IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

THE FRANCES KENNY FAMILY TRUST; SCOTT HEINEMAN AS TRUSTEE; KURT JOHNSON, AS TRUSTEE; AND SCOTT HEINEMAN AND KURT JOHNSON AS INDIVIDUAL ASSIGNEES ON BEHALF OF FRANCES KENNY,

Plaintiffs,

v.

WORLD SAVINGS BANK FSB; THE DIRECTORS AND OFFICERS OF WORLD SAVINGS BANK FSB; AND CASTLE CAPITAL CORPORATION,

Defendants.
_____/

AND RELATED ACTIONS.
_____/

No. C 04-03724 WHA

ORDER DENYING PLAINTIFFS' COUNSEL'S MOTION TO WITHDRAW AS MOOT; AWARDING ATTORNEY'S FEES AND COSTS; AND REFERRAL TO THE UNITED STATES ATTORNEY AND THE STATE BAR OF CALIFORNIA

INTRODUCTION

This "vapor money" case arises out of an elaborate Internet scam orchestrated by plaintiffs Scott Heineman and Kurt Johnson upon distressed homeowners on the verge of losing their homes. At least fifteen such cases were filed in this district. Nine cases were assigned to the undersigned. Each is frivolous and was filed in bad faith on the theory that no enforceable debt accrues from a lender that funds a loan through wire transfers rather than through hard cash. This alone would warrant an award of attorney's fees and costs. Disturbing allegations,

however, have been made by defense counsel that, if true, suggest mail and wire fraud, as set forth below. This matter thus warrants the attention of the United States Attorney as well as the State Bar of California with respect to plaintiffs' counsel, Thomas Spielbauer.

STATEMENT

Plaintiffs Scott Heineman and Kurt Johnson use the Internet to advertise to distressed homeowners, *e.g.*, borrowers who are critically behind on their mortgage payments, that they have a way to "eliminate your mortgage." They advertise that "[t]here is now a PROVEN legal and moral way of eliminating your mortgage while adding $50K to your pocket." The main premise is that no enforceable debt accrues from a lender that funds a loan through wire transfers rather than through hard cash. This is the so-called "vapor money" theory. The way in which Heineman and Johnson "eliminate your mortgage" is described in their website at www.ccresource.net.[1]

The process begins when the homeowner creates an online account with Capital Creation Resource (CCR), owned and operated by plaintiffs. With a username and password, the homeowner accesses plaintiffs' website and completes an online application. The website also requests that the homeowner prepare and sign a promissory note as well as a loan agreement for the encumbered property. The homeowner then sends these documents to plaintiffs with a cashier's check "of $3,000 [to eliminate a] 1st mortgage, and $1,500 [to eliminate] a second mortgage or home equity line of credit." Once this initial fee is received, Heineman and Johnson set up a Family Estate Amenable Complex trust in the homeowner's name, *i.e.*, the Frances Kenny Family Trust. Heineman and Johnson name themselves the trustees. Title to the homeowner's property is transferred to the trust.

Now in charge as trustees, Heineman and Johnson approach the bank or lending institution that lent the homeowner the money to purchase the property. They make a "Presentment" to the bank in the form of "a cash-backed bond in double-amount of the promissory note." The "bond" is allegedly "a valid, rated instrument backed by a $120 Million

[1] A step-by-step outline guides homeowners through this debt-elimination process. At defendants' request, this order finds this outline and other material posted on plaintiffs' website to be proper matter for judicial notice.

Letter of Credit against the Assets of an 85-year old, $800 Million Swiss Trust Company." This is essentially an offer to the lender to satisfy the borrower's indebtedness. The alleged "bond," however, is a ploy. The website explains to the homeowner that:

> The bank can keep the bond as payment based upon the following certain condition: The Lender must validate the debt. In other words, the Lender must PROVE a legitimate and valid loan was given.
>
> If the Lender accepts the bond and cashes it without providing the necessary documentation regarding the validity of the loan, the Lender agrees that the Client/Trust has been damaged 10 times the amount of the bond. Cashing and acceptance of the bond is acceptance of these conditions. (Remember, the Lender really never loaned you anything).

In addition to the "bond," Heineman and Johnson hire "Trustee lawyers" to "begin the legal process by sending out a legal complaint in the form of a CPA Report that outlines 40 or more different federal laws that have been violated in the 'lending process.'" The lending institution thereafter has a certain time frame within which to respond to the complaint. Purportedly, the homeowner will be notified by plaintiffs' legal team when the loan is "satisfied." The homeowner's "lender may or may not let [you] know or acknowledge this."

