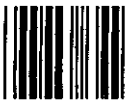


USDC SCAN INDEX SHEET



TKL 11/22/04 12:33

3:04-CV-02184 USA V. GUESS

\*39\*

\*RESP.\*

1 SHEPPARD MULLIN RICHTER & HAMPTON LLP  
A Limited Liability Partnership  
2 Including Professional Corporations  
PAMELA J. NAUGHTON, Cal. Bar No. 97369  
3 12544 High Bluff Drive, Suite 300  
San Diego, California 92130-3051  
4 Telephone: 858-720-8900  
Facsimile: 858-509-3691

5 LAW OFFICE OF FRANK J. JOHNSON  
6 FRANK J. JOHNSON, Cal. Bar No. 174882  
402 W. Broadway, 27<sup>th</sup> Floor  
7 San Diego, California 92101  
Telephone: 619-230-0063  
8 Facsimile: 619-230-1839

9 Attorneys for xélan Foundation, Inc.

10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

FILED

04 NOV 99 PM 3:23  
CLERK, U.S. DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA  
BY: DEPUTY

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,  
Plaintiff,  
v.  
L. DONALD GUESS, et al.,  
Defendant.

Case No. 04-CV-2184 ~~W~~ (AJB)  
**RESPONSE OF XELAN FOUNDATION,  
INC. TO ORDER TO SHOW CAUSE**

LAB

30

CB

TABLE OF CONTENTS

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

Page

I. INTRODUCTION ..... 1

II. FACTUAL BACKGROUND..... 3

    A. Overview of the Foundation..... 3

        1. Purpose of the Foundation..... 3

        2. The Foundation's Assets..... 3

        3. Foundation Costs..... 4

        4. Foundation Accounts..... 4

    B. History ..... 7

    C. Charitable Purposes..... 8

    D. Charitable Projects ..... 9

    E. Student Loans ..... 10

III. ARGUMENT ..... 12

        I. Government Has Failed To Demonstrate It Is Entitled To  
            Preliminary Injunctive Relief..... 12

        A. The Government Has No Likelihood Of Success On The Merits..... 13

        B. The Government's Major Fallacy..... 13

        C. The Government's Second Fallacy..... 14

        D. The Government's Meager Showing On The Merits Defeats Its Claim To A  
            Presumption Of Irreparable Injury ..... 18

        E. The Foundation and Third Parties Will Be Harmed By A Preliminary  
            Injunction That Freezes All Of The Foundation's Assets ..... 18

        F. The Public Interest Weighs Heavily Against Issuance Of An Injunction..... 24

        II. Should The Court Nevertheless Be Inclined To Issue A  
            Preliminary Injunction, It Should Apply To Only A Limited  
            Portion Of The Foundation's Assets..... 25

IV. CONCLUSION ..... 25

TABLE OF AUTHORITIES

Cases

America Airways Charters, Inc. v. Regan,  
746 F.2d 865 (D.C. Cir. 1984) ..... 19

Caplin & Drysdale v. United States,  
491 U.S. 617 (1989) ..... 21

Grosjean v. American Press Co.,  
297 U.S. 233 (1936) ..... 19

Jones v. Niagara Frontier Transp. Auth.,  
722 F.2d 20 (2d Cir. 1983) ..... 19

National Foundation, Inc. v. United States,  
13 Cls Crt. 486 (1974) ..... 7, 10

Rowland v. California Men's Colony,  
506 U.S. 194 (1993) ..... 21

United States v. Barnes,  
912 F. Supp. 1187 (N.D. Iowa 1996) ..... 12, 13, 18

United States v. Bohn,  
890 F.2d 1079 (9th Cir. 1989) ..... 21

United States v. Brown,  
988 F.2d 658 (6th Cir. 1993) ..... 13, 23

United States v. Jones,  
652 F. Supp. 1559 ..... 13

United States v. Odessa Union Warehouse Co-op.,  
833 F.2d 172 (9th Cir. 1987) ..... 12, 18

United States v. Rad-O-Lite of Philadelphia, Inc.,  
612 F.2d 740 (3d Cir. 1979) ..... 19

United States v. Unimex, Inc.,  
991 F.2d 546 (9th Cir. 1993) ..... 19, 20, 21

Statutes

Civil Local Rule 83.3 ..... 20

26 U.S.C. §170(b)(1) ..... 6, 17

26 U.S.C. §501(c)(3) ..... 1, 3, 7, 16, 21, 24

Section 501(c)(3) ..... 3, 7, 16, 17, 21

26 U.S.C. §7402 ..... 1, 2

1 18 U.S.C. §1345 ..... 1, 2, 12, 13, 15, 17, 18  
2 18 U.S.C. §1345(a)(2) ..... 2  
3 18 U.S.C. §1345(b) ..... 1  
4 Fed. R. Civ. P. 65 ..... 1

5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

I.

