (the "2007 Offering Circular"), (**Exhibit 22**, a copy of which is attached hereto and incorporated herein by this reference) to the DOC as part of the process to obtain a "new" offering permit (the "2007 Permit") which would authorize EFI/EFMF to sell membership interests in EFMF. At the time of the submission and based upon its previous Compliance Review, the Firm knew that 2007 Offering Circular (a) would be reviewed and relied upon by the DOC in deciding to issue the 2007 Permit, (b) would be justifiably and reasonably relied upon by EFI's management as being an appropriate Offering Circular with full and complete disclosures as required by law, and (c) would further be reasonably and justifiably relied upon by EFI's management in continuing to conduct EFI/EFMF's businesses. Notwithstanding, as set forth in the Application and as presented in her cover letter to the DOC, Windler wrongfully did not disclose, much less competently, completely, properly and clearly disclose, that the 2007 Offering Circular was incomplete, false, and misleading, and contained material omissions of fact. Moreover, Windler also failed to disclose to EFI that its reliance on and any use of the 2007 Permit and/or the 2007 Offering Circular in conducting EFI's business was misplaced, improper and exposed EFI to dire criminal, regulatory, civil and economic consequences. Windler's letter to the DOC states in relevant part:

> . . . ¶ . . . . The principal change in this Qualification from the Qualification that was filed last year, and for which a permit was issued, has been the revision of the Offering Circular to incorporate the past year's operating results and to respond to the current real estate market. In that regard, the Fund has elected to make disclosures to investors that reflect the risk of investments in the current market

> environment. . . . ¶ Please note that the Fund's current Permit was scheduled to expire on March 29, 2007.

In this letter and at no time, did Windler disclose to the DOC that the "current Permit" had not been extended and had expired, that the 2007 Offering Circular was incomplete, false and/or misleading because it did not disclose material prior or continuing EFI/EFMF violations then known to the Firm or that EFI/EFMF's ongoing business operations and that the 2007 Offering Circular still did not comply with applicable laws.

52. Windler's advice to EFI also extended to reviewing written communications that EFI intended to use in the solicitation of investors in EFMF. In an email of April 17, 2007 to Yaguda (**Exhibit 23**, a copy of which is attached hereto and incorporated herein by this reference), Windler opines:

> The document (a mailer that apparently related to EFMF at a time when there was no effective permit for the sale of its membership interests) looks fine to me. It is clear and doesn't have any misstatements or misleading information. The rules are you can send to anyone with whom you have a current or prior pre-existing relationship without problem. I'd say anyone in the past 5 years is fair game to receive it.

This email again encouraged EFI/EFMF, albeit unwittingly, to sell EFMF membership interests in violation of applicable laws, for at this time the Firm knew that the DOC's previously issued permit for the sale of EFMF's interests had expired on March 29, 2007 and that the 2007 Permit had not yet been issued. The Firm also knew about many of the EFI/EFMF regulatory violations and that those violations had not been competently, completely and properly disclosed in the previously effective offering circular or in the 2007 Application, nor in the letter EFI proposed to send to investors. Nevertheless, the Firm failed to competently, completely, properly and clearly (i) disclose those violations to EFI/EFMF; (ii) advise EFI/EFMF that they could not lawfully sell EFMF membership interests without first disclosing those violations to prospective investors and the DOC; and (iii) advise EFI/EFMF that there was no effective DOC permit for the sale of EFMF

membership interests and, (iv) that it was a violation of applicable laws to offer to sell and sell EFMF membership interests without a valid permit to do so.

53. The Application for the 2007 Permit was not acceptable by the DOC without modification. As noted in a May 8, 2007 email from Windler to Guth and Yaguda (with a copy to Puccio and Amberg) (**Exhibit 24**, a copy of which is attached hereto and incorporated herein by this reference):

> **Today I heard back from the DOC [regarding the 2007 Application] . . .they . . . will approve it directly, assuming I will agree to include a section on "Investor Suitability" ahead of "Risk Factors."** [¶] **I will add a section on investor suitability in the section starting at page 3 of all caps,** and we will send him [Anthony Colbert, Senior Corporate counsel with the DOC] a redline tonight. He indicated he will approve it immediately upon receipt.
>
> (Emphasis added.)

54. Windler then represented to Mr. Colbert of the DOC that she had amended the 2007 Offering Circular with the appropriate language. In a letter dated May 8, 2007, **(Exhibit 25,** a copy of which is attached hereto and incorporated herein by this reference) Windler states: "Enclosed . . . is Estate Financial Mortgage Fund, LLC's . . . revised portions of the Offering Circular." The letter included an amendment (Items 8-10) to the 2007 Application. Also included were the "all caps" "Investor Suitability" disclosures (two paragraphs) required by the DOC to be added at the front part of the 2007 Offering Circular as a condition to the issuance of the 2007 Permit. While the Firm affirmatively represented to the DOC and to EFI/EFMF that these disclosures would be included in "all caps" at page 3 of the 2007 Offering Circular, the Firm did not make those required disclosures. See **Exhibit 26**, 2007 Offering Circular used by EFI/EFMF in its solicitation of EFMF members, a copy of which is attached hereto and incorporated herein by this reference.

55. The 2007 Permit was issued on May 21, 2007 **(Exhibit 27**, a copy of which is incorporated herein by this reference), based upon the submissions made by the Firm, all of which

contained material misstatements and omissions of fact. However, because the Firm never competently, completely, properly and clearly advised EFI of the material omissions of fact, EFI/EFMF justifiably and reasonably, but erroneously, believed that the 2007 Offering Circular was accurate and complied with all applicable laws and that the 2007 Offering Circular and 2007 Permit allowed EFI/EFMF, without incurring regulatory, civil or criminal liability, to continue soliciting members for EFMF's business and, therefore, EFI/EFMF continued to sell EFMF membership interests based upon the work, advice and guidance of the Firm.

F. THE FIRM'S ANALYSIS OF STEIN & LUBIN'S REPRESENTATION OF EFI/EFMF[13]

56. After obtaining the 2007 Offering Permit, Windler turned her attention to developing a malpractice claim against EFI's former attorneys, Stein & Lubin, soliciting the input from Guy Puccio. In a memorandum dated May 23, 2007, to Windler, (**Exhibit 28**, a copy of which is attached hereto and incorporated herein by this reference) Puccio wrote:

> You have asked that I prepare a brief summary of some of the issues which I believe represent alleged malpractice of EFI's prior counsel . . . . [The preparation of] offering circulars/prospectuses upon which EFI relied to issue securities to investors in the form of fractionalized note offerings and in the form of LLC Mortgage Funds. . . . ¶ . . . .¶ **The proper due diligence of the activities of EFI would not have allowed EFI to proceed with the application for securities permits without correcting the violations of existing law and to the extent required, without making a repurchase offer to their investors in accordance with Corporations Code Section 25507 et seq.**
>
> (Emphasis added.) [14]

[13] As part of its representation of EFI, the Firm recommended that EFI dispute the billings of Stein & Lubin for the Locati Matter. The dispute resulted in an arbitration between Stein & Lubin and EFI, with EFI being represented by the Firm, including Amberg's participation.

