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LLC and Compass USA SPE LLC**

12  
13 UNITED STATES DISTRICT COURT  
14 DISTRICT OF NEVADA

15 3685 SAN FERNANDO LENDERS, LLC,  
et al.,  
16  
17 Plaintiffs,  
18 v.  
19 COMPASS USA SPE LLC, et al.,  
20 Defendants

Case No. 2:07-CV-892-RCJ-GWF-BASE  
Case No. 3:07-CV-241-RCJ-GWF

Bankruptcy Case No. BK-S-06-10725 LBR  
[Chapter 11]

**RESPONSE TO THE OBJECTIONS AND  
MOTION FOR RECONSIDERATION  
RELATIVE TO APRIL 28, 2008  
PROCEEDING**

21 **INTRODUCTION**

22 In December 2007, Donna Cangelosi approached Compass to request a standstill of the  
23 pending litigation so that the parties could meet and discuss a comprehensive settlement of the  
24 matter. At the time, Compass viewed that overture as a significant step forward in resolving its  
25 differences with the Direct Lenders and ultimately the portfolio of distressed loans that it services  
26 on their behalf. The request for a standstill came after several months of positive developments in  
27 resolving the portfolio. After Donna Cangelosi informed 50 Borrowers in May 2007 that  
28 Compass had been terminated and that they were to deal with Compass only at their own “peril,”

1 resolution of the Loans became virtually impossible. Judge Riegle's June 8 and August 1, 2007  
2 Orders attempting to bring order to these proceedings helped, but it was only after this Court  
3 entered Orders following the evidentiary hearing on October 1 and 2, that the Borrowers (and  
4 some of the Direct Lenders) finally understood that they must deal with Compass as loan servicer  
5 for this portfolio of Loans. The clarity in these Orders (entered on Nov. 6, 2007) provided  
6 Compass substantial momentum forward in negotiating resolutions for many of the Loans in the  
7 portfolio.<sup>1</sup> A timely resolution of these Loans is critical to many of the Direct Lenders, who  
8 desire liquidity, particularly in this deteriorating real estate market. Compass was able to work  
9 with and establish a rapport with certain Direct Lenders in mediating and resolving some of the  
10 Loans with Borrowers. And, on January 18, 2008 when the Standstill Agreement was signed,  
11 Compass had reason to be hopeful that Ms. Cangelosi's overture was the first step in finally  
12 resolving this case so that the Direct Lenders and Compass could focus (in a unified manner) on  
13 getting back from the Borrowers as much money as possible.

14 Unfortunately, the hope for and expectation of a constructive negotiation and mediation  
15 process to explore a consensual resolution of the litigation created by the January 18 standstill  
16 agreement proved short-lived and was unexpectedly dashed by the strong-arm tactics and threats  
17 initiated by counsel for the LLCs (Fulbright & Jaworski L.L.P.) during the early days of the  
18 standstill. On February 6, several weeks before the scheduled mediation, Fulbright shockingly  
19 sent Compass a letter insisting that Compass accept a settlement offer that had been proposed  
20 personally by Donna Cangelosi in less than 48 hours and threatening that, if the offer was not  
21 accepted, an entity named Cross Litigation Management Company LLC would take over the  
22 LLCs and the litigation, and the settlement offer would never be available again. This letter, and

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23  
24 <sup>1</sup> At the time of Ms. Cangelosi's instruction to borrowers to cease making payments to Compass  
25 in May 2007, Compass had resolved 6 of the former USA Capital loans in only three months. In  
26 light of the uncertainty and ensuing chaos created by Ms. Cangelosi's actions, Compass was only  
27 able to resolve one loan prior to the District Court's assumption of jurisdiction over this  
28 proceeding. However, of the 45 loans that Compass has serviced in accordance with this Court's  
Preliminary Injunction Order, 17 have been resolved (or have been resolved pending Direct  
Lender approval), 9 were the subject of successful foreclosures or lift-stay applications (and for  
which Compass is currently marketing the collateral), and 8 are the subject of pending foreclosure  
proceedings. Of the remaining 11 loans, 3 are the subject of ongoing mediation efforts, 1 is the  
subject of a pending bankruptcy case, while the other 7 are the subject of ongoing negotiations  
among Compass, the borrowers, and the guarantors.

1 the relationship with Cross suggested therein, were completely inconsistent with the Court's  
2 requirement that the LLCs obtain Court approval prior to encumbering any Beneficial Interest  
3 owned or held by the LLCs to obtain litigation funding and the Standstill Order intended to foster  
4 settlement discussions—not to provide the LLCs with time to identify a litigation sponsor and  
5 then pose unreasonable demands in advance of sitting down in a mediation environment. It was  
6 only after an exchange of correspondence in which counsel for the LLCs assured Compass that  
7 Cross would not present an impediment to the mediation that Compass agreed to go forward with  
8 settlement negotiations at the mediation.

9 The mediation was, from all apparent signs, a success. Compass and certain Direct  
10 Lenders participated in three full days of intensive mediation. At the end of those sessions,  
11 Compass presented an offer that it believed represented a fair and reasonable compromise of this  
12 dispute. Apparently, Ms. Cangelosi disagreed. After having spent two months appearing to  
13 negotiate in good faith a resolution with Compass, Ms. Cangelosi, who did not participate in the  
14 final day of mediation, took only five days after receiving Compass's offer to disseminate a  
15 competing offer from Cross. Ms. Cangelosi never told Compass that she was continuing to  
16 negotiate with Cross during the standstill, nor did she inform Compass that she intended to  
17 undermine any mediated proposal made by Compass with a competing offer from Cross.

18 Ms. Cangelosi's conduct has once again been enormously destructive, not only to  
19 Compass but to all of the Direct Lenders. Ms. Cangelosi seems constitutionally unable to conduct  
20 herself honorably in these proceedings. Her actions have further inflamed the Direct Lender base  
21 (particularly those Direct Lenders in the LLCs) that have come to look to her and the counsel she  
22 has selected for guidance and advice in these proceedings. She has rewarded the Direct Lenders  
23 who rely on her not with the acts of a measured fiduciary, but rather with zealotry,  
24 misrepresentations, and destructive behavior. As the Court recognized on April 28, it is time to  
25 remove Ms. Cangelosi from these proceedings. It is also time for the legal professionals and  
26 proposed "replacement servicer" affiliated with her efforts to be removed from these proceedings.  
27 And there is nothing in any of the papers submitted by Fulbright that would warrant  
28 reconsideration of the Court's April 28 Order.

1 The Court and the Direct Lenders reading this response, and following the briefing on this  
2 Motion, should understand:

- 3 • Compass remains fully committed to negotiating a resolution of this dispute.  
4 Compass has not and will not take the offer negotiated during the three-day  
5 mediation with Judge Nakagawa off of the table. Indeed, on June 6, 2008,  
6 Compass will participate in further mediation with Judge Nakagawa and intends  
7 to subsequently present an economically identical offer to all Direct Lenders,  
8 whether or not they were ever members of an LLC.
- 9 • Compass does not seek to deny the Direct Lenders the ability to organize or  
10 retain counsel. In fact, Compass would like very much for the Direct Lenders  
11 (particularly the members of the LLCs) to have the benefit of competent counsel  
12 independent of Ms. Cangelosi. There is nothing wrong with groups of Direct  
13 Lenders pooling their money to retain counsel. The Court has approved of that  
14 arrangement. Compass welcomes it.
- 15 • This hearing on June 2nd was necessitated by the longstanding refusal of Donna  
16 Cangelosi and certain of her close associates to comply with Orders of the  
17 Bankruptcy Court and this Court. Compass paid substantial consideration for the  
18 rights at issue in this litigation. Those rights were sold with the protection of the  
19 Confirmation Order. It should go without saying that Federal Courts are  
20 empowered to issue Orders and to enforce them. And the parties who are subject  
21 to those Orders must understand that Court orders are commandments to be  
22 followed and not obstacles to be evaded.