INTRODUCTION

Xelan Foundation, Inc. ("xelan Foundation"<sup>1</sup> or "the Foundation"), by and through its counsel, hereby responds to the Order To Show Cause issued by this Court on November 3, 2004. For the reasons stated below, the Foundation respectfully submits that no restraining order, preliminary injunction or freeze order should be issued by this Court as to the Foundation's assets, no receiver appointed, and no accounting required.

The Foundation is a public charity, approved by the Internal Revenue Service pursuant to 26 U.S.C. §501(c)(3). In 1997, the Foundation received a favorable determination letter from the IRS regarding its exempt status for the "advance ruling period," and in 2002 received a final determination of exempt status after IRS review and approval of its operations during the advance ruling period. It is an altogether **separate and distinct entity** from all other organizations identified in the Government's *ex parte* submissions to this Court. Its officers and directors include **none** of the individuals implicated in the activities described in that submission. The Government's evidence of improper transactions involving the Foundation accounts is extremely thin. Of the \$64 million in contributions taken in by the Foundation, the IRS alleges it is owed only approximately \$373,000, yet, it attempts here to seize millions of dollars of assets. For these and other reasons, the Government has failed to meet its burden to obtain the extraordinary relief it seeks under 18 U.S.C. §1345 and 26 U.S.C. §7402.

Proceedings initiated pursuant to 18 U.S.C. §1345 are governed by the Federal Rules of Civil Procedure. 18 U.S.C. §1345(b). Therefore, the United States must satisfy the requirements of Fed. R. Civ. P. 65 and its accompanying case law, as developed in the context of §1345, to obtain preliminary injunctive relief. In its *ex parte* submission to this Court, the United States has not come close to demonstrating a substantial likelihood of success on the merits of its claims.

---

<sup>1</sup> The Foundation's trademark purposely begins with a lower case "x."

1 The Government cannot establish the fundamental predicate for any action under §1345, *i.e.* that  
2 the Foundation "is alienating or disposing of property, or intends to alienate or dispose of  
3 property," obtained as a result of, or traceable to, criminal activity specified in the statute. 18  
4 U.S.C. §1345(a)(2). The Government fares no better under 26 U.S.C. §7402: It has presented no  
5 evidence to this Court that the Foundation has failed to pay its taxes, or indeed that any summons,  
6 deficiency notice, or assessment of any type was even served upon the Foundation. Moreover, the  
7 evidence before the Court, even if viewed in the light most favorable to the Government, only  
8 establishes that, at most, the amounts of money that could possibly be owed to the IRS from  
9 improper deductions by the donors amounts to less than one percent of the total contributions  
10 taken in by the Foundation.

11  
12 The Government also cannot show that the balance of harms—an indispensable component  
13 of any request for preliminary injunctive relief—weighs in favor of granting such relief under  
14 §1345. It relies on the statutory presumption of irreparable injury in its papers. *See Memorandum*  
15 *Of Points And Authorities In Support Of Application For Ex Parte Restraining Order*, filed  
16 October 29, 2004, ("Govt. Memo") at 13-14. That presumption arises, however, only if the  
17 Government has made the requisite showing of substantial likelihood of prevailing on the merits,  
18 which it cannot do. Furthermore, the Government makes no allegations that the Foundation (as  
19 opposed to individual defendants in regard to other entities) ever refused to produce documents, or  
20 evaded service, or obstructed the investigations in any way. The Government has provided no  
21 evidence to why the normal prescribed methods of audits, summons', and subpoenas are not  
22 sufficient to conduct and complete its inquiry.

23  
24 The harm from granting a preliminary injunction and freezing the assets of the Foundation,  
25 moreover, is devastating not only on the Foundation itself but upon innumerable innocent  
26 individuals and organizations who benefit from its charitable activities.

1 Finally, the public interest strongly favors the denial of injunctive relief and the issuance of  
2 a freeze order. An unnecessary injunctive action that needlessly terminates important charitable  
3 activities is fundamentally at odds with the public interest.

4  
5 **II.**

6 **FACTUAL BACKGROUND**

7 A. Overview of the Foundation

8 1. Purpose of the Foundation.

9 The Government's brief glaringly omits any reference to the charitable work and purpose  
10 of the Foundation. The Foundation is a Section 501(c)(3) tax-exempt charitable organization that  
11 has provided services and contributions throughout the world since its inception. The Foundation  
12 operates exclusively to raise and distribute funds to other non-profit organizations and charitable  
13 projects. Since its inception, the Foundation has donated approximately \$11,231,508 to other  
14 Section 501(c)(3) organizations, many of which are well-respected, charities or institutions;  
15 including but not limited to: universities, medical colleges, medical research and provider  
16 institutions and organizations such as the YMCA; Campus Ministries; Boys & Girls Club, Boy  
17 Scouts of America, and the Juvenile Diabetes Research Foundation.

18  
19 The Foundation has also established permanent endowments for the benefit of several  
20 educational, medical, state, and county institutions. The Foundation operates to fund and  
21 administer over 120 charitable, educational, religious, scientific, medical services and literary  
22 projects, which in turn have provided \$4,473,844 worth of charitable services.