[14] Remarkably, even after getting this memorandum, Windler ignored her own expert's observation that "the proper due diligence of the activities of EFI would not have allowed EFI to proceed with the application for securities permits without correcting the violations of existing law and to the extent required, without making a repurchase offer to their investors in accordance with Corporations Code Section 25507 et seq." As presented infra, Windler likewise failed to

The "issues" set forth in this memorandum are not disclosed in the 2007 Application, the 2007 Offering Circular, or in the other documents prepared by Bryan Cave and Windler and sent to the DOC on April 4, 2007 (***see* Exhibit 22**).

57. Windler then prepared a draft of the claims she believed could be appropriately brought against Stein & Lubin, forwarding the same to Yaguda for review (with a copy to Amberg). In her forwarding email, (**Exhibit 12**) Windler states:

> I prepared this draft of the claims that I feel are appropriate against Stein & Lubin relating to their securities offerings and provisions of other legal advice to you. . . My insert **attached is limited to the securities issues** I raised in a call with you and Karen. [¶] **I believe this is factually accurate based on what I understood from our first compliance review** [on November 14, 2006] **in your office. However, I need you to verify that I am correctly ascribing to Stein & Lubin the work that EFI retained that firm to perform.** (Emphasis added.)

Windler's draft identified numerous claims that EFI/EFMF might have against Stein & Lubin relating to their preparation of real estate and securities offering documentation for and legal advice to EFI/EFMF and was prepared as a proposed insert to EFI's pre-trial brief in the Stein & Lubin Fee Arbitration. Although Windler prepared the draft based on what she had learned in her November 14, 2006 review of EFI/EFMF documents, none of the defalcations presented in this memorandum are disclosed in the 2007 Application, the 2007 Offering Circular or in the other documents Windler sent to the DOC on April 4, 2007. Moreover, Windler did not send the draft of claims to EFI/EFMF until more than six months after her November 14, 2006 review of their documents and only after the 2007 Permit had been issued. Finally, and what is most troubling, is that Bryan Cave and Windler were, at a minimum, blind to the fact that they were repeating many of the wrongful acts and omissions they attributed to Stein & Lubin. Those include wrongfully: (i) failing to "undertake [a complete and competent] evaluation of EFI's[/EFMF's] business plan,

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advise EFI that it could not proceed with the application for securities permits without correcting the violations of existing law and to the extent required, without making a repurchase offer to their investors in accordance with Corporations Code Section 25507 et seq."

transactional documents, trust fund policies, loan origination activities and securities compliance"; (ii) "fail[ing] to tell EFI[/EFMF] that the offering circulars it prepared were inadequate"; (iii) "ignor[ing] . . . [its] affirmative obligation to inform EFI[/EFMF] of various rules and regulations affecting its operation"; (iv) "ignor[ing] . . . the conflict between its role as securities counsel and . . ."; (v) "fail[ing] to undertake adequate due diligence . . ."; (vi) "re-wr[iting] the EFI/[EFMF] offering circular . . . completely ignoring the unwitting lack of compliance by EFI[/EFMF] with legal constraints placed upon its operations"; (vii) hid[ing] facts"; (viii) "willful omissions[s] in its legal advice;" and (ix) as counsel retained to prevent exactly such an outcome, yet to protect its reputation, and its consistent flow of legal work from EFI[/EFMF ", . . cover[ing] up its deficiencies."

G. THE LOCATI ARBITRATION DECISION AND AWARD

58. On May 30, 2007, the arbitrator in the Locati Arbitration issued his award (a true and correct copy of which is attached as **Exhibit 29** and incorporated herein by this reference) in favor of Locati and against EFI, based upon a number of findings, including that EFI:

i. made illegal payments to an unlicensed broker (**Exhibit 29, Award, p. 3**);

ii. breached its duty to the borrower by failing to withhold part of the disputed commission for the unlicensed broker (**Exhibit 29, Award, p.70**); and,

iii. had used money from the loan for one lot, to fund construction on another lot (lot 12) and as a result submitted an excessive demand for payment upon the sale of Lot 12, which caused the sale to fail (**Exhibit 29, Award, pp 7-8, lines 28-11**).

59. Windler did not present this information to the DOC, or seek to amend the 2007 Offering Circular or Permit Application based upon the results of the Locati Arbitration Award and thus continued to cover up EFI's deficiencies.

H. BRYAN CAVE/WINDER'S ACTIVITIES ON BEHALF OF EFI BETWEEN JULY 2007 AND 2008, EFI'S BANKRUPTCY AND GUTH AND YAGUDA'S ARREST AND CONVICTIONS FOR FRAUD

60. In July 2007, Windler started taking steps to complete yet another offering for EFI for the sale of individual fractionalized interests in loans. On July 27, 2007, Windler received a

memorandum from Puccio that noted, among other things, "The offering circulars/prospectuses (the LLC fund and the fractionalized note and deed of trust offerings) were vague, ambiguous, and incomplete, and did not at the time of the Locati transaction(s) correctly address the business plan being utilized and, did not describe the true nature of the loan products upon which EFI was relying to invest its private investor funds." A true and correct copy of the memorandum is attached as **Exhibit 30** and incorporated herein by this reference.

61. Notwithstanding Puccio's advice, the Firm did not then fully, properly or clearly advise EFI to correct or discontinue its business operations or to appropriately amend the previous offering prospectus used by EFI in the solicitation of investors in fractionalized notes and deeds of trust, or to notify the investors of the misrepresentations. For these reasons, and based on the Firm's expertise in the areas of securities laws and real estate and prior advice, EFI reasonably and justifiably believed that its continuing operation of EFI's and EFMF's businesses complied with all state and federal laws, rules and regulations.

62. On August 3, 2007, EFI's Guth wrote to EFI Investors about the current real estate market and specifically the condition of EFI's investment portfolio. Among other things, Guth noted:

> In some cases, where builders have completed houses and put them on the market we have issued forbearance agreements for a limited period of time to allow for the suspension of interest payments until the house is sold. ***There are a number of projects currently in foreclosures and it is likely that this number will increase.*** [Emphasis added.]

A true and correct copy of one such letter is attached as **Exhibit 31** and incorporated herein by this reference.

63. On October 5, 2007, Windler submitted to the DOC a renewal Application for Qualification of Securities for EFI and Offering Circular on Fractionalized Interests, prepared by the Firm. A true and correct copy of the Windler cover letter to the DOC is attached as **Exhibit 32** and incorporated herein by this reference. A true and correct copy of the Offering Circular is

attached as **Exhibit 33** and incorporated herein by this reference. The Offering Circular contained material misstatements of fact and omissions of material facts, including but not limited to the failure to disclose the results of the Locati Litigation, the cost of legal services to EFI during the years 2006-2007, and the failure to disclose current and prior violations of real estate and securities laws, rules and regulations, all of which were material to EFI's business and were known to the Firm at the time Windler prepared the Application and Offering Circular.

64. On October 11, 2007, the DOC issued its Permit for the Fractionalized Note Offerings based upon the Application and Offering Circular prepared by the Firm (the "October Offering"). A true and correct copy of the letter from the DOC indicating issuance of the permit and the permit is attached as **Exhibit 34** and incorporated herein by this reference. Among other things, the Offering Circular represented:

> Since the year 2000, EFI through its prior broker and current broker has originated approximately 2,702 loans for an aggregate principal amount of approximately $1,011,113,556.00. Since 2000, EFI has recorded a total of 18 notices of default, and has foreclosed on 3 loans. During this time, no investor of EFI has lost any of his or her principal investment. As of the date of this Offering Circular, EFI has approximately 632 active loans for a total principal amount of approximately $344,684,050.00.