Once the loan is satisfied, "re-financing begins." The homeowner is told to "refinance [his] property at the maximum loan to value ratio possible" with a new lender. The alleged "purpose of this new re-financing is for you, the client, to compensate the Provider and CCR." Heineman and Johnson are the "Provider." They run CCR. The proceeds from this new loan are disbursed as follows: "The Provider receives 50%. CCR receives 25%. You, the client, receives the other 25%." This entire process takes "5–7 months in most cases." And, "[t]he end result is that the [homeowner] gets free and clear title to the home and a good amount of cash in hand."

Plaintiffs, however, perpetrate a fraud to "satisfy" the original indebtedness.[2] One of the documents Heineman and Johnson present to the bank or lending institution is entitled a "power

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[2] These additional details were brought to the Court's attention at a recent hearing by Ronald M. Arlas, co-counsel for defendant Greenpoint Mortgage Funding Inc. At the Court's request, Mr. Arlas thereafter submitted a declaration and documentation to support the allegations made at the hearing. The Court does not rely on these materials for the purpose of assessing attorney's fees and costs. These matters, however, are relevant to demonstrate the broader (likely fraudulent) reaches of plaintiffs' conduct.

of attorney." This document demands that the lender sign and thereby acknowledge that it has given the homeowner "vapor money" in exchange for an interest (via a deed of trust) in the subject property at the time of financing. A provision of this "power of attorney" provides that the lender's "silence is deemed consent." When the lender fails to respond, plaintiffs execute the power of attorney. They then sign a deed of reconveyance reconveying the lender's security interest in the property to Heineman and Johnson. The forged power of attorney and the deed of reconveyance are duly recorded at the county recorder's office. The county's records thus show a power of attorney from the lender granting Heineman and Johnson the right to sign the deed of reconveyance and the reconveyance from the original lender. The title seems clear and unencumbered. The lender is unaware of the maneuver.

Plaintiffs then turn around and from an unsuspecting new lender seek a loan to refinance the property. When the new lender conducts a preliminary title search, it discovers the power of attorney and deed of reconveyance, both of which appear to have been validly executed. From the new lender's point of view, the property appears to be unencumbered. And it is thus willing to refinance the property. Assuming that a refinancing loan of $200,000 is obtained, the proceeds are disbursed according to plaintiffs' agreement with the borrower (*i.e.*, fifty percent to Heineman and Johnson, 25 percent to CCR and 25 percent to the borrower). Plaintiffs clear at least $150,000. The remaining $50,000 supposedly goes to the borrower, who, of course, has the obligation to repay all $200,000.

At the conclusion of this process, the borrower is in even worse condition than when he or she first looked to plaintiffs for debt relief. Two lenders believe that they have valid security interests in the subject property. When the homeowner defaults on both loans, both lenders commence foreclosure proceedings. In response, Heineman and Johnson, as trustees, file a bankruptcy petition on behalf of the borrower or file suit alleging that no enforceable debt

accrued from either lender because the loans were funded through wire transfers rather than cash. Fifteen such lawsuits were filed in this district on such a "vapor money" theory.[3]

* * *

This Court rejected plaintiffs' theory in *The Frances Kenny Family Trust*, *et al. v. World Savings Bank FSB*, *et al.*, No. C 04-03724. This is the current procedural posture. Following the dismissal of the *Kenny* complaint under Rule 8 of the Federal Rules of Civil Procedure, an order was issued directing plaintiffs' counsel Thomas Spielbauer to show cause why he should not be sanctioned and referred to the State Bar of California. The Court set a briefing schedule and the matter was set for hearing. Mr. Spielbauer was sanctioned ten-thousand dollars. At the hearing, he tendered a check in that amount to defendant World Savings Bank FSB, who had brought the motion to dismiss. At the time, the Court decided not to refer Mr. Spielbauer to the State Bar. Counsel was further directed to dismiss the remaining "vapor money" cases. Mr. Spielbauer confirmed that he would do so. Eventually, each case would be dismissed.