23  
24 2. The Foundation's Assets.

25 The Foundation operates funds that are dedicated to the purpose of charitable giving, and  
26 functions as one of the country's leading charitable arms. The Foundation has received  
27 \$64,268,130 (\$40,059,862 in cash; \$10,348.22 in brokerage securities; \$4,513,201 in real estate;  
28 \$9,346,244 in business interest) (Farrington Dec ¶ 7) and currently has \$42,160,938 million in



1 assets. (Farrington Dec. ¶ 6). The Foundation operates by having all cash contributions initially  
2 deposited, in a single bank account, from which all cash transactions occur. From this account  
3 \$23,418,105 is invested in securities currently maintained in *only one* account, owned by the  
4 Foundation, and dedicated for future charitable contributions. Attached as Exhibit A to the  
5 Farrington Dec. is a spreadsheet of the net assets of the Foundation. (Farrington ¶ 6; Wakefield  
6 Dec. ¶ 9). As one can see from the financials, every cent of Foundation money is accounted for.  
7

8 The Foundation is audited on a regular basis by an independent outside auditing firm,  
9 which has never indicated that there has been any evidence of fraud or financial improprieties.  
10

11 3. Foundation Costs

12 The Foundation's costs and expenditures are consistent with its charitable purposes to  
13 cover necessary administrative and management costs, and reasonable attorneys' fees and  
14 expenses. Up to six percent of all contributions is paid to xélan, Inc. to cover marketing and  
15 research expenses of the Foundation. An annualized 1.1% of all managed funds (i.e. donations  
16 invested in securities) are paid on a quarterly basis to xélan Investment Services, for the  
17 management of the invested funds. (Wakefield Dec. ¶ 14). An administrative overhead of only  
18 7% is extremely frugal for a public charity, many of which operate at 25% administrative  
19 overhead. The Foundation's donors are made aware of the relevant marketing, management, legal,  
20 and accounting fees by their financial counselors. (Wakefield Dec. ¶ 16; Flatley Dec. ¶ 6; Hedrick  
21 Dec. ¶¶ 17-19; Appleman Dec. ¶ 6; Devlin Dec. ¶ 6.  
22

23 4. Foundation Accounts.

24 The Foundation has one primary bank account. Declaration of Farrington ¶ 10. It serves  
25 as the cash clearing account for the operations of the Foundation.<sup>2</sup> The sources of the deposits in  
26

27 <sup>2</sup> The Government's allegation that Foundation donors have contributed more than \$67.3  
28 million is in error. *See* France Dec. ¶ 50. This figure is based on a review of account  
statements for May 1, 1999 through April 30, 2004, and an assumption that all deposits

1 this account came by four primary means. First, all cash contributions made by donors were  
2 deposited into this account. (Wakefield Dec. ¶ 6). If the donor advised that an immediate  
3 contribution be made to a charitable organization, and such contribution was approved by the  
4 Foundation, the contribution was made from this account payable to the identified organization.  
5 *Id.* If donated monies were not distributed to a charitable organization upon donation, the funds  
6 were deposited into the Foundation's investment account or other investments such as annuities.  
7 *Id.* Secondly, when the Foundation determined to make a contribution to a charity, money was  
8 withdrawn from the brokerage account and re-deposited into the primary bank account, and, in  
9 turn, a check was drawn on the bank account. *Id.* Thus, a significant source of the deposits in the  
10 First National Bank account was the result of "re-deposits." A third source was proceeds from  
11 donated securities. *Id.* ¶ 7. Upon distribution to a charitable organization, the securities were  
12 liquidated, deposited into the First National Bank account, and then distributed to a charitable  
13 organization by check. *Id.*

14  
15 Why does the donor contribute to the Foundation instead of just donating directly to the  
16 charity of his choice? Many donors wish to establish their own charitable foundation, but don't  
17 wish to bear all of the administrative tasks and costs. Others wish to accumulate their  
18 contributions until they are enough to fund the donation, such as endowing a Chair at a college.

19  
20 The Fourth source of deposits in the Bank account was annuity payments made to donors,  
21 as charitable gift annuities. A charitable gift annuity is a well-recognized method which a person  
22 can use to provide an annuity for his/her survivors and have the remainder donated to charity.  
23 Many major charities and churches offer these annuity plans. The donor makes a donation to the  
24 charity. The charity can buy an annuity policy or pay the annuity itself. If it buys the policy, the  
25 policy makes annuity payments to the charity which then passes it on to the donor's survivors.

26  
27  
28 made in that account were contributions. That assumption is erroneous as cash  
contributions only amount to \$40,059,862. (Farrington Dec. ¶ 7).

1 The remainder goes to the charity. The present value of the remainder interest is deductible. The  
2 annuity payments are taxable to the extent they exceed the basis. (Section 72 of the IRC).