See, **Exhibit 33**, p. 48.

65. Five days after the receiving the permit for the October Offering, EFI wrote its Investors that EFI would not be making monthly distribution payments based upon the failure of many of EFI's borrowers to make their payments on time, or their failure to make their payments at all. EFI also advised Investors that EFI did not have sufficient money to fund its construction loan obligations: ***"As existing loans pay off and new money is received our priorities are to pay construction vouchers so that our borrowers can complete their projects. . ."*** [Emphasis added.] A true and correct copy of the letter dated October 16, 2007 is attached as **Exhibit 35** and incorporated herein by this reference. The Firm approved the form and content of the letter prior

to its being sent to EFI investors. The Firm, however, did not advise EFI to amend the October 2007 permit application or offering documents to disclose this information.

66. Twelve days after the filing of the Offering Circular, EFI again wrote its Investors about the status of EFI's business operations, advising that they should "assume for at least the time-being, that their loans are now non-performing and that future payments, while accruing to you, will not be made." A true and correct copy of the letter dated October 23, 2007 is attached as **Exhibit 36** and incorporated herein by this reference.

67. On November 19, 2007, EFI wrote to EFMF investors advising that EFMF would make no distributions in November. EFI further advised: "There are projects in the portfolio which are either in forbearance or foreclosure but additionally there are development projects for which interest impounds are exhausted." A true and correct copy of the letter is attached as **Exhibit 37** and incorporated herein by this reference.

68. During October-December 2007, many EFI/EFMF investors began to demand that they be repaid their principal, and/or that properties be liquidated. During this time, Windler had a series of discussions with Guth and Yaguda on how to address the various issues raised by these demands.

69. In November 2007, Heritage Oaks Bank ("HOB") renewed a $5 million line of credit (drawn down to $4.3 million) as EFI was unable to pay off the line of credit as and when it became due (November 15, 2007). The loan was renewed in part based upon a pledge of certain loans or properties to HOB, which pledge was made without adequate consideration, and in preference to all other creditors.[15]

70. On January 29, 2008, the Firm counseled Guth and Yaguda on a workable solution for them. In an email to Guth and Yaguda, Windler expressed her knowledge about previous securities violations and breaches of fiduciary duty and counsels Guth and Yaguda in ways to avoid disclosure to the Investors:

[15] Subsequent to the entry of the Order of Relief, HOB agreed to release its security interests in the properties.

I'm not sure where to even start with this. This is rife with securities violations and fiduciary duty issues. First, ***the Fund and fractionalized interest holders should have never been mixed as your offering did not permit that (at least until this most recent one).*** Second, you have no authority under your original offering to subordinate their interests to a new first TD to complete construction (or carry interest or any other purpose for the borrowing) -- this is called an unauthorized promotional note. Third, I recall that your existing servicing agreement imposes an obligation on you to foreclose promptly on the existing interests, but doesn't likely give you authority to subordinate to a new loan. ***And I don't think you could take steps to complete construction without a 50% vote of the holders of interests, unless it was an emergency and then you took steps to quickly get their vote after the fact. It is so frustrating and hard for me to see you in this situation. There are no easy solutions. That all said, I know you are looking for a practical solution. The problem is that I can't really counsel you to a workable solution without exposing you to the potential for a further securities violation.*** The ultimate answer is still to seek a revised DOC securities permit for winding down the Fund or using receivers, both of which you have made clear that you don't wish to pursue. ***So, what you might try to do is send a full disclosure on the loan portfolio to the investors along with a voting form to all the 1,700 investors,*** asking specifically for authority on all 600 loans in the Fund to do the things you might want, with check the boxes for (i) foreclose and sell the property and give us the cash, (ii) forbear but don't permit new borrowing, (iii) forbear and subordinate to new borrowing, (iv) foreclose and hold title to the property, repair it with new borrowing and then sell, (v) foreclose, repair and then lease to tenants until the market recovers, and (vi) take any actions you would do as if you were acting on your own behalf under a reasonable man standard on each property as the circumstances may warrant -- allowing each investor to check as many boxes as

> they may wish to authorize and then see if you have 51% of any single instruction. ***Another idea is to meet with the title company, give them half of all 1,700 servicing agreements, prove to them that 851 are not EFI, and that you can act on behalf of the investors and then see if on all deals going forward they will accept EFI's signature for the majority vote of the Fund. Title companies are willing to issue policies despite potential securities violations because they do not have liability for securities following the title industry support for a specific carve out in their favor. So beware that title companies may do things that solve the practical problem but may not solve the securities problem***. [Emphasis added.]

A true and correct copy of the email is attached as **Exhibit 38** and incorporated herein by this reference.

71. In or about January/February 2008 the California DOC and the DRE notified Guth and Yaguda of a criminal investigation regarding EFI's business activities.

72. In or around February 2008, EFI obtained a $1.1 million increase on its revolving line of credit from HOB. Guth then used EFI's credit facility to pay her ex-husband, Applebaum, $1.1 million in satisfaction of her personal obligation to Applebaum, pursuant to a divorce decree/judgment obtained by Applebaum against Guth.

73. On or about February 29, 2008, Windler sent an email to Bryan Cave attorneys Jeffrey Modisett (at the time of the email, the managing partner of Bryan Cave's Los Angeles Office) and Jim Mercer, requesting referrals for a criminal attorney for her client, apparently in this case, Karen Guth. In her email titled "Referral on criminal matter" she states:

> John Amberg recommended ***I speak with you two about a possible counsel we could refer for a client. We previously represented a mortgage broker who runs a Qualified and Registered Fund and sells fractional interests in notes and TDs. She has roughly 3,000 investors in about $400,000,000 of outstanding loans.*** All new lending has ceased. She learned in recent weeks that the Dept of Real Estate received a complaint accusing her of running a Ponzi scheme as a result of an

> alleged practice of partially funding loans. I believe she should engage a criminal defense counsel and would like to make a recommendation or two. Do you have any? [Emphasis added.]

A true and correct of the email is attached as **Exhibit 391** and incorporated herein by this reference. The email is misleading given Windler's statement that "[w]e previously represented a mortgage broker (EFI) who runs a Qualified and Registered Fund . . . .", when in fact the Firm continued to represent EFI and EFMF. Windler also refers to Guth ("she") as the client, rather than EFI or EFMF.

74. In or about March/April 2008, law enforcement investigators from the San Luis Obispo County District Attorney's Office and the Federal Bureau of Investigation (the "FBI") began a preliminary inquiry into EFI's business practices.

75. On March 20, 2008, Puccio presented a memorandum to Windler recommending a way to protect Guth and Yaguda from criminal prosecution:

> . . . . ¶ . . . . Because ***I do not believe that a properly constructed receivership will necessarily result in criminal protection of Karen [Guth] and Joshua [Yaguda]***, a receivership accomplished through the efforts of EFI hopefully maintaining the present administration and management without access to any funds would be an acceptable method to accomplish the workout plan and structured liquidation of the offerings." [Emphasis added.]

A true and correct copy of the memorandum is attached as **Exhibit 40** and incorporated herein by this reference.