23 **STATEMENT OF PROCEEDINGS**

24 Over the past two years, this Court and the Bankruptcy Court repeatedly have announced  
25 a series of clear and reasonable Orders. These Orders have been ignored, undermined, and  
26 willfully violated by certain parties to these proceedings (chiefly Ms. Cangelosi and others acting  
27 under her leadership). On April 28, 2008, in light of the most recent violations of its Orders, this  
28 Court took measures to enforce them—as it certainly is the Court’s right to do.

1 In the Plaintiffs' Motion for Reconsideration, Plaintiffs' counsel has attempted to justify  
2 its clients' conduct by adopting nonsensical interpretations of the Court's repeated prior Orders,  
3 and by making the absurd suggestions that (1) the Court cannot supplement or enforce its Orders  
4 unless one of the parties requests relief in a noticed motion, and (2) for the Court to enforce or  
5 supplement its own Orders, it must meet the standards of an applicant for a preliminary  
6 injunction. Both of these propositions are obviously contrary to law and common sense. Counsel  
7 for the LLCs argues that on April 28th, the Court "*sua sponte*" created new obligations with  
8 which its clients never had an opportunity to comply. This is simply false. A careful review of  
9 the record is essential here, for the benefit of the thousands of Direct Lenders who, throughout  
10 these proceedings, systematically have been misled as to the results of various hearings, the  
11 Court's Orders, and the nature and extent of the longstanding misconduct by Ms. Cangelosi and  
12 her cohorts.

### 13 **The September 10th Hearing**

14 On September 10, 2007, this Court conducted a hearing and announced its intention to  
15 enter a preliminary injunction related to Ms. Cangelosi's efforts to terminate Compass as loan  
16 servicer. At that hearing, the Court found that to the extent a Direct Lender transferred his or her  
17 participation interests in USACM-originated loans to LLCs formed by Ms. Cangelosi, and to Ms.  
18 Cangelosi's LLC management vehicle, "FDH Management Company," those transfers were  
19 solicited in violation of state and federal law. (Declaration of Gabriel Weaver In Support of  
20 Response to Objections and Motion For Reconsideration Relative to April 28, 2008 Hearing  
21 ("Weaver Decl.") Ex. A (September 10 Hearing Tr. at 19:4-14).) As a result, the Court observed  
22 that:

23 Ms. Cangelosi must be restrained from taking assignment of rights by consumers, and she  
24 must be required in this injunctive relief to re-transfer, to submit those back, to the direct  
lenders.

25 (*Id.* (September 10th Hearing Tr. at 19:11-14).)

### 26 **The Preliminary Injunction and the Contempt Order**

27 In light of the Court's statements at the September 10th hearing, Ms. Cangelosi's counsel,  
28 Alan Smith, requested *an evidentiary hearing* to defend Ms. Cangelosi's conduct in forming the

1 LLCs and soliciting Direct Lenders to contribute their loan interests to her LLCs.<sup>2</sup> The Court  
2 conducted that evidentiary hearing on October 1 and 2, 2007. During the hearing, the Court  
3 received into evidence substantial documentary evidence and testimony concerning Ms.  
4 Cangelosi's formation of the LLCs, her solicitations of Direct Lenders, her purported termination  
5 of Compass, and her communications with borrowers on behalf of the LLCs she had formed.  
6 Compass sought a preliminary injunction in that hearing to extend Judge Riegler's August 1st  
7 Order (that had already enjoined Ms. Cangelosi) and a finding of contempt against Ms. Cangelosi  
8 for her numerous violations of the Orders of the Bankruptcy and District Courts.

9 At the conclusion of the October 1 and 2 evidentiary hearings, this Court entered two  
10 Orders: the Contempt Order re Donna Cangelosi ("Cangelosi Contempt Order"), which found  
11 Ms. Cangelosi in contempt of court for violating the Bankruptcy Court's Orders, and the  
12 Preliminary Injunction Order. The Court found that Ms. Cangelosi improperly solicited hundreds  
13 of millions of dollars from the investing public (all of the USACM Direct Lenders), without  
14 observing the regulations and procedures imposed by the federal securities laws or state fair trade  
15 laws.

16 This finding was based on testimony from Ms. Cangelosi herself, including, for example,  
17 her testimony that she never attempted to determine if the Direct Lenders were accredited or  
18 sophisticated lenders (Weaver Decl. Ex. B (Oct. 2 Hearing Tr. Vol. I at 100:20- 101:8)), and the  
19 fact that the solicitation materials that Ms. Cangelosi provided to Direct Lenders at the road  
20 shows to induce them to join the LLCs were not the operative LLC documents (*Id.* at 74:8-15).  
21 The scope of the proven violations of law was substantial. The "accounting" that was  
22 subsequently filed by the LLCs, pursuant to the Preliminary Injunction on November 15, 2007  
23 (Docket Entry 215) reveals that following her improper solicitations, Ms. Cangelosi actually  
24 acquired loan interests of over **\$205 million** from approximately 1,400 Direct Lenders. Put  
25 simply, Donna Cangelosi successfully solicited and now controls hundreds of millions of dollars  
26

27 <sup>2</sup> Mr. Smith is still Ms. Cangelosi's counsel of record in this matter. (*See* Docket Entry 12.)  
28 Although Ms. Cangelosi advised the Court on April 28th that Mr. Smith had "withdrawn" from  
the case, a review of the docket in this case reveals that he has not sought nor received this  
Court's permission to do so.

1 in investments from the public that were obtained in violation of law. And she did this without  
2 ever having attempted to comply with the comprehensive regulatory scheme embodied by the  
3 federal securities laws.

4 The Court further found that as part of her solicitation efforts, Ms. Cangelosi violated the  
5 Confirmation and Sale Order entered by the Bankruptcy Court on January 8, 2007. The  
6 Confirmation and Sale Order expressly confirmed and preserved Compass's rights to certain fees  
7 it acquired in the Bankruptcy, and stated that "neither the Direct Lenders nor any replacement  
8 servicer would have the right to 'compromise, subordinate, or impair'" any of the interests in  
9 these fees purchased by Compass. (Cangelosi Contempt Order, Docket Entry 198, at ¶ 7.) Ms.  
10 Cangelosi had induced the Direct Lenders to join her LLCs *by promising them these fees and*  
11 *interests for themselves.* The Confirmation and Sale Order further protected Compass from  
12 interference by providing that "[a]fter the Closing, the Direct Lenders are obligated to comply  
13 with the terms of the applicable Loan Servicing Agreements..." (*Id.* at ¶ 8.) The Confirmation  
14 and Sale Order provided that "[f]ollowing the Closing, no holder of an Interest in the Sellers shall  
15 interfere with the Asset Purchaser's title to or use and enjoyment of the Acquired Assets based on  
16 or related to such Interest" and in the same paragraph expressly enjoined any holder from doing  
17 so. (*Id.* at ¶ 9.) The parties holding an "Interest in the Sellers" expressly included the "Direct  
18 Lenders ... and their respective successors or assigns." (*Id.*)