3  
4 The Government cites several payments to the donors or their family as evidence of either  
5 diversion or improper activity. That is wrong and out of context. Typically those payments were  
6 from the charitable annuities that were purchased.<sup>3</sup>

7  
8 Contrary to the Government's allegations, donors relinquished *all ownership and control*  
9 over money and property donated to the Foundation pursuant to the tax laws of the United States.  
10 See 26 U.S.C. § 170(b)(1)(A); Appleman Dec. ¶ 3; Hedrick Dec. ¶ 4; Flatley Dec. ¶ 11. Monies  
11 not immediately contributed to a charitable organization are held by the Foundation in the  
12 investment account for future distribution. They *are not* invested according to a donor's choice.  
13 (Wakefield Dec. ¶¶ 16, 19). Upon donation, funds and property are owned and maintained by the  
14 Foundation and **at no time are available to the donors for withdrawal.** *Id.* ¶ 19. Doctors have  
15 the ability to establish "donor advised funds," which have been approved by the IRS and the  
16 courts, however, the Foundation's Board exercises the ultimate control and authority over the  
17 property in the fund to assure that that the charitable purposes of the Foundation are followed. *Id.*  
18 This is the same procedure followed by other donor advised funds throughout the United States.  
19 Examples of such funds are the Jewish Community Foundation, the Fidelity Charity Fund and the  
20 Vanguard Charitable Fund.

21  
22  
23  
24 <sup>3</sup> It is impossible for the Foundation to produce the documents to demonstrate this because  
25 the Government refused to identify the donors in their chart on pages 53-56 of Agent  
26 France's declaration. Since the Receiver has custody of all the Foundation's documents, it  
27 is not possible for the Foundation to access the data bank to confirm that these payments  
28 were charitable remainder annuities. The Government should not be allowed to cite  
"evidence" and then refuse to identify the account so that the Foundation cannot rebut the  
"evidence." It is clearly a denial of due process. If taxpayer privacy was the issue, the  
Government could have filed the unredacted chart under seal.

1 B. History

2 The Government never mentioned in its brief that it has twice approved the Foundation as  
3 a public charity 501(c)(3) organization. The history is as follows. The xélan Foundation, Inc. was  
4 incorporated on December 18, 1997, in the State of Oklahoma as a not-for-profit-corporation. It  
5 was modeled after the foundation that received United States Court of Claims approval in  
6 *National Foundation, Inc. v. United States*, 13 Cls. Ct. 486 (1987), 87-2 USTC 89,827. On  
7 December 20, 1997, it filed with the IRS an application for tax-exempt status under Section  
8 501(c)(3). A copy of the Foundation's IRS Form 1023, Application for Recognition of  
9 Exemption, is attached as Exhibit C to the Paternoster Dec.<sup>4</sup>

10  
11 On March 20, 1998, the IRS issued a temporary determination letter declaring the  
12 Foundation's tax-exempt status under Section 501(a) as a Section 501(c)(3) organization,  
13 retroactive to the date of incorporation. A copy of the temporary determination letter is attached  
14 as Exhibit E to the Paternoster Dec. On or about December 1, 2001, the Foundation submitted  
15 Form 8734, "Support Schedule for Your Advance Ruling," a copy of which is attached as Exhibit I  
16 to the Paternoster Dec. On May 6, 2002, the Director of Exempt Organizations of the IRS issued a  
17 final determination to the Foundation that it qualifies as a public charity under Section 501(c)(3).  
18 A copy of the final determination letter is Exhibit K to the Paternoster Dec.<sup>5</sup> It is noteworthy that  
19 this final determination in 2002 occurred after the IRS began its audits and investigation.

20  
21  
22  
23 <sup>4</sup> The current members of the Board of the Foundation are Carl Flatley, Donald Devlin, and  
24 Robert Appleman. Dr. Guess previously served as a board member of the Foundation, but  
25 he was only one of at least three and sometimes five members; thus, he never had voting  
26 control as has been alleged. The Board works to ensure that the Foundation achieves its  
27 charitable purposes through programs the Foundation sponsors and supports. The current  
28 officers of the Foundation are Dr. Flatley, as President, and Dr. Appleman, as Vice  
President/Secretary. (Appleman Dec. ¶ 2; Devlin Dec. ¶¶ 2, 3; Flatley Dec. ¶ 2. The  
Government has made no allegations against any of the Foundation's board members.  
<sup>5</sup> The IRS has subsequently commenced an administrative review of the Foundation's  
501(c)(3) status, but its tax-exempt status remains in effect.

1 C. Charitable Purposes

2 As stated in its Certificate of Incorporation and By-Laws, the purposes of the Foundation  
3 are “exclusively charitable and educational, specifically to (1) raise and distribute funds to other  
4 nonprofit charitable organizations; and (2) to initiate, fund and administer a wide variety of  
5 charitable, educational, religious, scientific and literary projects.” A copy of the Certificate of  
6 Incorporation is Exh. L to the Paternoster Dec, and a copy of the By-Laws is attached as Exh. M.