However, prior to voluntarily dismissing five such cases, Mr. Spielbauer moved in each case to withdraw as plaintiffs' counsel.[4] Various defendants opposed the withdrawal request and made demands for attorney's fees and costs. A hearing was held. The main question is whether plaintiffs' voluntary dismissals stripped this Court of jurisdiction to make any further rulings,

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[3] *The Case Family Trust*, *et al. v. Ameriquest Mortgage Co.*, *et al.*, No. C 04-04559; *The James J. Shyrock*, *Jr. Family Trust*, *et al. v. America's Wholesale Lender*, *et al.*, No. C 04-04487; *The Shavirovich Family Trust*, *et al. v. WMC Mortgage Co.*, *et al.*, No. C 04-04486; *The Beard Family Trust*, *et al. v. Washington Mutual Bank*, *et al.*, No. C 04-04466; *The Pafundi Family Trust*, *et al. v. Wells Fargo Bank N.A.*, *et al.*, No. C 04-04465; *The Mitchell Family Trust*, *et al. v. Keybank Nat'l Ass'n*, *et al.*, No. C 04-04285; *The Edward A. & Janice L. Costa Family Trust*, *et al. v. Capital Commerce Mortgage Co.*, *et al.*, No. C 04-04246; *The Heineman Family Trust*, *et al. v. Freedom Mortgage Corp.*, *et al.*, No. C 04-04185; *The Elisia's Hope Trust*, *et al. v. Fieldstone Mortgage Co.*, *et al.*, No. C 04-04014; *The Komes Family Trust*, *et al. v. World Savings Bank*, *et al.*, No. C 04-04013; *The Margery Naomi Johnson Family Trust*, *et al. v. Homecoming Financial Network*, *Inc.*, *et al.*, No. C 04-04012; *The Williamson Family Trust*, *et al. v. CIT Group/Consumer Finance*, *Inc.*, *et al.*, No. C 04-03898; *The Magoon Family Trust*, *et al. v. Greenpoint Mortgage Funding*, *et al.*, No. C 04-03897; *The Raymond J. Gaudreau Family Trust*, *et al. v. Ameriquest Mortgage Co.*, *et al.*, No. C 04-03776; and *The Frances Kenny Family Trust*, *et al. v. World Savings Bank FSB*, *et al.*, No. C 04-03724.

[4] Motions to withdraw were filed in the following actions: *The Edward A. & Janice L. Costa Family Trust*, *et al. v. Capital Commerce Mortgage Co.*, *et al.*, No. C 04-04246; *The Elisia's Hope Trust*, *et al. v. Fieldstone Mortgage Co.*, *et al.*, No. C 04-04014; *The Komes Family Trust*, *et al. v. World Savings Bank*, *et al.*, No. C 04-04013; *The Williamson Family Trust*, *et al. v. CIT Group/Consumer Finance*, *Inc.*, *et al.*, No. C 04-03898; *The Magoon Family Trust*, *et al. v. Greenpoint Mortgage Funding*, *et al.*, No. C 04-03897; and *The Frances Kenny Family Trust*, *et al. v. World Savings Bank FSB*, *et al.*, No. C 04-03724.

including rulings on counsel's motions to withdraw and the various requests for attorney's fees and costs. Additional briefing on these matters was requested and received.

ANALYSIS

A plaintiff's right to dismiss under Rule 41(a)(1)(i) of the Federal Rules of Civil Procedure is absolute before a defendant serves an answer or files a motion for summary judgment. *American Soccer Co., Inc. v. Score First Enterprises*, 187 F.3d 1108, 1110–12 (9th Cir. 1999). Even where a defendant has filed a motion to dismiss, a plaintiff may terminate the action voluntarily by filing a notice of dismissal under Rule 41(a)(1). *Concha v. Londo*, 62 F.3d 1493, 1506–07 (9th Cir. 1995). Hence, "a dismissal under Rule 41(a)(1) is effective on filing, no court order is required, the parties are left as though no action had been brought, the defendant can't complain, and the district court lacks jurisdiction to do anything about it." *Commercial Space Mgmt. Co., Inc. v. Boeing Co., Inc.*, 193 F.3d 1074, 1078 (9th Cir. 1999).

In light of the foregoing, there can be no dispute that once the voluntary dismissals were filed, Mr. Spielbauer's motions to withdraw were rendered moot. This order thus denies those motions on that basis. The Court, however, does not agree that the same result must apply to the various requests for attorney's fees and costs.