19 As this Court explained in the Cangelosi Contempt Order, after the Confirmation and Sale  
20 Order was entered, Ms. Cangelosi and other members of what was then called the "Lenders'  
21 Protection Group," vigorously campaigned to persuade other Direct Lenders to terminate  
22 Compass as their loan servicer and to pledge their beneficial interests in each of their loans to Ms.  
23 Cangelosi's LLCs. In this campaign, Ms. Cangelosi and her LPG colleagues made material  
24 misrepresentations about Compass and its business practices (which many of the Direct Lenders  
25 to this day believe) in order to induce Direct Lenders to join the LLCs. They also made material  
26 misrepresentations about how the LLCs would work, including the benefits the Direct Lenders  
27 could expect to gain from membership and the compensation Ms. Cangelosi herself would take  
28 from them. On October 2nd, the Court explicitly stated:

1 I do find that Ms. Cangelosi is in contempt of several of the orders, and that [] in soliciting  
2 various limited interests there were violations of securities laws.

3 (Weaver Decl. Ex. C (Oct. 2 Hearing Tr. Vol. II at 117:9-12).) The Court explained that the  
4 interests that had been assigned to the LLCs need not be *returned* at that time, **but they needed to**  
5 ***be re-solicited***. Contrary to the LLCs' argument, the Court never ruled that Ms. Cangelosi and  
6 the LLCs *only* needed to re-solicit the interests *if* they determined to try again to terminate  
7 Compass. Such a limited ruling would have been nonsensical in any event, as the Court had  
8 clearly and repeatedly stated that the LLCs were formed in violation of law.

9 The quotations in the LLCs' Motion to Reconsider taken from the Court's October 2nd  
10 discussion (having found that Ms. Cangelosi's purported termination letters were invalid and  
11 violated Judge Riegler's Orders) were in the context of explaining what would be necessary as a  
12 condition precedent to a new attempt to terminate Compass. Ms. Cangelosi had told the Court  
13 that "the investors were screaming at [Cangelosi and the LLCs] terminate, terminate, terminate,  
14 terminate, terminate," and counsel for the LLCs advised the Court that they wanted to try again to  
15 terminate in the near future. (Weaver Decl. Ex. C (Oct. 2 Hearing Tr. Vol. II at 22:15-17); *see*  
16 *also id.* (Oct. 2 Hearing Tr. Vol. II at 79:13-19), *and* Weaver Decl. Ex. P (Oct. 1 Hearing Tr.  
17 31:6-10).) And the Court understood that Plaintiffs were "seeking relief here in these hearings . .  
18 . today and, namely, termination of those service rights." (*See* Weaver Decl. Ex. P (Oct. 1  
19 Hearing Tr. at 8:16-21).) It was in that context that the Court stated that it would not consider a  
20 new termination effort without a re-solicitation of the LLC interests. But the Court never said the  
21 re-solicitation requirement was *limited to* a new termination effort, as counsel for the LLCs now  
22 contends.

23 As demonstrated below, the need to re-solicit LLC interests in compliance with law was  
24 obviously *for all purposes* (not just termination). After the Preliminary Injunction was entered,  
25 this Court *repeated its directive to Fulbright and Ms. Cangelosi that the loan interests must be re-*  
26 *solicited in order for the LLCs to be recognized* in numerous contexts unrelated to termination.  
27 On at least two occasions subsequent to the entry of the Preliminary Injunction Order (and *months*  
28 prior to the April 28, 2008 hearing), this Court has admonished the LLCs that in order to be

1 recognized, they *must* re-solicit Direct Lender interests because the original solicitation was done  
2 in violation of law.

3 For example, at the December 3, 2007 hearing, counsel for the LLCs asked this Court to  
4 require Compass to pay to the “La Hacienda LLC” (one of Ms. Cangelosi’s LLCs) the proceeds  
5 of the La Hacienda loan resolution that were due to Direct Lenders who had joined the LLCs.  
6 This hearing had nothing to do with the termination of Compass. The Court refused to allow the  
7 La Hacienda LLC to receive the Direct Lenders’ distributions because Fulbright and Ms.  
8 Cangelosi had not made a showing that they had re-solicited the interests in the LLCs, in  
9 compliance with the Court’s prior rulings. (Weaver Decl. Ex. D (Dec. 3 Hearing Tr. at 6:18-23).)  
10 The Court specifically told counsel for the LLCs that it would not allow the La Hacienda LLC to  
11 accept funds on behalf of individual Direct Lenders, stating “I’m not going to allow a distribution  
12 to the LLCs based upon the old assignments. I’ve already told you I think there are problems,  
13 securities law violations and such.” (*Id.*) The Court ordered Compass to pay 99% of the La  
14 Hacienda loan proceeds immediately, directly to the individual lenders. (*Id.* (Dec. 3 Hearing Tr.  
15 at 19:3-6).) This ruling had nothing to do with terminating Compass.

16 At another hearing on January 7, 2008, the Court told Plaintiffs that they must re-solicit  
17 the interests of LLC members before they would be allowed to plead injury in a new “Second  
18 Amended Complaint”

19 THE COURT: I do think adding them [Standard Property LLC] as a plaintiff before they  
20 were even formed is sanctionable conduct, and I will entertain a sanctions request for that  
21 conduct, but I do think that they can also be joined even after a complaint has been filed.

22 But you do not need to name the proper parties. You need to name either the direct  
23 lenders in Standard -- in other words, we do represent direct lenders -- or you need to  
24 name the Standard LLC by virtue of the transfer and assignment of direct lenders who  
25 were injured when they were direct lenders as opposed to LLC members.

26 And, of course, *you’ll also have to comply with the requirements the Court previously  
27 informed you of. I do need some kind of re-solicitation compliance –*

28 MR. HERRING: *We can do that.*

THE COURT: -- so that I can know that, in fact, you do represent their interest.

MR. HERRING: *We can do that, your Honor.* Let –

1 THE COURT: Okay.

2 (Weaver Decl. Ex. E (Jan. 7 Hearing Tr. at 24:10-25:2) (emphasis added).) The Fulbright  
3 lawyers plainly knew that this Court had required that, to pursue damage claims on behalf of the  
4 LLCs (another separate and distinct act from termination), they must re-solicit the interest of each  
5 purported LLC member. Fulbright plainly understood the Court’s unambiguous directive:

6 THE COURT: If you contend that they’re members of the Standard LLC, and that,  
7 therefore, Standard represents their interest at the time they were a direct lender before the  
8 assignment into LLC –

8 MR. HERRING: Yes.

9 THE COURT: -- you may do so, but, of course, *subject to the same complaint I’ve had*  
10 *before, and that is the solicitation is defective.*

11 MR. HERRING: *We understand.*

12 (*Id.* (Jan. 7 Hearing Tr. at 31:18- 32:1)(emphasis added).)

13 **The Standstill Order**

14 In December 2007, Ms. Cangelosi approached Compass and requested a litigation  
15 standstill to mediate and (hopefully) resolve the dispute between the parties. Compass agreed to  
16 stay the litigation and work collaboratively with the Direct Lenders so that the parties could  
17 present a united front to the recalcitrant borrowers that have used this dispute as an excuse to  
18 delay resolution of their debt to the Direct Lenders.