7  
8 Although the Foundation also operates as a “donor advised fund,” contrary to the  
9 Government's assertion, the donors *do not* maintain ownership and control over the funds/property  
10 donated and this is made clear in the published materials. Donors understand that the money  
11 belongs to the Foundation. Appleman Dec. ¶¶ 3-4; Hedrick Dec. ¶ 4; Flatley Dec. ¶ 3. Donor  
12 advised funds allow individual donors *to request* that donated funds be directed to a specific  
13 charitable cause or activity. Wakefield Dec. ¶ 19. The Foundation may agree to use the donation  
14 for purposes suggested by the donor, as long as the designated purposes of the fund and the use is  
15 consistent with the charitable and educational purposes of the Foundation. *Id.* ¶ 26. However, the  
16 Foundation's Board *at all times* exercises the ultimate and direct authority and control over such  
17 funds or property in order to assure that the purposes of the Foundation are followed. *Id.* ¶¶ 19  
18 and 25; Flatley Dec. ¶ 3. In fact the Foundation has denied contribution requests by donors on  
19 several occasions. Wakefield Dec. ¶ 18.

20  
21 Donors must apply to establish a donor advised fund. The application requires detailed  
22 information, including the desired name for the donor advised fund; fund advisor's identification  
23 information; type of funding; proposed charitable purpose(s); and successor donor advisement  
24 information. *Id.* Each donor is required to review, understand, and execute a “Fund Advisor  
25 Statement.” *Id.* The donor must certify that he/she understands the nature of donor-advised funds  
26 and will conduct activities, which satisfy the requirements of the Internal Revenue Code, and that  
27 in order to qualify for a deductible contribution, they must relinquish all ownership and custody of  
28 the donated funds and property to the donor advised fund. *Id.* The Receipt of Donation that each

1 donor receives clearly states: "your contribution must be a completed and unrestricted gift to the  
2 xelan Foundation." (Exh. B to Wakefield Dec.). Donors are informed of the requirements of the  
3 Code with respect to deductible contributions, before any distributions or charitable projects are  
4 approved by the Foundation. *Id.* The Foundation Manager reviews all applications, and a  
5 preliminary determination is made. *Id.* ¶ 25. The Application is then forwarded for review and  
6 approval by the Board of the Foundation. *Id.* ¶ 18.

7  
8 Although the Foundation maintains separate internal accounting for each donor advised  
9 fund and charitable project (described below), the monies at in the investment account *are not* in  
10 segregated accounts in the donor's name. Donated monies cannot be withdrawn by donors at any  
11 time. Donors can provide advice on investment philosophy, but all investment decisions are made  
12 exclusively by the Foundation.

13  
14 In some cases, the suggested donee is another not-for-profit organization. In other  
15 instances, the suggested donee is a local charitable activity known to the donor. For every request  
16 to have a distribution made out of a donor advised fund, the donor must submit details to the  
17 Foundation. (Wakefield Dec. ¶ 25). Prior to approving the donor's suggested donee, the  
18 Foundation takes action to insure that all expenditures are for bona fide charitable purposes. *Id.*  
19 The request must be made either by completing and submitting a Distribution Request Form or by  
20 providing other adequate, written documentation. *Id.* ¶ 24. The Foundation on several occasions  
21 has denied Distribution Requests of donors. *Id.* ¶ 25. All distributions are ultimately reviewed  
22 and ratified by the Foundation's Board. *Id.* ¶¶ 18-19.

23  
24 D. Charitable Projects

25 The Foundation's work with charitable projects was consistent with the work contemplated  
26 by a charitable contribution recognized by the Internal Revenue Code. A donor has the option of  
27 developing his/her own charitable project that may be funded by the donor's donor advised fund,  
28 provided the charitable project furthers the charitable purposes of the Foundation and is approved

1 by the Foundation. *Id.* ¶ 26. For example, a donor/doctor may establish a medical clinic in an  
2 inner city or Third World country. The donor/doctor can provide services to his/her charitable  
3 project. *Id.* The donor's expenses can be funded by the donor's donor advised fund. *Id.* The  
4 charitable contribution is the service provided to the indigent patient. *Id.* This concept was  
5 approved in the *National Foundation* case. 13 Cls. Ct. 486.

6  
7 Prior to establishing a charitable project, the Foundation ensures that the request is vetted  
8 and reviewed for approval by the Foundation Board. (Wakefield Dec. ¶ 28). If the project is  
9 approved, the donor executes an Independent Contractor Agreement. *Id.* ¶ 29. If the donor  
10 receives compensation for services provided to the project, the Foundation issues the donor a  
11 Form 1099 (for every year in which services were provided), which is filed by the Foundation  
12 with the IRS, and the donor is obligated to include that income on his/her tax return and pay  
13 income taxes thereon. *Id.* ¶ 34.