A district court has the inherent power to assess attorney's fees against a party who has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 258–59 (1975) (internal quotations omitted). In this regard, if a court finds "that fraud has been practiced upon it, or that the very temple of justice has been defiled," it may assess attorney's fees against the responsible party. *Universal Oil Products Co. v. Root Refining Co.*, 328 U.S. 575, 580 (1946). In such instances, the imposition of sanctions "transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of 'vindicat[ing] judicial authority without resort to the more drastic sanctions available for contempt of court and mak[ing] the prevailing party whole for expenses caused by his opponent's obstinacy.'" *Chambers v. Nasco*, 501 U.S. 32, 46 (1991) (quoting *Universal Oil*, 328 U.S. at 580).

The Court here has seen the scam at work. Greater bad faith would be hard to imagine. Plaintiffs and their counsel have employed a smokescreen to burden various lending institutions and impose upon them litigation costs in hopes of extracting settlements. The complaint filed in *Kenny* is exemplary of plaintiffs' oppressive litigation tactics. In a 35-page, 221-paragraph complaint, plaintiffs made the following baseless allegations:

- World Savings "placed the promissory note into a temporary depository account in Frances Kenny's name and recorded the note as an asset . . . thereafter removed this asset into a transactional account . . . and issued credits from that account which constituted the draft which was issued" (Compl. ¶ 41).
- World Savings "removed the corpus of this deposit from Frances Kenny's temporary depository account without the knowledge nor consent of Frances Kenny" (*id*. ¶ 42).
- The note and deed of trust executed by Kenny on July 18, 2002 were "uncertified security instruments" (*id*. ¶ 44).
- World Savings "converted Frances Kenny's promissory note into a negotiable instrument without compensation to Frances Kenny" (*id*. ¶ 46).
- World Savings "converted the promissory note of which the deed of trust was security into a self funding note" (*id*. ¶ 47).
- World Savings "took this note, monetized it, and then recorded it as an asset on its accounting books" (*id*. ¶ 48).
- World Savings "utilized this note as a money reserve and engaged in other loans of *non-existent (vapor) money* based on the recorded asset value of this promissory note" (*id*. ¶ 49) (emphasis added).
- World Savings "converted the equity value of Frances Kenny's interest in the promissory note into an exchange of credits" (*id*. ¶ 50).
- "This exchange of credits did not transfer entitlement rights nor meet the standard of a sale for such rights under the Uniform Commercial Code nor under any other standard of commercial law" (*id*. ¶ 51).
- World Savings "did this under the auspices of fractional reserve banking" (*id*. ¶ 52).
- The "sale of servicing rights is not equal to the legal rights in the assets" (*id*. ¶ 55).

- "By World Savings Bank FSB's act of conversion of Frances Kenny's promissory note, Frances Kenny and Defendant World Savings Bank FSB simply exchanged negotiable instruments" (*id.* ¶ 56).

- By "converting the promissory note," Kenny and World Savings "simply exchanged book entry securities credits" (*id.* ¶ 57).

- World Savings misrepresented to Kenny that this book entry securities exchange was instead a debt owed by Kenny to World Savings (*id.* ¶ 58).

- World Savings failed to disclose to Kenny "the asset entries on the bank accounting ledger" (*id.* ¶ 59).

- World Savings did not disclose to Kenny "that it would convert the promissory note into a monetized negotiable instrument upon which it would 'lend' as available money to other 'borrowers' over ten (10) times the amount of Frances Kenny's promissory note" (*id.* ¶ 60).

- Although plaintiffs acknowledge making monthly payments to World Savings, Kenny "does not owe this money" to World Savings (*id.* ¶ 63–65).

These contentions have no basis in fact. They are disjointed, vague and incomprehensible. Fourteen separate complaints containing nearly identical allegations were filed in this district.

Moreover, plaintiffs' "vapor money" theory has no basis in law. It has been squarely addressed and rejected by various courts throughout the country for over twenty years. *See, e.g.*, *Nixon v. Individual Head of St. Joseph Mortg. Co.*, 615 F. Supp. 898 (C.D. Ind. 1985); *Theil v. First Federal Sav. & Loan Ass'n of Marion*, 646 F. Supp. 592 (N.D. Ind. 1986); *In re Stickland*, 179 B.R. 979 (Bankr. N.D. Ga. 1995); *Rene v. Citibank NA*, 32 F. Supp. 2d 539 (E.D. N.Y. 1999); *Hinz v. Washington Mut. Home Loans*, 2004 WL 729239 (D. Minn. 2004). Plaintiffs' counsel completely neglected to bring these authorities to the attention of the Court. It is this kind of abuse of the judicial process (again, which the Court has seen first hand) that justifies an award of attorney's fees against plaintiffs and their counsel.