19 Based on Ms. Cangelosi’s representations that she was committed to working toward a  
20 comprehensive settlement of the dispute, Compass agreed to a two-month standstill of the  
21 litigation. On January 28, 2008, this Court ordered that the parties stand down from litigation,  
22 according to the terms outlined in the January 18, 2008 Letter Agreement between the parties.

23 That Agreement required:

24 Mediation. Representatives of the Standstill Parties shall engage in an in-person  
25 mediation in Las Vegas before the Honorable Mike Nakagawa to commence on a date no  
26 later than 2 business days prior to the end of the Standstill Period. Plaintiffs and Counter-  
27 Defendants and Cross-Defendants on the one hand, and Defendants on the other, shall  
28 exchange at least three days prior to the commencement of the mediation comprehensive  
written global settlement proposals authorized, in the case of the Plaintiffs and Counter  
Defendants and Cross-Defendants, by each of them subject only to such further actions, if  
any, as may be required by members of the LLCs under operative organizational  
documents to bind such LLCs, and in the case of the Defendants, by each of them, that, at

1 a minimum, shall provide for dismissals with prejudice of all causes of action set forth in  
 2 the Amended Complaint and the Compass Counterclaims against all parties, other than  
 3 causes of action setting forth contractual-based claims seeking a determination of the  
 4 priority and extent of Compass's entitlement to recover default interest, late fees, and  
 5 extension, success or related fees out of recoveries under the Loans.

6 (Weaver Decl. Ex. F (Letter Agreement at ¶ 2).) The parties agreed that the Mediation before  
 7 Judge Nakagawa would take place on February 25 and 26, 2008. Compass even agreed to  
 8 participate in some preliminary discussions with Ms. Cangelosi, before the Mediation dates, and  
 9 paid for Ms. Cangelosi's trip to New York to conduct such preliminary discussions. Ms.  
 10 Cangelosi made a settlement offer to Compass in these preliminary discussions that the parties  
 11 agreed would be a possible template for a global settlement structure and would be the subject of  
 12 continued discussion at the formal mediation attended by additional Direct Lender  
 13 representatives. These actions were fully in accord with the expectations of the Court and the  
 14 parties, as reflected in the language of the January 18 standstill letter agreement quoted above.

15 Unbeknownst to Compass, during this very period, Fulbright was introducing Ms.  
 16 Cangelosi *to one of its other clients*—a group of companies called “Cross”—in an effort to  
 17 escalate the litigation (and, apparently, to identify a source of payment of its substantial  
 18 outstanding legal bills). According to Ms. Cangelosi, *Fulbright introduced her to Cross* because  
 19 the LLCs “needed some more ammunition” against Compass. (Weaver Decl. Ex. G (How are  
 20 you voting, Donna? at 1).)<sup>3</sup>

21 On February 6, 2008 (during the Standstill period and two weeks prior to the scheduled  
 22 mediation), Fulbright attorney Walt Herring sent a bizarre email to Compass's counsel stating  
 23 that:

- 24 1. At 12:01 pm this Friday (February 8) Donna Cangelosi will no longer manage the  
 25 litigation on behalf of the LLCs. . . .
- 26 2. As a result, as of 12:01 pm this Friday (February 8) there will be absolutely no reason  
 27 for Compass to contact Donna, unless they are contacting her (i) in her capacity as a direct

28 <sup>3</sup> Ms. Cangelosi's assertion that Fulbright introduced her to (its other client) Cross and Fulbright's  
 February 6th email communication described below directly contradict the representation Ms.  
 Price made to this Court on April 28, 2008 (in response to questioning from the Court), that  
 Fulbright did not “solicit or negotiate the potential contract with Cross.” (Weaver Decl. Ex. I  
 (Apr. 28 Hearing Tr. at 18:21-23).) *In fact, it was Fulbright that initiated the relationship  
 between Cross, Ms. Cangelosi and the LLCs.*

1 lender, or (ii) as an officer of the manager (FDH) of the LLCs on non-litigation  
2 matters . . . .

3 3. All litigation issues on behalf of the LLCs will be managed by Cross Litigation  
4 Management Company, LLC (“Cross”), however, any settlement offer should be  
5 conveyed to Fulbright & Jaworski, LLP . . . ; and

6 4. [As to the then-existing settlement offer by Ms. Cangelosi] Cross has instructed us to  
7 inform Compass that this offer will never again, under any circumstances, be made  
8 available to Compass.

9 (Weaver Decl. Ex. H (Herring email).) This email (which was directly contrary to Ms.  
10 Cangelosi’s representation that she was contractually authorized to negotiate for the LLCs, and  
11 indeed sought, a settlement) was the first time that Compass learned that Fulbright had introduced  
12 Ms. Cangelosi to Cross and was seeking to continue costly litigation rather than mediation and  
13 settlement.

14 On February 7, 2008, Compass counsel Linda Dakin-Grimm wrote to Fulbright advising  
15 that Fulbright’s introduction of Cross into the litigation was in violation of the Standstill  
16 Agreement. (Weaver Decl. Ex. J (Dakin-Grimm Feb. 7 letter).) On February 14, 2008, after  
17 conducting a preliminary investigation of Cross, Ms. Dakin-Grimm again wrote to Fulbright,  
18 identifying the specific violations of law and court orders that were implicated by Fulbright’s  
19 conduct in arranging a relationship between its long-time client Cross and the LLCs. (Weaver  
20 Decl. Ex. L (Dakin-Grimm Feb. 14 letter).) Compass’s counsel advised that the relationship  
21 between Cross and the LLCs violated the Preliminary Injunction, the Standstill Order, and was in  
22 violation of Nevada law on champerty. (*Id.*)

23 In the few days between Mr. Herring’s February 6th email announcing that Cross had  
24 taken control of the litigation and February 14th, Compass had learned that the entity Mr. Herring  
25 asserted had taken control of the litigation, “Cross Litigation Management Company,” ***did not***  
26 ***even exist on the day Mr. Herring sent the email.*** (Weaver Decl. Ex. M (Cross Litigation  
27 Management Certificate of Formation).) Rather, it was created the next day, February 7, 2008,  
28 when a former Fulbright associate named McAlan Duncan caused to be filed with the  
Corporations Section of the Texas Secretary of State, a certificate of formation for that entity.  
(*Id.*)

1 Compass learned, however, that other Cross-related entities, their principals and Fulbright  
2 have a long-standing attorney-client relationship. Fulbright represents these entities (and  
3 individuals) in multiple litigation matters (defending claims that Cross wrongfully terminated  
4 loans it originated). Compass learned that Fulbright actually represented Cross *adverse to certain*  
5 *Direct Lenders in this very case*, wiping out the junior interests of the Direct Lenders in the  
6 Huntsville loan. (Weaver Decl. Ex. Q (Joint Notice at 1).) Perhaps most astonishingly, Compass  
7 learned that Fulbright represented Joseph D. Milanowski in these bankruptcy proceedings and  
8 against criminal charges stemming from actions against Direct Lenders. (Weaver Decl. Ex. K  
9 (Jan. 3 2006 Hearing Tr. in 06-10725 at 4:2-7).) Compass’s counsel brought all of this  
10 information to Fulbright’s attention in the February 14th letter. (Weaver Decl. Ex. L (Dakin-  
11 Grimm Feb. 14 letter).)