14  
15 Service providers are required to certify the services provided, such as medical and dental  
16 care, as specified on the certification sheet, free of charge with the understanding that payment  
17 would neither be required nor expected for these services. *Id.* ¶ 30. The service providers are also  
18 required to submit a Charitable Services Time Allocation Log detailing the name of the charitable  
19 project, the date and service performed, the time spent, the standard rate, and charitable amount.  
20 *Id.* ¶ 33. The Allocation Log is subject to Foundation approval. *Id.*

21  
22 The Foundation also includes a charitable gift annuity program for the donation of non-  
23 cash assets and a permanent endowment program to educational institutions none of which are  
24 challenged by the Government.

25  
26 E. Student Loans

27 The Government focuses nearly exclusively on the student loan program. The student loan  
28 program served as just one small component of the Foundations charitable efforts, and was

1 monitored and administered in a manner consistent with a charitable foundation's activities while  
2 it was in effect. Until February 25, 1999, when the program was suspended, educational student  
3 loan programs could be established by the donor advised funds, whereby students could borrow  
4 college and graduate school tuition and expenses in an area related to the Foundation's charitable  
5 purposes. (Wakefield Dec. ¶ 40). In exchange, the student was required to commit to either  
6 provide 2000 hours of pro bono services to a charitable organization or approved charitable  
7 activity for each year of tuition and expenses received or repay the funds advanced back to the  
8 Foundation, with interest, five years after their education was complete. *Id.* This program was  
9 patterned after government programs such as the United States Public Health Service  
10 Commissioned Corps, the Indian Health Service, the National Health Corporation, the National  
11 Institute of Health, the Association of American Medical Colleges and the United States Military,  
12 all of which contemplate partial repayment of loans with community service.

13  
14 To participate in the student loan program, students had to execute a Commitment  
15 Agreement and Education Expense Repayment Agreement. *Id.* ¶ 41. The Repayment Agreement  
16 charged an interest rate of 5% of unpaid principal, together with interest, thereon each year for 5  
17 years. *Id.* Thereafter, any remaining amounts of unpaid principal and interest had to be repaid at  
18 the rate of 20% of principal, together with interest each year. *Id.* The Repayment Agreement also  
19 provided for a definite repayment date. *Id.* The entire loan had to be repaid by the end of the 15<sup>th</sup>  
20 year following the original scheduled graduation date. Thus the loans were documented as  
21 financial transactions that were expected to be repaid.

22  
23 The Government has cited no law stating that a recipient of a donation cannot be related to  
24 the donor. In fact, it is quite common for board members of charities to have a personal interest in  
25 the program because, perhaps, a loved one is suffering from a disease which the charity is  
26 administering to. The board member's loved one can certainly benefit from the charity's activities  
27 without violating any statute or regulation as long as the distributions are not for a private purpose  
28



1 and recipients are not limited to those related to the donors. The student loans in this case were  
2 not limited to the children of the donors. The recipient could be any qualified student.

3  
4 Nevertheless, because the program was interfering with other charitable commitments of  
5 the Foundation, on October 15, 2002, the Board made the decision to terminate the student loan  
6 program altogether, effective January 1, 2003. Attached as Exhibit HH to the Paternoster Dec. is a  
7 copy of the Board Minutes reflecting that decision. Only 34 of the 415 donors ever participated in  
8 the program, and only 2.4% of the total contributions were distributed as student loans.  
9 (Wakefield Dec. ¶ 42).

10  
11 **III.**

12 **ARGUMENT**

13 I. **Government Has Failed To Demonstrate It Is Entitled To Preliminary Injunctive Relief**

14 The Government must satisfy a four-part test in order to obtain a preliminary injunction in  
15 the form of a freeze order under 18 U.S.C. § 1345. It must demonstrate (1) a substantial  
16 likelihood of success on the merits; (2) irreparable injury in the absence of preliminary injunctive  
17 relief; (3) absence of harm to the non-movant and to third parties from the granting of such relief;  
18 and (4) that the public interest supports the issuance of a preliminary injunction. *See United States*  
19 *v. Odessa Union Warehouse Co-op.*, 833 F. 2d 172, 174-76 (9<sup>th</sup> Cir. 1987); *United States v.*  
20 *Barnes*, 912 F.Supp. 1187, 1192-94 (N.D. Iowa 1996). Although the irreparable injury  
21 requirement is relaxed in the context of "statutory injunction" actions brought under federal  
22 statutes authorizing the Government to obtain such relief, *see Odessa Union Warehouse Co-op.*,  
23 833 F. 2d at 174-75, the United States enjoys that relaxed standard only when it has met its burden  
24 of demonstrating an ongoing fraud, or prior, or ongoing, dissipation of assets. In this case, the  
25 Government's submission falls well short in all respects.