76. On April 3, 2008, the DRE advised EFI that it would be conducting an examination of its books and records to determine whether EFI was in compliance with the provisions of the Real Estate Law (§10000 *et seq.* of the Business and Professions Code) and the Commissioner's Regulations enacted thereunder relating (to) the handling of trust funds. A true and correct copy of the DRE letter of April 3, 2008 is attached as **Exhibit 41** and incorporated herein by this reference.

77. On April 9, 2008, the DOC notified EFI that it would be conducting an examination of EFI's and EFMF's books and records pursuant to Corporations Code § 25531 and § 11180-11182 of the Government Code. A true and correct copy of the DOC letter of April 9, 2008 is attached as **Exhibit 42** and incorporated herein by this reference.

78. On April 14-15, 2008, Windler met with Guth to discuss the DOC investigation and then sent her the seven page "Notes for Wind Down Plan" memorandum (the "Memorandum") she prepared in March, 2008. (**Exhibit 3**). The Memorandum identifies (at least 26) possible securities laws violations and, as noted by Windler, is a road map on how to attack EFI and the Fund for all contractual and securities issues. As presented in the Memorandum, it was known by Windler since December 2006, that:

i. investor money intended for development and construction purposes was improperly diverted to pay interest due to investors and to pay expenses and forbearance fees;

ii. loan to value limitations were exceeded without documented justification;

iii. unauthorized promotional notes were issued and used;

iv. prohibited and/or unauthorized loan transactions were engaged in;

v. loan transactions with affiliates were engaged in through fractional note offering without making full and accurate disclosure of those transactions;

vi. investor subscription and interest funds were improperly commingled;

vii. common construction trust accounts (for both pre-loan closing and disbursements subject to loan closing) were improperly used;

viii. required consideration was given inadequately to project or construction costs in the context of the amounts of intended loans; there was improper reliance on general contractors to supply such information and there was no independent system in place to review construction estimates;

ix. borrowers improperly were not required to pay certain costs up front or to deposit costs that were required to be paid by the borrowers outside of the construction funds;

x. loan documents, business plans and models and/or offering documents and disclosures were outdated, inaccurate and/or incorrect;

xi. disclosures concerning the partial funding of loans was inadequate and/or incorrect;

xii. loan development and construction inspection processes were inadequate;

xiii. unauthorized construction disbursements were made;

xiv. required and necessary assignments among lenders and borrowers to secure cash collateral were not obtained or were inadequate;

xv. disclosures regarding the payment of third-party fees in net funded loan transactions were inadequate;

xvi. commissions and loan fees were collected on the unfunded portion of the total amount of loans without proper authorization;

xvii. applicable license requirements in connection the partial funding of real estate loans in the form of fractionized notes and deeds of trust were not complied with;

xviii. disclosures to investors concerning the scope of loans made for land acquisition and development and vertical construction were inadequate;

xix. loans were improperly made on separate subdivision lots prior to compliance with the Subdivision Map Act of the Subdivision Lands Law;

xx. applicable laws regarding the maximum permitted number of investors were violated;

xxi. dual broker agency disclosures and disclosures concerning the capacity in which the broker was acting were not made or were inadequate;

xxii. required “as-is” and “as completed” appraisals by a proper state certified appraiser were not obtained;

xxiii. monthly interest due and paid to investors was paid improperly from funds advanced by other investors without proper disclosures and establishing proper trust agreements with the borrower and lenders/investors;

xxiv. fractionalized note holder interests were converted to non-managing membership interests without properly qualifying and registering the transactions;

xxv. investor loans were improperly subordinated to other liens; and

xxvi. required loan to value ratios were not properly documented.

79. As heretofore presented, each of the violations aforesaid was known to the Firm in or around December 2006, as part of the Firm's Compliance Review. After the Firm knew of these improper activities, the Firm also knew that the improper activities, or at least a substantial number of them, were continuing. The Firm did not counsel EFI to stop those activities from continuing, and did nothing to prevent those activities from continuing, all as heretofore set forth notwithstanding that it had been engaged to provide such advice. In fact, the Firm encouraged EFI to continue its business operations and practices notwithstanding the Firm's knowledge that those business practices violated state and federal laws, rules and regulations. It was not until April 15, 2008 that the Firm finally started to offer advice on how EFI could address its regulatory issues.

80. Even after finally providing EFI with options to consider given the ongoing investigations, including addressing issues relating to a possible receivership or bankruptcy case, the advice and counseling the Firm provided in relation to a receivership or bankruptcy case was contrary to the interests of EFI and its investors, and was given with a goal of keeping Guth and Yaguda in control of EFI and EFMF and Windler in control of the legal relationship and the legal fees that would be generated as a result thereof. *See*, *e.g.* **Exhibit 43**, email from Windler to "Joshua: Karen" dated April 20, 2008, a true and correct copy of which is attached hereto and incorporated herein by this reference.

81. On or about April 28, 2008, the California Corporations Commissioner issued the Order Summarily Suspending Permit Issuance Under Section 25113 (the "Order"). A true and correct copy the Order is attached as **Exhibit 44** and incorporated herein by this reference.

82. Notwithstanding the Firm's knowledge of EFI's improper business activities, the Firm continued to counsel EFI contrary to the interests of EFI and EFI's creditors and investors at a time when EFI was insolvent and contrary to EFI's fiduciary obligations owed to EFMF and its

members.[16] On May 5, 2008 Yaguda sent an email to Windler, asking for guidance in regard to payoff demands from borrowers: "We're getting some payoffs and I need some guidance. The question: Prior to foreclosure we can accept a short pay. Can EFI take its accrued servicing fee off the top?" Windler advised: ***"I believe you should be drawing the servicing fee off the top, before any distribution to the FI (fractional interest) holders or Fund members. The same is true for advances made by EFI for improvements, costs, attorney's fees, etc. …***" [Emphasis added.] A true and correct copy of this email is attached as **Exhibit 45** and incorporated herein by this reference.

83. Throughout its representation of EFI, the Firm ignored the conflicts of interest that existed as to its continuing representation of EFI and EFMF, and continued to counsel EFI contrary to EFI/EFMF and its creditors' best interests, including that Guth and Yaguda should somehow remain in control of EFI, notwithstanding the Firm's knowledge that there were criminal implications as to the manner in which Guth and Yaguda were conducting EFI's business. It appears that one of Windler's over-riding concerns was to continue to represent EFI so that she could continue to generate billings and create new business opportunities from this representation.[17] On May 6, 2008, Windler sent an internal Bryan Cave email to all attorneys, stating that she:

> [L]anded a new matter that requires work on what will be a new California receivership action. The client is a mortgage broker who has 2 qualified and registered offerings using private investor funds to invest in trust deeds. If anyone has experience in this area and can help on a receivership application, please contact me.

[16] As previously set forth, EFI met at least one test for insolvency in December 2007 when it was unable to pay its $5 million unsecured line of credit when due. As set forth in paragraph 43 above, EFI was insolvent as of November 2006 due to its over $200 million liability to EFI Investors for claims for rescission, etc., which claims far exceeded the asset value of EFI.

[17] Windler has taken her EFI experience "on the road" lecturing to similarly structured businesses on how to address the issues presented during the EFI representation. In her presentation, she counsels that under any circumstances "giving up is not an option." A true and correct copy of the presentation is attached hereto as **Exhibit 46** and incorporated herein by this reference.