12 Compass nevertheless agreed to move forward with the mediation before Judge  
13 Nakagawa, rather than bringing this matter directly to the Court, only after Fulbright gave  
14 assurances that they “believe and fully expect that all settlement positions will be presented,  
15 reviewed and entertained at mediation” and that Cross did not represent an “impediment to  
16 mediation.” (Weaver Decl. Ex. N (Herring Feb. 19 Letter).) When representatives of Cross  
17 appeared at the beginning of the first day of mediation, Compass explained its position to Judge  
18 Nakagawa. The Cross representatives did not participate in the mediation that day. And they did  
19 not return for the second or third day of mediation.

20 At no time during the mediation did Ms. Cangelosi or Fulbright ever inform Compass or  
21 Judge Nakagawa that they continued to deal with Cross, or that Cross intended to offer a  
22 “competing proposal” to any settlement offer Compass made at the mediation. Nor did they tell  
23 Compass they were seeking litigation financing from Cross to continue the litigation.

24 After three days of mediation, with the able assistance of Judge Nakagawa, Compass  
25 submitted a final settlement proposal to Direct Lenders on April 4, 2008—as the parties agreed  
26 Compass would do at the mediation. To Compass’s astonishment, Ms. Cangelosi disseminated a  
27 “New LLC *Litigation Proposal*” five days later that set forth the terms she secretly negotiated  
28 with Cross during the Standstill Period.

1 As Compass's Response to Emergency Motion for Order Authorizing Encumbrance of  
 2 Beneficial Interests (the "Encumbrance Motion") (Docket Entry 485) made clear, the Cross  
 3 Proposal and its solicitation materials plainly misrepresented the terms of the proposal.  
 4 Nevertheless, on April 18, 2008, rather than asking the LLC Members to vote on the Compass  
 5 mediated settlement offer, Ms. Cangelosi presented a "Compass or Cross" ballot that directed the  
 6 LLC Members to vote either for the Cross proposal or the Compass offer.<sup>4</sup> Three days later,  
 7 Fulbright filed the Encumbrance Motion which directly sought, with an assertion that relief  
 8 should be granted on an expedited basis and without even the need for a hearing, authority to  
 9 further encumber (beyond the 1% already owed to Ms. Cangelosi) at least \$10 million of Direct  
 10 Lenders' investments, and implicitly sought the Court's approval of the Cross Litigation  
 11 Proposal, Cross's absolute control of the litigation, and the existence and validity of the LLCs  
 12 themselves, *without a re-solicitation*.<sup>5</sup>

### 13 **April 28th Hearing**

14 The Court set two matters for hearing on April 28th: (1) Plaintiffs' Emergency Motion  
 15 Regarding Encumbrance of Beneficial Interests (Docket Entry 481), and (2) Objections to San  
 16 Fernando Loan Payoff (Docket Entry 294). At the April 28th hearing, based upon the evidence in  
 17 Fulbright's own filings and Compass's response, the Court found:

- 18 • The LLCs "arranged for funding the continuation of the litigation, even  
 19 assignment of rights of these people who have been defrauded, already, further  
 20 compensation in order to fund the litigation, further litigation" in violation of the  
 Standstill Agreement. (9:19-24.)

21 <sup>4</sup> The LLCs' latest filing requests that the Court note that the LLCs voted "over 96 percent" in  
 22 favor of the Cross Proposal. There is no credible evidence of this statement—which has been  
 23 widely touted to the Direct Lenders. There is only Ms. Price's statement to this effect (but she  
 24 has no personal knowledge of the vote outcome) and a declaration by Ms. Cangelosi, who has  
 25 already admitted to perjury in these proceedings. (Weaver Decl. Ex. B (Oct. 2 Hearing Tr. Vol. I  
 26 at 92:17-21).) Moreover, upon further inquiry, Ms. Cangelosi contradicts herself in her own  
 declaration. Ms. Cangelosi writes that "there were, during the voting period, 3699 individual  
 lender members of Plaintiff LLCs" but later notes that she received only 2864 votes in favor of  
 Cross. (Docket Entry 507 at ¶¶ 8, 12.) This means that, even if Ms. Cangelosi's tally is taken as  
 true, at most 77% of Direct Lender LLC Members voted in favor of the Cross proposal.

27 <sup>5</sup> As set forth in Compass's Response to the Motion to Encumber, Cross's Litigation Proposal  
 28 assigned to Cross 50% of all recoveries in the form of awards, damages, forfeitures, and  
 disgorgements in the litigation, gave Cross complete control over the litigation and its resolution,  
 and gave Cross and its servicer broad indemnity by Direct Lenders for any wrongdoing. (Resp. to  
 Encumbrance Motion, Docket Entry 485 at 5.)

- 1 • “[T]he managing member will sign reassignments of all assignments of direct-  
2 lender interests back to the direct lenders within 30 days.” (13:16-19.)
- 3 • Failure to return the assignments of Direct Lender interests back to the Direct  
4 Lenders may result in arrest to induce compliance with the Court’s orders. (13:24-  
5 25.)
- 6 • The LLCs must perform a full accounting. (14:4.)
- 7 • “The LLCs and Cangelosi are specifically barred from any further representation  
8 of direct-lender interests in the mediation or of member interests or direct-lender  
9 interests here in these proceedings.” (14:5-8.)
- 10 • Compass shall file a motion asking for a receiver to be appoint for the LLCs  
11 conditioned upon whether Ms. Cangelosi complies with the April 28th Orders.  
12 (14:17-20.)
- 13 • “So let’s get it clear, and counsel for Compass will take careful notes, and you’ll  
14 prepare an order.” (12:20-21.)
- 15 • The Court expected the Proposed Order from Compass “this week.” (28:20.)
- 16 • Cross should be informed that “[i]f they involve themselves in interference with  
17 Compass’ rights, they will be held in contempt, similarly, and they will be visited  
18 with substantial sanctions.” (15:25- 16:2.)
- 19 • The LLCs may not encumber any further Direct Lender interest and that the one  
20 percent previously withheld for disbursement to the LLCs will now go to the  
21 members. (29:1-4.)
- 22 • Ms. Cangelosi had acted in contempt of orders of the bankruptcy court and the  
23 district court “from day one,” and she continued to ignore these orders and injured  
24 the Direct Lenders she purported to represent. (29:11-14.)
- 25 • The LLCs would be dismembered and dissolved. (16:18, 20.)
- 26 • The Court would ensure proper representation for the Direct Lenders. (29:20-22.)

27 (All citations above refer to Weaver Decl. Ex. I (April 28 Hearing Tr.).)

28 Compass drafted a Proposed Order that followed the Court’s April 28th pronouncements.  
As a courtesy, Compass sent this Proposed Order to Fulbright at 3:30 p.m. on April 30, 2008, and  
informed Fulbright that Compass would lodge the Proposed Order with the Court that evening.  
Mark Weibel of Fulbright responded “Fulbright objects to Section 13. Delete this Section in its  
entirety. . . . Norlynn may have additional comments - you are instructed to withhold filing  
anything with the Court until you have received her comments.” (Weaver Decl. Ex. O (Weibel  
email).) Compass deleted Paragraph 13 from the Proposed Order it submitted. Compass lodged  
the Proposed Order with the Court at 7:35 p.m. PDT on Wednesday, April 30, 2008.