In a similar vein, the Court has the authority to award costs incurred. Despite plaintiffs' voluntary dismissals, a district court retains jurisdiction to consider collateral matters such as requests for costs. *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 395–96 (1990) (recognizing generally that "federal courts may consider collateral issues after an

action is no longer pending," including motions for costs); *Sequa Corp. v. Cooper*, 245 F.3d 1036, 1037–38 (8th Cir. 2001) (noting that voluntary dismissal without prejudice under Rule 41(a)(1)(i) does not deprive a district court of its authority to award costs).

Against this backdrop, this order turns to the various applications for attorney's fees and costs. In most instances, counsel submitted their fee requests through lodestar calculations, having multiplied the number of hours spent defending this litigation by the hourly rate of each attorney who performed services. In the Court's view, some of these requests were inflated or presented insufficient specificity to support the requested amount.[5] As such, reductions have been made where necessary. The following chart sets forth the respective awards to each attorney in each applicable case, which plaintiffs and their counsel (jointly and severally) are hereby ordered to pay within thirty days:

ATTORNEY	CASE	ATTORNEY'S FEES	COSTS	TOTAL
Richard Darwin	04-03776	$7,000.00		$7,000.00
Brian Cella	04-03897	$10,000.00	$245.36	$10,245.36
Sunny S. Huo	04-03897	$10,000.00	$174.27	$10,174.27
	04-04246	$5,000.00	$886.93	$5,886.93
Ronald M. Arlas	04-03897	$4,000.00		$4,000.00
Julie M. Wei & Paul E. Rice	04-03898	$10,000.00		$10,000.00
	04-04014	$10,000.00		$10,000.00
Karen A. Braje	04-03898	$10,000.00		$10,000.00
	04-04014	$10,000.00		$10,000.00

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Given the serious and disturbing nature of the allegations set forth above, including the possibility of mail and wire fraud to further an Internet scam upon distressed and

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[5] By way of example, attorney Karen A. Braje made a fee request of $29,795.18 as counsel for defendant CIT Group/Consumer Finance, Inc., in *The Williamson Family Trust*, *et al. v. CIT Group/Consumer Finance*, *Inc.*, *et al.*, No. C 04-0389. She also requested fees of $34,026.50 as counsel for defendant Ocwen Federal Bank FSB in *The Elisia's Hope Trust*, *et al. v. Fieldstone Mortgage Co.*, *et al.*, No. C 04-04014. Although counsel filed motions to dismiss for each client, the motions were largely duplicative in style and substance. This order thus finds the fee requests excessive and reduces them to so reflect.

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vulnerable citizens about to lose their homes, not to mention the lenders, the Clerk shall send a copy of this order to Kevin V. Ryan, United States Attorney for the Northern District of California, 450 Golden Gate Avenue, Box 36055, San Francisco, California 94102. The Court makes no recommendation as to how the United States Attorney should deal with the instant matter.

This matter is further referred to the State Bar of California. Accompanying his requests to withdraw, Mr. Spielbauer submitted a declaration under seal explaining that he brought these "vapor money" cases in good faith and in no way participated in the possibly fraudulent conduct discussed above. The declaration has been considered in full. The Court still questions whether any member of the State Bar in good standing, and especially a former deputy public defender like Mr. Spielbauer, could have agreed to represent litigants like Heineman and Johnson and filed as many cases on their behalf as was done here. The Clerk shall send a copy of this order to: Intake Unit, The State Bar of California, 1149 South Hill Street, Los Angeles, California 90015. Again, the Court makes no recommendation as to how the State Bar should address the issue.

CONCLUSION

In light of the foregoing, this order **DENIES** Mr. Spielbauer's motions to withdraw as **MOOT**. Within thirty days of this order, plaintiffs Scott Heineman and Kurt Johnson and plaintiffs' counsel Thomas Spielbauer (jointly and severally) shall pay the attorney's fees and costs set forth above. The Clerk shall send a copy of this order to the United States Attorney and the California State Bar. The Clerk shall further file this order in the following cases: No. C 04-03724; No. C 04-03776; No. C 04-03897; No. C 04-03898; No. C 04-04013; No. C 04-04014; and No. C 04-04246. As this order resolves the various motions for attorney's fees and costs, the hearings thereon are hereby **VACATED**.

IT IS SO ORDERED.

Dated: January 19, 2005.

/S/ WILLIAM ALSUP
WILLIAM ALSUP
UNITED STATES DISTRICT JUDGE

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For the Northern District of California