A true and correct copy of this email is attached as **Exhibit 47** and incorporated herein by this reference.

84. On May 9, 2008 Windler sent an email to Guth and Yaguda stating "I am still strongly on the side of a receivership, and not directly into bankruptcy. ***It is a cost and control issue more than anything else.*** And I don't think you can stand still any longer and do nothing." A true and correct copy of this email is attached as **Exhibit 48** and incorporated herein by this reference.

85. Notwithstanding that the Firm was aware of a criminal investigation into Guth's and Yaguda's actions, Windler continued to attempt to obtain a new offering permit for EFI from the DOC, with Guth and Yaguda still in full control of EFI. On May 21, 2008, Windler sent a letter to Mary Ann Smith, Senior Corporations Counsel for the DOC, stating:

> ***[w]e were heartened to learn that the Commissioner is willing to leave open the door to a new permit application by EFI, particularly since we felt the 2007 offerings were well written to protect investors….***

A true and correct copy of the letter is attached as **Exhibit 49** and incorporated herein by this reference.

86. During the pre-bankruptcy time period in May 2008, Windler worked with Guth, Yaguda and Puccio in an attempt to install Puccio as the new Chief Executive Officer of EFI, including trying to engineer a receivership or alternatively, a Chapter 11 bankruptcy as a "debtor in possession" that would result in Guth and Yagua retaining control of EFI. On May 22, 2008, Windler authored the following e-mail:

> would love to tell you I embrace Mary Ann Smith's opinion and that you are home free. But I can't. I don't believe that. ***I wanted to*** do 2 things below. (1) explain that there is still risk, and as you go forward, you should act only knowing full well of the risk, and (2) ***encourage you to consider still doing a 2008 permit to get specific authority to do what you want as a work out solution. A 2008 permit for a brand new pool of investors who will make 1st TDs to complete construction on***

> ***the earlier pool's loans would solve the authority issue raised below, and would solve the problem with raising money under B&P 10238 which co-mingles a new 2008 private placement with the 2006 permitted offering.*** Of course, the risk is that you ask and the DOC says no. Then you may be forced to use a court order function (bankruptcy or receivership) to be allowed to act. ***Should you ask for permission or forgiveness? I prefer permission, but I understand if you decline.*** Nothing in this is easy or risk free. I fully understand that you are in a very constrained position… ***By the way, Guy mentioned to me that he thinks the DRE is at least 12 months out from taking licenses or disciplining licensees.*** He concurs with Josh's thought that they are moving very slowly. This is based on the dozens of cases he has with the DRE and is more global thinking than your specific fact pattern. [Emphasis added.]

A true and correct copy of this email is attached as **Exhibit 50** and incorporated herein by this reference.

87. Six days later, on or about May 28, 2008 the DOC revoked EFI's permit to offer and sell securities for EFI and EFMF (the "Revocation Order'). The Revocation Order provides:

> In April 2008, the Department determined that Respondent was violating the terms of the permit in the following manner: a. Failing to disclose that Respondent was no longer making monthly interest payments to investors in the Fund in direct contradiction of the representations made in the Offering Circular. b. Failing to provide prospective investors with the subscription agreement, operating agreement and suitability questionnaire prior to accepting investor funds.

The Revocation Order concludes:

> the Commissioner finds it is in the public interest to revoke the permit issued to Respondent and that Respondent's proposed plan of business and proposed issuance of securities is no longer fair, just and equitable because the Respondent's Offering Circular contains material misrepresentations about the investment and the

Respondent is not conducting business as disclosed in the Offering Circular. *See* the Revocation Order, **Exhibit 4.**

88. As previously presented, the Firm knew on or about October 16, 2007 that EFI was no longer doing business as represented in EFI's Offering Circulars. Nevertheless the Firm failed to advise EFI as to its obligations to disclose these issues to investors and to the DOC; or how to address these issues in the context of EFI's business operations.

89. On or about June 27, 2008, the DRE sent a "Statement" to EFI, Guth and Yaguda notifying them that an accusation was filed against them by a Deputy Real Estate Commissioner with the DRE. A true and correct copy of the Statement is attached as **Exhibit 51** and incorporated herein by this reference.

90. On or about October 16, 2008, the San Luis Obispo County District Attorney's Office filed criminal charges against Guth and Yaguda. The criminal complaint included 26 felony violations of the California Corporations Code and penalty enhancements. Guth and Yaguda were arrested by a joint task force including agents from the DOC, DRE, the San Luis Obispo County District Attorney's office, the Internal Revenue Service and the FBI. A true and correct copy of the second amended criminal complaint is attached hereto as **Exhibit 52** and incorporated herein by this reference.

91. On or about October 5, 2009, Guth and Yaguda pled guilty to all counts against them.

92. In or about December 2009, Judge Jac A. Crawford, San Luis Obispo County Superior Court, sentenced Guth to 12 years in prison and Yaguda to 8 years in prison.

I. BRYAN CAVE/WINDER'S JOINT REPRESENTATION OF EFI AN EFMF, BILLINGS AND FEES FOR SERVICES RENDERED, AND CLAIMS IN THE EFI AND EFMF BANKRUPTCY ESTATES

93. As hereinabove alleged, EFI retained the Firm to represent its interests in the Locati Arbitration, to conduct the Compliance Review, to prepare new offering circulars and applications to the DOC, and to counsel EFI and EFMF as to matters pertaining to the DRE and the DOC, among other activities; and to advise EFI on how to properly address all deficiencies of its

business operations. In conjunction therewith the Firm undertook a review and investigation of the business affairs and operations of both EFI and EFMF as heretofore set forth. The services included a review of, and advice pertaining to, EFI and EFMF's solicitation of Investors and members pursuant to permits issued by the DOC and, a review of the offering materials and permit applications for solicitation of members in EFMF was done on behalf of EFMF as the issuer. In addition, in conjunction with the submissions made to the DOC for EFMF permits, the Firm represented and identified itself as the attorney for EFMF.

94. Between October 2006 and July 2008, the Firm billed EFI over $800,000 for services rendered and received payment of approximately $500,000.

95. Bryan Cave also accepted, without protest, the payment of its legal bills by EFMF. Those payments include a $10,000 EFMF check cashed on February 27, 2008, a $10,851.82 EFMF check cashed on April 17, 2008, and a $15,000 EFMF check cashed on May 14, 2008.

96. On March 31, 2010 Bryan Cave filed a Proof of Claim in the EFI bankruptcy estate, signed by Windler, for services rendered and costs incurred by Bryan Cave to EFI for $281,684.25. A true and correct copy of the proof of claim is attached as **Exhibit 53** and incorporated herein by this reference.

97. On March 31, 2010, Bryan Cave filed a Proof of Claim in the EFMF bankruptcy case for fees and costs in the amount in excess of $280,000. That Proof of Claim (signed by Windler) represents that:

> [I]n 2007, the Debtor [EFMF] made, executed and delivered one or more oral or written engagement agreement [sic] (the "Agreements"), in favor of Bryan Cave promising to pay for services rendered and costs incurred by Bryan Cave to or for the benefit of the Debtor [EFMF] or its related party, chapter 11 debtor Estate Financial, Inc., ... Bryan Cave performed the services requested by the Debtor [EFMF], for its benefit and the benefit of the related debtor . . . .