1 The Proposed Order submitted by Compass tracked the directives of the Court. It states,  
2 in pertinent part, that:

- 3 • The LLC Encumbrance Motion was denied because of Plaintiff LLCs’ failure to  
4 comply with court orders and improper disclosures in soliciting the further  
5 encumbrance of this interest;
- 6 • The proposal by Cross was disallowed and ineffective;
- 7 • Any prior vote by an LLC member for Cross was also void and ineffective;
- 8 • Ms. Cangelosi and the LLCs must return all Direct Lenders the assignments of any  
9 beneficial interests executed by Direct Lenders on behalf of the LLCs and any  
10 powers of attorneys executed by Direct Lenders on behalf of the LLCs;
- 11 • FDH and Ms. Cangelosi are barred from acting on behalf of any Direct Lender in  
12 any matter related to the current litigation; and
- 13 • Cross is prohibited from acting on behalf of any Direct Lender in any matter  
14 related to the current litigation.

15 (Proposed Order, Docket Entry 492.) On May 15, 2008, the Court entered the Proposed Order  
16 with certain modest changes, none of which changes the substance of the motion for  
17 reconsideration submitted by the LLCs.

18 **ARGUMENT**

19 Fulbright has identified neither facts nor law to support its Motion to Reconsider the  
20 Court’s April 28th Order. “A motion to reconsider must provide a court with valid grounds for  
21 reconsideration by: (1) showing some valid reason why the court should reconsider its prior  
22 decision, and (2) setting forth facts or law of a strongly convincing nature to persuade the court to  
23 reverse its prior decision.” *Frasure v. United States*, 256 F. Supp. 2d 1180, 1183 (D.Nev. 2003).  
24 “Reconsideration is appropriate if the district court (1) is presented with newly discovered  
25 evidence, (2) committed clear error or the initial decision was manifestly unjust, or (3) if there is  
26 an intervening change in controlling law.” *Id.* quoting *School Dist. No. 1J, Multnomah County v.*  
27 *ACandS, Inc.*, 5 F.3d 1255, 1263 (9th Cir. 1993).

28 Plaintiff LLCs have not presented new evidence, shown that the Court has committed  
clear error, or identified a change in law. Instead, Plaintiff LLCs make a series of misguided  
arguments challenging the Court’s authority to enforce or supplement its extant Orders as it did at

1 the April 28th hearing. But as shown below, each of the Court's pronouncements are fully  
2 supportable by the evidence presented and were made within the Court's sound discretion.

3 **I. The April 28th Order Obviously Does Not Violate the United States**  
4 **Constitution**

5 Plaintiffs have identified no facts or law that support their contention that the April 28th  
6 Order violates the United States Constitution. The Court did not deprive Ms. Cangelosi or the  
7 LLCs of any right to notice and the opportunity to be heard. Nor did the Court thwart Ms.  
8 Cangelosi's or any of the LLC Members' ability to associate, pay their attorneys, or otherwise  
9 converse amongst themselves.

10 Instead, the Court reiterated its earlier (repeated) finding that Ms. Cangelosi acted in  
11 violation of law in forming the LLCs and that pledge of interests to Ms. Cangelosi and her LLCs  
12 was improper. The Court therefore issued an Order to Show Cause *that provided Ms. Cangelosi*  
13 *and the LLCs with notice* that she would be held in contempt of Court if she does not comply with  
14 the Court's prior orders to this effect within 30 days. As explained *infra*, the Court has the  
15 inherent and broad authority to enforce its rulings through contempt proceedings. The Court's  
16 actions were justified.

17 **II. The Court Explicitly Ordered in September, October, December and January**  
18 **that a Re-Solicitation of LLC Interests Was a Condition Precedent to the**  
19 **Ability of the LLCs to Act on Behalf of Direct Lenders**

20 Counsel for the LLCs contends that the Court never ordered a re-solicitation or reiteration  
21 of LLC interests as a condition to their ability to act on behalf of Direct Lenders. This is simply  
22 wrong.

- 23 • the Court ordered a re-solicitation of Direct Lender interests long before the entry of the  
24 Preliminary Injunction Order (*See Weaver Decl. Ex. A (Sept. 10 Hearing Tr. at 19:11-14)*  
25 (*Ms. Cangelosi "must be restrained from taking assignment of rights by consumers, and*  
26 *she must be required in this injunctive relief to retransfer, to submit those back, to the*  
27 *direct lenders."));*
- 28 • at the hearing on the Preliminary Injunction, the Court discussed re-solicitation in the  
context of termination because that was the stated relief the Plaintiff LLCs sought at the

1 October 1st and 2nd hearing (Weaver Decl. Ex. P (Oct. 1 Hearing Tr. at 8:16-21  
2 (Plaintiffs were “seeking relief here in these hearings . . . today and, namely, termination  
3 of those service rights.”));

- 4 • at other subsequent hearings, the Court repeatedly advised that it would not recognize the  
5 LLCs for any purpose, absent a re-solicitation (*See generally* Weaver Decl. Exs. D, E  
6 (Dec. 3 Hearing Tr., Jan. 7 Hearing Tr.)); and
- 7 • Fulbright repeatedly told this Court that it understood that re-solicitation of LLC interests  
8 was a necessary condition to action by the LLCs on behalf of Direct Lenders. (Weaver  
9 Decl. Ex. E (Jan. 7 Hearing Tr. at 24:10-25:2) (THE COURT: “And, of course, you’ll also  
10 have to comply with the requirements the Court previously informed you of. I do need  
11 some kind of re-solicitation compliance –“ MR. HERRING: “We can do that.”)).

12  
13 Counsel for the LLCs now disingenuously states that the Court only required a re-  
14 solicitation if the LLCs decided to file a new motion to terminate Compass. (Mot. at 6.) Counsel  
15 for the LLCs takes umbrage with the Court’s admonition on April 28th that it “ordered that there  
16 would be reiteration as a condition for further representation.” (Weaver Decl. Ex. I (April 28  
17 Hearing Tr. at 5:20-22).) But this position is contradicted by Counsel’s express words at the  
18 January 7th hearing—Counsel then plainly understood that re-solicitation of the purported LLC  
19 interests was necessary as a condition to further representation. (Weaver Decl. Ex. E (Jan 7  
20 Hearing Tr. at 31:18- 32:1) (THE COURT: “—you may do so, but of course, subject to the same  
21 complaint I’ve had before, and that is the solicitation is defective.” MR. HERRING: “We  
22 understand.”).)