1 A. The Government Has No Likelihood Of Success On The Merits

2 The Government has no likelihood of success on the merits of its claims under 18 U.S.C.  
3 §1345. In order to prevail in an action brought under this statute, the Government must  
4 demonstrate by a preponderance of the evidence that "a person is alienating or disposing of  
5 property, or intends to alienate or dispose of property" obtained as a result of criminal activity  
6 specified in the statute. *Id.* "The United States bears the burden of proof in establishing that fraud  
7 has been committed, and the extent of that fraud, under section 1345." *United States v. Brown*,  
8 988 F.2d 658, 663 (6<sup>th</sup> Cir. 1993); *see also United States v. Barnes*, 912 F. Supp. 1187, 1198  
9 (N.D. Iowa 1996). A freeze order under the statute may only reach assets "that might be  
10 forfeitable to the United States in the event that fraud is established at trial," *Id.* at 664. Thus, a  
11 blanket freeze order attaching to all the assets of a person or organization is not permissible, for  
12 the District Court must "**distinguish between** the proceeds of the alleged . . . fraud and **untainted**  
13 **funds**" from unrelated business activities. *Id.*, *see also United States v. Jones*, 652 F.Supp. 1559,  
14 1560 (S.D.N.Y. 1986 emphasis added)(refusing to freeze assets acquired "before the scheme  
15 alleged in the indictment came into being").

16  
17 The Government has failed to make its case for the freezing of the Foundation's assets.<sup>6</sup> It  
18 has failed to meet its burden of proof that the Foundation's assets were obtained as a result of, or  
19 are traceable to, criminal activity encompassed by § 1345. The Government has likewise failed to  
20 establish that Foundation assets are now, or are intended to be disposed of or alienated.

21  
22 B. The Government's Major Fallacy

23 This case is not like the typical case where injunctions are granted to prevent dissipation of  
24 assets. Those cases involve the freezing of money that was obtained by an illegal means — such  
25 as drug money or by defrauding investors. That is not the case here. Here ALL of the money that  
26 was contributed to the Foundation was from legal sources — money earned by doctors and

27 <sup>6</sup> Notably the Government has had 4 years to collect and present its evidence. Counsel for  
28 the Foundation has had ten days.

1 dentists. The money in the Foundation's accounts is not "dirty" money. The Government is not  
2 entitled to it as any sort of seizure or forfeiture. The Government claims that the doctors were  
3 "victims", but yet the Government seeks money from them. That is not your typical victim.  
4

5 The only issue here is whether the donors should have deducted some or all of their  
6 contributions.  
7

8 If it is adjudicated that the donor deducted more than he should have, the donor will owe  
9 the IRS money – not the Foundation. Funds in Foundation accounts belongs to the Foundation.  
10 Period. This Court cannot attach any monies of the Foundation because they are not the donor's  
11 funds and it would be only the donors who owe the IRS. Even if the Foundation lost its 501(c)(3)  
12 status, its funds would not be returned to donors. The Foundation would merely be non-exempt  
13 and pay taxes on its income. The donors have no entitlement to the Foundation's money and thus,  
14 the Foundation's money cannot be attached, or garnished to pay the debts' of the donors.  
15

16 C. The Government's Second Fallacy

17 The Government's papers allege that L. Donald Guess and various individuals working in  
18 conjunction with him established a purported tax avoidance scheme that, in essence, involved the  
19 payment of sums by medical doctors for the stated purpose of obtaining insurance, but the actual  
20 objective was unlawfully to shield those sums from income taxes. Not a single allegation is made,  
21 however, that the Foundation attempted to shield any of its own income. Nor does the  
22 Government claim the Foundation made no charitable donations. Instead, the Government  
23 isolated a small number of payments to recipients which they claim were not appropriate to justify  
24 contribution deductions by the donors.  
25

26 The total extent of the Government's allegations against the Foundation are all set forth in a  
27 small portion of Agent France's declaration ("France Dec.") (p. 50-56).  
28

1 It is not possible to discern from the Government's papers the precise volume or content of  
2 bank records or other information examined to produce this modest array of allegedly improper  
3 transactions, although Agent France does allude to the fact that "The deposits to this account are  
4 from a variety of sources." France Declaration, ¶48. He avers that records embracing the period  
5 1999 to 2004 were examined. *Id.* Assuming that account statements were issued monthly, his  
6 review would have embraced more than 60 monthly statements and hundreds of individual  
7 transactions. Yet all that is presented to this Court are contributions by 26 physicians. Even  
8 viewed most favorably to the Government, the identified sums are a tiny fraction of the total assets  
9 of the Foundation. Indeed, the 26 doctors associated with the transactions he presents comprise  
10 only 5% of the donors who contributed to the Foundation. With this paltry submission, the  
11 Government has fallen far short of meeting its burden to demonstrate that the sums in the  
12 Foundation's possession were obtained from or are traceable to predicate criminal activity  
13 encompassed by §1345.