Bryan Cave knew that its Proof of Claim was required to be accurate, as the form so states: "*Penalty for presenting fraudulent claim:* Fine of up to $500,000 or imprisonment for up

to 5 years, or both. 18 U.S.C. §§ 152 and 3571." A true and correct copy of the EFMF Proof of Claim is attached as **Exhibit 54** and incorporated herein by this reference.

J. ACCOUNTING RELATING TO INVESTORS AND EFMF DURING THE TIME THE FIRM REPRESENTED EFI

98. During the time period from December 1, 2006 through the Petition Date, EFI received approximately $31 million from individuals who invested in EFI generated notes and deeds of trust. During the same time, EFMF received approximately $64 million from the sale of new membership interests ("New Investments") in EFMF. EFMF invested or re-invested virtually all of this money with EFI.

99. Every dollar invested in EFI and in EFMF through EFI between November 2006 and July 2008, represented a liability to EFI, based upon the acts and conduct of the Firm, all as heretofore set forth.

VII.

CLAIMS FOR RELIEF

FIRST CLAIM FOR RELIEF

MALPRACTICE-PROFESSIONAL NEGLIGENCE FAILURE TO PROPERLY ADVISE EFI (AGAINST BRYAN CAVE AND WINDLER)

100. The Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 99 above as if fully set forth herein.

101. As set forth above Bryan Cave and Windler were first retained by EFI in October 2006 to represent EFI in the Locati Arbitration. (see, e.g. paragraphs 27-29). Bryan Cave and Windler were then retained to conduct the Compliance Review (see, e.g. paragraphs 30-32) and later provided legal services with respect to EFI's general business practices, securities/investment offerings, and real estate regulatory matters.

102. Bryan Cave holds itself out as one of the world's leading law firms specializing in the areas of securities laws and regulations, real estate regulatory matters, corporate, insolvency law and creditor's rights, and legal ethics. Bryan Cave and Windler are aware that the learning

and skill of a specialist in the areas of securities laws and regulations, real estate regulatory matters, corporate and insolvency law and creditor's rights were required for the Firm's representation of EFI, particularly given the Firm's knowledge of EFI's business practices as of November 2006. Accordingly, Bryan Cave and Windler had a duty to exercise the skill, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in the same fields required by the Firm's representation of EFI practicing in a similar area or location (Los Angeles, California).

103. In rendering legal services to EFI, Bryan Cave and Windler breached their duty of due care owed to EFI to exercise reasonable care and skill in representing the interests of EFI as specialists in areas of securities laws and regulations, real estate regulatory matters, corporate law, insolvency and creditors rights, by failing to exercise the skill, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in the same fields practicing in a similar area or location, including but not limited to:

i. failing to advise EFI that because of EFI's and EFMF's respective past and continuing business operations were in violation of applicable state and federal laws, rules and regulations, EFI should discontinue the solicitation and sale of securities and fractionalized ownership interests until such time as the violations were cured;

ii. failing to provide EFI with advice which would fully and completely correct or address EFI's past and continuing violations of state and federal laws, rules and regulations;

iii. failing to advise EFI to make full disclosure to EFI's Investors and to EFMF members, the DOC, the DRE, the California Attorney General and/or the SEC as appropriate and required by law, of EFI's previous and continuing violations of state and federal laws, rules and regulations, until May 2008, after the DOC and DRE commenced criminal investigations into the conduct of Guth and Yaguda;

iv. failing to advise EFI that the Firm's preparation of, and filing of applications with the DOC without properly disclosing material facts and risk factors in the

Offering Circulars or other application materials, were violations of applicable state and federal securities laws and would result in breaches of fiduciary duty owed to the individual investors in fractionalized ownership interests and to members of EFMF;

v. failing to advise EFI that its interests were adverse or potentially adverse to the interests of Guth and Yaguda, and of the risks to EFI associated with such adverse or potentially adverse interests;

vi. failing to advise EFI that the actions, omissions, and conduct of Guth and Yaguda on behalf of EFI likely would result in substantial injury to EFI and to EFI's Investors and creditors, and that such actions were not in the best interests of EFI, or of EFI's creditors at a time EFI was insolvent (December 2006);

vii. failing to timely advise EFI's management to cease business practices and operations that were in violation of state and federal laws, rules and regulations;

viii. failing to address properly the potential or actual conflict of interest that existed as a result of Bryan Cave and Windler's representation of EFI and EFMF;

ix. failing to resign as counsel for EFI, assuming *arguendo*, Bryan Cave advised EFI to cease violating California securities and real estate laws, rules and regulations and EFI refused to follow that advice;

x. failing to advise EFI that Windler, in accepting the representation of EFI and as the lawyer primarily responsible for the EFI representation, lacked sufficient background and expertise to handle competently the EFI "Compliance Review" including but not limited to addressing the securities issues presented thereby, the drafting of the applications and offering circulars for the issuance of securities, all of which required an in-depth knowledge of state and federal securities laws, rules and regulations, and an in depth knowledge of California's real estate laws, rules and regulations;

xi. failing to staff the EFI representation with lead attorneys (primary contact) with the appropriate legal expertise and experience to address the highly technical real estate and securities issues presented by the EFI representation;

xii. failing to properly conduct a complete and thorough Compliance Review and Audit, and failing to provide EFI with appropriate advice to address any and all deficiencies that should have been noted and addressed, had the Compliance Review been properly conducted and completed; and,

xiii. abandoning the client interests (EFI) in favor of EFI's principals, Guth and Yaguda, at a time when EFI was insolvent, at which time EFI and its officers and directors owed fiduciary obligations to EFI and to its creditors to act reasonably, prudently in the conduct of EFI's business and to protect asset values to the extent possible and appropriate.

104. By engaging Bryan Cave and Windler as its attorneys, EFI reasonably and justifiably believed that it was engaging highly competent attorneys with the skills and expertise necessary for the EFI engagement based upon the general quality, experience and expertise of Bryan Cave's attorneys, and thus reasonably and justifiably relied on the advice and counsel provided by Bryan Cave and Windler, and acted in accordance with Bryan Cave and Windler's advice and counsel.

105. The advice, counsel and services provided by Bryan Cave and Windler included but are not limited to the non-disclosures and failures to properly advise, all as set forth above, including the Firm's advice to continue EFI's current business operations (post December 2006) in violation of state and federal laws, rules and regulations, notwithstanding that Bryan Cave and Windler knew that EFI's business operations and past and then current investment offerings violated federal and state laws, rules and regulations.

106. Bryan Cave's and Windler's conduct as set forth in this claim for relief was a direct and proximate cause, and a substantial factor, in causing harm to EFI and resulted in EFI's damages in excess of $100 million, including but not limited to EFI's becoming liable to the over 1,000 individuals who invested over $95 million with EFI, either in Fractionalized Note Interests or by purchasing membership interests in EFMF ("Membership Interests"), after December 2006 through April 2008.

107. In addition, Bryan Cave's and Windler's advice, counsel, services and encouragement was a substantial factor in EFI's continuing to operate its business in violation of federal and state laws, rules and regulations and continuing to sell membership interests in EFMF during the time EFI/EFMF's offering permit had expired, and based upon permits that were obtained in violation of state laws, rules and regulations, all of which created liability to EFI Investors and members in EFMF for each dollar invested in the Fractionalized Note Interests and Memberships Interests, the amount for which is in excess of $5 million.