### 23 **III. The LLCs Violated the Standstill Agreement Between the Parties**

24 The Motion to Reconsider contains no evidence to rebut the Court’s finding that the  
25 Plaintiffs violated the litigation Standstill Order between the parties. As set forth, *supra*, at Ms.  
26 Cangelosi’s request, this Court ordered that the parties *stop litigating the dispute* between them  
27 and mediate a resolution. The evidence is undisputed that during the standstill period, as  
28 Compass proposed settlement terms and explored options to resolve the dispute, both Fulbright,

1 which introduced Cross into this litigation, and Ms. Cangelosi, solicited and negotiated a proposal  
2 from third-party Cross to continue the litigation against Compass. This conduct proves that  
3 neither Ms. Cangelosi nor Fulbright mediated with Compass in good faith and that their failure to  
4 do so violated both the terms and the spirit of the Standstill Order.<sup>6</sup>

5 **IV. The Proposed Order Encompasses the Court's Ruling at the April 28th**  
6 **Hearing**

7 Plaintiff LLCs object to the Proposed Order submitted by Compass on the basis that it  
8 supposedly "misrepresents" the record, the statements by the Court, and the Court's directives.  
9 (Mot. at 8-10.) As a preliminary matter, this Court requested that Compass draft and lodge a  
10 Proposed Order. (Weaver Decl. Ex. I (Apr. 28 Hearing Tr. at 12:20-21).) Compass shared the  
11 Proposed Order with Plaintiff LLCs (and Ms. Chubb) before filing it, and integrated certain of the  
12 comments it received. To the extent Plaintiff LLCs complain that the Proposed Order  
13 misrepresents the record, Compass prepared the Proposed Order in accordance with the Court's  
14 findings, which, as discussed herein, are entirely supported by the evidence.

15 Counsel to the LLCs objects to the description of their Motion to Encumber (Mot. at 8).  
16 But as the Court stated at the hearing, the Motion "arranged for funding for continuation of the  
17 litigation, even assignment of rights of these people who have been defrauded, already, further  
18 compensation in order to fund the litigation, further litigation." (Weaver Decl. Ex. I (April 28  
19 Hearing Tr. at 9:20-24).) The Motion to Encumber implicitly asked the Court to recognize and  
20 endorse the Cross Proposal by authorizing the pledge of *over \$10 million* in Direct Lender  
21 interests (solicited in violation of law) to Cross. It is reasonable, therefore, that a description of  
22 the champertous Cross Proposal appear in the Proposed Order.

23  
24  
25 <sup>6</sup> The LLCs' contention that their violation of the Standstill Agreement is excusable because  
26 "Compass violated it too" is simply wrong. At the March 13th mediation before Judge  
27 Nakagawa, the parties explicitly agreed (in Judge Nakagawa's presence) that the Standstill  
28 Agreement would continue for thirty days to allow the settlement offer to be presented to the LLC  
members, but that during that time, Compass would be allowed to file two motions (the Mountain  
House Contempt Motion and the San Fernando Priority Motion, docket entries 473 and 456  
respectively) as an exception to the Standstill Agreement. In turn, it was explicitly agreed that the  
LLCs would not be required to respond to those motions unless and until the LLCs rejected  
Compass's settlement proposal.

1           Furthermore, as discussed *supra*, the Court found that the LLCs violated the Standstill  
2 Agreement when they solicited and marketed the Cross Proposal during the Standstill Period.  
3 The Court also ordered a re-conveyance of each LLC Member's interest. It is thus reasonable that  
4 this Court require Compass to work directly with the purported LLC Members to effectuate a  
5 settlement. Paragraph 3 of the Proposed Order was implied by the Court at the hearing.

6           In Paragraph 4 of the Proposed Order, Compass understood this Court's admonition that  
7 Ms. Cangelosi and the LLCs must return all assignments of "Direct Lender interests" to include  
8 any funds paid to Ms. Cangelosi or the LLCs by the direct Lenders or on the Direct Lenders'  
9 behalf. This is eminently reasonable given the rationale of the Court in ordering the LLCs to  
10 return the assignments, *i.e.*, that the interests and any concomitant funds obtained by the LLCs  
11 from the Direct Lenders must be disgorged and sent back to the Direct Lenders. Nevertheless, the  
12 Court removed this language from the Order Denying LLCs' Emergency Motion for Order  
13 Authorizing Encumbrance of Beneficial Interests (Docket Entry 516) and the issue is moot.

14           Rather than going "far beyond anything in the record," (Mot. at 8) the Proposed Order  
15 accurately represents the findings of the Court on April 28th.

16       **V.    The Court Has the Inherent Authority to Supplement and Enforce its**  
17       **Preliminary Injunction**

18           Plaintiff LLCs argue that the Court's April 28th pronouncements violated the LLCs'  
19 rights under the Federal Rules of Civil Procedure. (*See* Mot. at 11-14.) Specifically, they claim  
20 that the Court improperly ordered that the LLCs re-convey the beneficial interests to the Direct  
21 Lenders, on the premise that the Court entered a new preliminary injunction without following  
22 certain procedural rules. (*Id.*) This argument ignores the fact that *the Court already entered the*  
23 *Preliminary Injunction on November 6, 2007*. The Court held a full evidentiary hearing, with  
24 proper notice to all parties and in compliance with all procedural rules before entering the  
25 Preliminary Injunction. Indeed, the possibility that the LLCs would be dissolved (due to  
26 securities violations) or that a re-conveyance would be ordered were the primary evidentiary  
27 issues disputed during the October 1 and 2 hearing. The Court did not "enter a preliminary  
28

1 injunction” subject to the requirements identified by Plaintiff on April 28, 2008, but rather  
2 supplemented and enforced its already existing Preliminary Injunction.

3 A district court has the inherent authority to enforce and/or modify a preliminary  
4 injunction in consideration of new facts. *A&M Records, Inc. v. Napster, Inc.*, 284 F.3d 1091,  
5 1098 (9th Cir. 2002) (modifying preliminary injunction to require internet service that facilitated  
6 transmission and retention of digital audio files by its users to use new filtering mechanism to  
7 achieve compliance with previously entered injunction) citing *System Federation No. 91 v.*  
8 *Wright*, 364 U.S. 642, 647-48 (1961) (holding that a district court has “wide discretion” to modify  
9 an injunction based on changed circumstances or new facts).

10 Pursuant to the Federal Rules of Civil Procedure, such modifications based on new facts  
11 can be made by a district court at “any time.” *See* Fed. R. Civ. P. 54(b) (a district court can  
12 modify an interlocutory order “at any time” before entry of a final judgment). As the Supreme  
13 Court noted in *System Federation*, “[t]he source of the power to modify is of course the fact that  
14 *an injunction often requires continuing supervision by the issuing court* and always a continuing  
15 willingness to apply its powers and processes on behalf of the party who obtained that equitable  
16 relief . . . and *neither the plaintiff nor the court should be subjected to the unnecessary burden of*  
17 *re-establishing what has once been decided.*” *System Federation*, 364 U.S. at 647 (emphasis  
18 added).

19 During the April 28th hearing, the LLCs themselves presented the Court with new  
20 evidence of Ms. Cangelosi’s latest refusal to comply with the longstanding Orders of the Court.  
21 Thus, the Court, based on its inherent authority, enforced and/or effected a modification of the  
22 Preliminary Injunction.

23 The Court spent two full days (Oct. 1 and 2, 2007) hearing testimonial evidence and  
24 reviewing documentary evidence on the formation and solicitation of the Plaintiff LLCs. Indeed,  
25 in concluding its arguments, Compass expressed to the Court its belief that “the evidence . . .  
26 overwhelmingly establishes that Ms. Cangelosi has violated state and federal law [in forming the  
27 LLCs].” (Weaver Decl. Ex. C (Oct. 2 Hearing Tr. Vol. II at 74:18-21).) And the Court agreed,  
28 finding that there was probability of success in finding that Ms. Cangelosi violated securities laws

1 and also that she violated several previous orders of the Court, which ultimately led to an Order  
2 of Contempt against her. (*Id.* (Oct. 2 Hearing Tr. Vol. II at 118:2-122:15).) But the LLCs'  
3 counsel made arguments on equitable grounds during the evidentiary hearing that: (1) the LLCs  
4 should not immediately be dissolved (without an opportunity to re-solicit and fix the problems)  
5 because it was the Direct Lenders' only mechanism to fund the litigation, and (2) immediate  
6 dissolution (without a chance to re-solicit) would make the termination efforts procedurally  
7 impossible due to the difficulty in representing many individual Direct Lenders. (*Id.* (Oct. 2  
8 Hearing Tr. Vol. II at 78:2-80:4).) Based on these equitable arguments, the Court did not order  
9 the immediate return of interests to Direct Lenders but allowed them a chance to remedy the  
10 serious legal problems inherent in the formation. (*Id.* (Oct. 2 Hearing Tr. Vol. II at 122:13-15).)  
11 Counsel for the LLCs and Ms. Cangelosi acted as if this never happened.

12 *Indeed, over seven months have passed* since the Court made these pronouncements and  
13 gave counsel to the LLCs and Ms. Cangelosi a chance to re-solicit membership in the LLCs.  
14 They never did so. There has been no re-solicitation of powers of attorney. There has been no  
15 full and complete disclosure to Direct Lenders. Instead, with Ms. Cangelosi still at the helm, the  
16 LLCs have continued to misrepresent and spin the facts to the ultimate detriment of Direct  
17 Lenders. The new contemptuous conduct, as outlined above, involves the LLCs' further violation  
18 of the Orders of the Bankruptcy Court, the Preliminary Injunction Order, the Cangelosi Contempt  
19 Order, the Standstill Order, the LLCs' participation in the mediation between the parties in bad  
20 faith, and solicitation of an agreement from an outside third party to fund the continued litigation  
21 in a manner that violates Nevada law (which prohibits champerty).

22 Lastly, Plaintiff LLCs make an irrelevant and inaccurate argument that Compass is not  
23 entitled to injunctive relief because it has been found to have engaged in "inequitable conduct."  
24 (Mot. at 13.) This is simply untrue. What is true is that Plaintiffs have made serious (but  
25 unproven) allegations. The Preliminary Injunction specifically lays out a procedure for the  
26 Plaintiff LLCs to bring evidence of Compass's alleged "inequitable conduct" to the attention of  
27 the Court. The Court repeatedly invited Plaintiffs to bring such evidence on for hearing on  
28 shortened notice. They have not done so, and Compass stands ready to defend any such

1 allegations if they are ever made again. And to the extent that Plaintiff LLCs are now relying on  
2 an argument that “inequitable conduct” bars the injunctive relief granted in the Preliminary  
3 Injunction, the time to move for reconsideration of the Preliminary Injunction (entered Nov. 6,  
4 2007) lapsed long ago. *See* Fed. R. Civ. P. 59(e) (motion to alter or amend preliminary injunction  
5 must be made within 10 days after entry of the judgment.)

6 **VI. The Court has the Authority to Issue an Order to Show Cause Regarding**  
7 **Contempt**

8 Counsel for the LLCs contends that there was something improper about the Court’s “*sua*  
9 *sponte*” admonishments of Ms. Cangelosi and its setting of an Order to Show Cause for Contempt  
10 regarding her conduct. (*See* Mot. at 2-3.) Essentially, Counsel for the LLCs argues that the Court  
11 has power only to grant or deny the motions made by the LLCs—nothing more. The Court,  
12 however, acted entirely within its inherent and statutory authority to coerce compliance with its  
13 extant orders by punishing contemptuous conduct. *See International Union, UMWA v. Bagwell*,  
14 512 U.S. 821, 831-832 (1994) (district courts have the inherent “power of self defense”); 18  
15 U.S.C. §§ 401-402. When coercing compliance through civil contempt, a court must give the  
16 contemnor the opportunity to purge herself of contempt by complying with the court’s order. *See*  
17 *Bagwell*, 512 U.S. at 828 (jailing a reluctant witness until he or she is willing to testify; the  
18 alleged contemnor has the “key to the jailhouse door” in his or her pocket).

19 This is exactly what the Court has done. During the April 28th hearing, the Court  
20 repeatedly warned Ms. Cangelosi that she was in violation of previous court orders, that she was  
21 in danger of another finding of civil contempt, and gave her instructions on how to avoid a further  
22 contempt finding against her. (Weaver Decl. Ex. I (Apr. 28 Hearing Tr. at 11:11-14) (“You’re on  
23 the verge of being held in contempt and arrested, ma’am, and that’s why I’m giving you very  
24 strong caution before you speak *pro se* because I will consider what you say.”).) Indeed,  
25 recognizing that Ms. Cangelosi had not complied with the Preliminary Injunction over the  
26 preceding seven months, the Court gave Ms. Cangelosi clear and explicit instructions regarding  
27 her compliance with that order within thirty days. (*Id.* (Apr. 28 Hearing Tr. at 13:15-14:21).)  
28

1 Presumably, if Ms. Cangelosi timely complies with the order, she will not be found in contempt  
2 on June 2, 2008, with respect to the subject matter of that order.

3 \* \* \* \*

4 Compass understands that the LLCs served as a mechanism for Direct Lenders to come  
5 together and present a unified position in dealing with the loan portfolio. Compass recognizes  
6 that disagreements continue to exist between Compass and many Direct Lenders regarding,  
7 among other things, the priority or “waterfall” of payments under the loans. Compass believes  
8 that the Court’s April 28th ruling was absolutely necessary in light of the contemptuous conduct  
9 presented here. Nevertheless, Compass believes that the LLC structure itself is not the source of  
10 the problem, but rather that a few bad actors have abused the LLC structure and used it to provide  
11 misinformation to the bulk of the Direct Lenders. Fulbright has shown an unwillingness (perhaps  
12 due to reporting to the managing member of the LLCs, Ms. Cangelosi) to keep Direct Lenders  
13 fully and accurately apprised of the most straightforward court orders and events.

14 For these reasons, and as the Court directed, Compass will submit a Motion for  
15 Appointment of an Equity Receiver, which will present a potential solution for the Court in  
16 appointing a sophisticated receiver for the LLCs—completely independent of Compass—that  
17 could serve to represent Direct Lenders’ interests and possibly appoint new counsel for Direct  
18 Lenders. Compass does not believe further litigation is in the interest of any party to this dispute,  
19 and believes that a Court-appointed receiver that can, at a minimum, fairly present settlement  
20 offers and provide sound advice to Direct Lenders is the best solution for this complicated and  
21 unfortunate situation.

22  
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1 Dated: May 19, 2008  
2

3 /s/ Paul M. Torres

4 Linda Dakin-Grimm (admitted *pro hac vice*)  
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**CERTIFICATE OF SERVICE**

This certifies that, pursuant to Rule 5 of the FEDERAL RULES OF CIVIL PROCEDURE, on the May 19, 2008, a true and correct copy of the foregoing *RESPONSE TO THE OBJECTIONS AND MOTION FOR RECONSIDERATION RELATIVE TO APRIL 28, 2008 PROCEEDING* and the Declaration of Gabriel Weaver in support thereof were served on all counsel via the Court's CM/ECF System.

By:           /s/ Paul M. Torres          

Paul Torres