108. Bryan Cave's and Windler's negligence and conduct as presented in this claim for relief was also a direct and proximate cause, and a substantial factor, in EFI continuing its business activities by continuing to create new loans and fund loans on construction projects between December 2006 through June 2008, notwithstanding EFI would have been better served to have ceased its business operations in December 2006, limit funding of projects and liquidate assets (loans and properties) which would have been required had Bryan Cave and Windler properly and competently advised EFI after conducting the compliance audit and review. By continuing its business operations as instructed by Bryan Cave and Windler in violation of state and federal laws, rules and regulations, EFI continued to increase EFI's liabilities to its detriment and to the detriment of its creditors as a whole from December 2006 through 2008, during which time EFI was insolvent and "market conditions" substantially decreased the value of EFI and EFMF's assets. Accordingly, had Bryan Cave and Windler properly advised EFI, EFI assets would not have been adversely impacted by future market conditions, which assets would have been liquidated prior to the decline in the real estate market that occurred in late 2007 and 2008.

109. Bryan Cave and Windler's conduct, as heretofore set forth, was a direct and proximate cause of, and a substantial factor of the acts, omissions and conduct that resulted in EFI being damaged in a sum of not less than $100 million, the exact amount of which will be determined by proof at trial.

SECOND CLAIM FOR RELIEF

MALPRACTICE – PROFESSIONAL NEGLIGENCE
FAILURE TO PREVENT DEFICIENT DISCLOSURE IN SECURITIES OFFERINGS
(AGAINST BRYAN CAVE AND WINDLER)

110. The Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 99 above as if fully set forth herein.

111. The Firm holds itself out as one of the world's leading law firms specializing in the areas of securities laws and regulations, real estate regulatory matters, corporate and insolvency law and creditor's rights, and legal ethics. Bryan Cave and Windler are aware that the learning and skill of a specialist in the areas of securities laws and regulations, real estate regulatory matters, corporate, insolvency law and creditor's rights were required for the Firm's representation of EFI, particularly given the Firm's knowledge of EFI's business practices as of November 2006. This was so especially with regard to the applications and offering circulars to be submitted to the DOC, and with regard to determining whether securities offerings needed to be submitted to the SEC. Accordingly, the Firm had the duty to exercise the skill, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in the same fields in its representation of EFI practicing in a similar area or location.

112. Bryan Cave failed to exercise the skill, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in securities and real estate laws, rules and regulations practicing in a similar area or location in the preparation of the application and offering materials for the permit issued in May 2007 (the "May Permit"), and the application and offering materials for the permit issued in October 2007, in that the application and the offering materials prepared by the Firm contained material misstatements and omissions of fact, which facts were known to the Firm prior to the preparation and filing of the applications for the May Permit, as a result of its previously conducted Compliance Review as hereinabove set forth. Specifically, and without limitation, the Firm failed to disclose in the application and the 2007 Offering Circulars submitted in conjunction therewith, EFI's past and continuing business

practices which violated various state and federal laws, rules and regulations, including failing to disclose that EFI:

i. failed to provide investors prospective outlooks and disclosures on the projects prior to taking investor money;

ii. sold interests to investors outside of California in violation of state and federal securities laws;

iii. failed to properly screen prospective investors for their risk of suitability before taking their money;

iv. took in over $5 million in investor money during a period of time EFI's permit to sell such securities had lapsed;

v. converted first trust deeds to second trust deeds without notifying investors;

vi. failed to pay investors monthly interest payments from appropriate sources and used investor money to pay interest payments to other investors;

vii. failed to notify investors of EFI's filing of re-conveyances of trust deeds eliminating Investor's secured interest;

viii. failed to notify investors that their funds might not be used on the projects in which they invested;

ix. used investors' funds for projects in which they did not invest;

x. failed to secure EFMF investments with deeds of trust;

xi. invested more than 15% of EFMF's assets in Guth's and Yaguda's affiliated entities; and,

xii. that as of December 31, 2006, more than 5% of EFMF's loans were to affiliate companies of EFI: Republic Properties, Inc., First Press Partners, LLC, and Second Press Partners, LLC, in direct contradiction of the representations made in the offering circular used for the May 2007 permit.

113. In addition, the Firm failed to disclose in the 2007 Offering Circulars and application materials that, as early as 2003, builder borrowers were not making their payments,

and rather than foreclose EFI began using Investor money to cover expenses in an effort to keep the company running; and, that EFI operated under a façade that the projects were going forward and the builder borrowers were not in default, by paying interest as promised.

114. Further, the Firm failed to exercise the skill, expertise, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in securities laws and regulations practicing in a similar area or location in the preparation of the May 2007 permit application and offering materials, by failing to prevent the deficient disclosures, and/or failing to make a reasonable, independent investigation to detect and correct false or misleading materials, all as set heretofore set forth.

115. By engaging Bryan Cave and Windler as its attorneys, EFI reasonably and justifiably believed that it was engaging highly competent attorneys with the skills and expertise necessary for the EFI engagement based upon the general quality, experience and expertise of Bryan Cave's attorneys, and thus reasonably and justifiably relied on the advice and counsel provided by Bryan Cave and Windler and acted in accordance with Bryan Cave and Windler's advice and counsel.

116. Bryan Cave and Windler's conduct as hereinabove alleged in this claim for relief, was a direct and proximate cause of, and a substantial factor in EFI becoming liable to all EFMF members who invested in EFMF from and after May 28, 2007 to April 28, 2008. The total amount of memberships purchased during that time is $24,740,000, all to EFI's damage.

117. Further, Bryan Cave and Windler's conduct was a direct and proximate cause, and a substantial factor, in causing harm to EFI and resulted in EFI's damages in excess of $100 million, including but not limited to EFI's becoming liable to the over 1,000 investors who invested over $95 million with EFI, either individually, by investing in Fractionalized Interests or through EFMF, by purchasing Membership Interests, after December 2006 through April 2008. In addition, Bryan Cave and Windler's advice, counsel, services and encouragement was a substantial factor in EFI's continuing to operate its business in violation of federal and state laws, rules and regulations and continuing to sell membership interests in EFMF during the time

EFI/EFMF's offering permit was expired, and based upon permits that were obtained in violation of state laws, rules and regulations, all of which created liability for EFI to investors for each dollar invested in the Fractionalized Interests and Memberships Interests, the amount for which is in excess of $95 million.

118. As a further direct and proximate result, and a substantial factor, of Bryan Cave's and Windler's conduct, EFI continued its business activities by continuing to create new loans and fund loans on construction projects between December 2006 through June 2008, notwithstanding EFI would have been better served to have ceased its business operations in December 2006, to have limited funding of projects and liquidate assets (loans and properties) which would have been required had Bryan Cave and Windler properly and competently advised EFI after conducting the compliance audit and review. By continuing its business operations as instructed by Bryan Cave in violation of state and federal laws, rules and regulations, EFI continued to increase EFI's liabilities to its detriment and to the detriment of its creditors as a whole from December 2006 through 2008, during which time EFI was insolvent and "market conditions" substantially decreased the value of EFI and EFMF's assets. Accordingly, had Bryan Cave properly advised EFI, EFI assets would not have been adversely impacted by future market conditions, which assets would have been liquidated prior to the decline in the real estate market that occurred in late 2007 and 2008.

119. Bryan Cave's and Windler's conduct, as heretofore set forth, was a direct and proximate cause of, and a substantial factor in, the acts, omissions and conduct that resulted in EFI being damaged in a sum of not less than $100 million, the exact amount of which will be determined by proof at trial.

THIRD CLAIM FOR RELIEF

PROFESSIONAL NEGLIGENCE-FAILURE TO CONDUCT A PROPER AND COMPETENT COMPLIANCE REVIEW AND AUDIT (AGAINST BRYAN CAVE AND WINDLER)

120. The Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 99 above as if fully set forth herein.

121. Bryan Cave holds itself out as one of the world's leading law firms specializing in the areas of securities laws and regulations, real estate regulatory matters, corporate, insolvency law and creditor's rights, and legal ethics. Bryan Cave and Windler are aware that the learning and skill of a specialist in the areas of securities laws and regulations, real estate regulatory matters, corporate and insolvency law and creditor's rights were required for the Firm's representation of EFI, particularly given the Firm's knowledge of EFI's business practices as of November 2006. Accordingly, Bryan Cave and Windler had the duty to exercise the skill, prudence, and diligence exercised by other specialists of ordinary skill and capacity specializing in the same fields in its representation of EFI practicing in a similar area or location. Windler also holds herself out as an expert in representing companies engaged in offering Fractionalized Interests and real estate brokers who manage limited liability companies formed to invest in real estate loans.

122. In conducting the Compliance Review, and in rendering advice and counsel to EFI thereafter, Bryan Cave and Windler acted negligently and below the standard of care required by specialists of ordinary skill and capacity specializing in the same fields engage in such an undertaking practicing in a similar area or location.

123. Specifically, had the Compliance Review been conducted in a competent and professional manner, the Compliance Review would have revealed that EFI was:

i. failing to provide Investors prospective outlooks and disclosures on the projects prior to taking the investors' money;

ii. selling interests to Investors outside of California in violation of state and federal securities laws;

iii. failing to properly screen prospective investors for their risk of suitability before taking their money;

iv. failing to tell its Investors they were unlicensed;

v. converting first trust deeds to second trust deeds without notifying investors;

vi. failing to notify investors of EFI's filing re-conveyances, eliminating investor's secured interests;

vii. failing to notify Investors that their funds were not being used on the projects in which they invested;

viii. using investors' funds for projects in which they did not invest;

ix. failing to secure mortgage fund investments by EFMF with appropriate recorded assignments of EFMF's interests in deeds of trust; and,

x. failing to advise clients that more than 15% of EFMF's Fund assets were invested in the Guth's and Yaguda's affiliated entities.

124. In addition, had a proper Compliance Review been conducted in a competent and professional manner, the Compliance Review would have revealed that as early as 2004 builder borrowers were not making their payments, and rather than foreclose, EFI began using Investor money to cover expenses in an effort to keep the company operating and failed to record deeds of trust properly and timely. EFI operated under a facade that the projects were going forward and that the builder borrowers were not in default, by paying interest as promised.

125. But for the Firm's failure to properly conduct the Compliance Review, Bryan Cave and Windler would have discovered each and every event and action set forth in above, and based thereon should have advised EFI to cease and desist its business operations and the practices that violated state and federal laws, rules and regulations. In addition, Bryan Cave and Windler should have advised EFI's officers and directors, Guth and Yaguda, to obtain independent counsel and management for EFI and EFMF to avoid any question of impropriety in the conduct and management of the business affairs of EFI and EFMF; and should have advised EFI about each and evey deficiency noted above, and further advised EFI on how to remedy that deficiency so the

EFI's business practices complied with all applicable laws, rules and regulations. By failing to do so, Bryan Cave and Windler fell below the standard of care required of specialists in the fields of corporate and securities law and real estate regulatory laws practicing in the same or similar area.

126. By engaging Bryan Cave as its attorneys, EFI reasonably and justifiably believed that it was engaging highly competent attorneys with the skills and expertise necessary for the EFI engagement based upon the general quality, experience and expertise of Bryan Cave's attorneys, and thus reasonably and justifiably relied on the advice and counsel provided by the Firm.

127. Bryan Cave's and Windler's conduct was a direct and proximate cause, and was a substantial factor, in causing harm to EFI and resulted in EFI's damages in excess of $100 million, including but not limited to EFI's becoming liable to the over 1,000 investors who invested over $95 million with EFI, either individually, by investing in Fractionalized Interests or through EFMF, by purchasing Membership Interests, after December 2006 through April 2008. In addition, Bryan Cave's and Windler's advice, counsel, services and encouragement were substantial factors in EFI's continuing to operate its business in violation of federal and state laws, rules and regulations and continuing to sell membership interests in EFMF during the time EFI/EFMF's offering permit was expired, and based upon permits that were obtained in violation of state laws, rules and regulations, all of which created liability for EFI to investors for each dollar invested in the Fractionalized Interests and Memberships Interests, the amount for which is in excess of $95 million.

128. Bryan Cave and Windler's conduct was a direct and proximate cause, and a substantial factor, in EFI continuing its business activities by continuing to create new loans and fund loans on construction projects between December 2006 through June 2008, notwithstanding EFI would have been better served to have ceased its business operations in December 2006, to have limited funding of projects and liquidate assets (loans and properties) which would have been required had Bryan Cave and Windler properly and competently advised EFI after conducting the compliance audit and review. By continuing its business operations as instructed by Bryan Cave and Windler in violation of state and federal laws, rules and regulations, EFI continued to increase

EFI's liabilities to its detriment and to the detriment of its creditors as a whole from December 2006 through 2008, during which time EFI was insolvent and "market conditions" substantially decreased the value of EFI's and EFMF's assets. Accordingly, had Bryan Cave and Windler properly advised EFI, EFI assets would not have been adversely impacted by future market conditions, which assets would have been liquidated prior to the decline in the real estate market that occurred in late 2007 and 2008.

129. Bryan Cave and Windler's conduct, as heretofore set forth, was a direct and proximate cause, and a substantial factor, of the acts, omissions and conduct that resulted in EFI being damaged in a sum of not less than $100 million, the exact amount of which will be determined by proof at trial.

FOURTH CLAIM FOR RELIEF

MALPRACTICE – PROFESSIONAL NEGLIGENCE - FAILURE TO COMPETENTLY STAFF AND SUPERVISE THE EFI REPRESENTATION (AGAINST BRYAN CAVE)

130. The Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 99 above, as if fully set forth herein.

131. Bryan Cave holds itself out as one of the world's leading law firms specializing in the areas of securities laws and regulations, real estate regulatory matters, corporate and insolvency law and creditor's rights, and legal ethics. Bryan Cave is aware that the learning and skill of a specialist in the areas of securities laws and regulations, real estate regulatory matters, corporate and insolvency law and creditor's rights were required for the Firm's representation of EFI, particularly given the Firm's knowledge of EFI's business practices as of November 2006. Bryan Cave knew that the Compliance Review required that the lead attorney for the EFI representation have expertise in securities laws and real estate regulatory matters. As such, Bryan Cave owed EFI a duty of due care to staff the EFI representation with attorneys with the requisite skill and expertise in the areas of securities laws and regulations and real estate laws and regulations to address the complex and highly technical issues presented by the EFI representation; and, to have an attorney with the requisite skill and expertise supervise the