14  
15 One of only two specific Foundation activities identified by Agent France is a student loan  
16 program in which the children of donors allegedly received financial assistance for higher  
17 education. France Dec. ¶49. The Foundation respectfully submits that for purposes of the present  
18 motion, this Court need not resolve the propriety of that program under the Internal Revenue Code  
19 (though the Foundation concedes no impropriety), for Agent France has neglected to inform the  
20 Court that as noted above, the program was suspended in 1999 and terminated in 2002, except  
21 insofar as loans then outstanding continue to be repaid. Since there is no danger of this activity  
22 continuing, no injunction is warranted.

23  
24 The second area of concern to Agent France involves payments to contributing doctors by  
25 the Foundation. In many instances, those payments have been limited to reimbursement of travel  
26 and similar expenses associated with the conduct of the Foundation's charitable work.  
27 Reimbursement is not a taxable. If, for example, a contributing doctor traveled abroad to assist in  
28 the establishment of a clinic in an impoverished, remote region, he would receive repayment of

1 expenses incurred. (Wakefield Dec. ¶ 33). The Government contends that these payments are  
2 improper, but offer no legal support for that theory.

3  
4 Even assuming arguments that all such payments to doctors were improper, they total a  
5 mere \$323,259.00 out of \$64 million in contributions. Assuming further that all student loans  
6 identified by Agent France were somehow improper—truly an indulgent assumption, since the  
7 Government offers no evidence that any educational institution were even contacted during its  
8 investigation—the total loan payments amount to \$208,558.06. Adding these two sums produces  
9 a combined total of \$531,818.00. Using the Government's proposed tax rate of 35%, the total  
10 amount in taxes the Government could claim here is \$186,136.00. Even allowing for an a 100  
11 percent penalty and interest, the total that could possibly be due strains to reach \$373,000.00.

12 That is **less than 1%** of the assets! On this slender reed, the Government asks that the  
13 Foundation's entire \$42.3 million asset base be frozen indefinitely. Freeze the 99% legitimate  
14 assets to get the 1% in dispute. Does that make sense?

15  
16 Similarly, the Government has not connected the Foundation to any of the alleged  
17 improper diversion of funds attributed to defendant David Jacquot. He is alleged to have  
18 redirected money from accounts containing sums related to various insurance products offered by  
19 other xelan entities that are separate and distinct from the Foundation. (Fance Dec. ¶¶23-33) **Not**  
20 **a single dollar is alleged to have been diverted to Mr. Jacquot from Foundation accounts.**

21 Similarly, Agent France makes **no** assertion that any Foundation charitable expenditures went to  
22 the benefit of Donald Guess. There were no questionable funds diverted into the Foundation.  
23 There was NO diversion of funds from the Foundation and the Government does not allege any.

24  
25 Conspicuous by its absence from the Government's *ex parte* submission is the fact that, as  
26 noted previously, the Foundation was approved by the IRS as a public charity under 26 U.S.C.  
27 §501(c)(3) in 1997. Five years later, or more than two years *after* the Government began its  
28 audits, the IRS gave full approval of the Foundation's status as a public charity after detailed

1 review of the contributions made to the Foundation. *Id.* And notwithstanding the undertones  
2 suggested in the Government's memorandum of law, donor-advised contributions to charities are  
3 recognized in the law. *See* 26 U.S.C. §170(b)(1)(A). Even after the IRS questioned the  
4 Foundation's charitable status, it never assessed any penalty for fraud or inaccuracy.

5  
6 Moreover, the Government has failed to demonstrate that the Foundation is engaged in or  
7 contemplating any alienation or disposal of assets that would warrant issuance of a §1345  
8 injunction, even assuming *arguendo* that the Government's general theory of the alleged fraud  
9 scheme has any merit in the first place. The Foundation is a separate and distinct entity from other  
10 Xelan corporations, as discussed earlier in this filing. L. Donald Guess currently holds no office in  
11 the Foundation, nor does he serve as a Director, nor does he receive compensation from the  
12 Foundation. (Farrington Dec. ¶¶ 3, 14; Wakefield Dec. ¶ 17). He does not own, control, or  
13 exercise any authority over Foundation funds. Those functions are performed by the Directors and  
14 officers of the Foundation. Drs. Carl Flatley, Donald Devlin, and Robert Appleman currently  
15 serve as Directors, and Drs. Flatley and Appleman also serve as President and Vice-  
16 President/Secretary, respectively. Flatley Dec. ¶ 2; Appleman Dec. ¶ 2; Devlin Dec. ¶ 2. These  
17 individuals are not implicated in any manner whatsoever in the allegedly wrongful conduct  
18 described in the Government's papers.

19  
20 Significantly, most of the funds contributed are still in the Foundation's accounts, *i.e.*  
21 \$42 million out of \$64 million. Forty-Two Million dollars have not yet been sent to any recipient.  
22 Therefore, how can the Government claim the contribution was not deductible? Is the  
23 Government psychic? If all \$42 million is distributed to qualified charities in the future, then the  
24 Government has no grounds to object, let alone attach the funds.

1 D. The Government's Meager Showing On The Merits Defeats Its Claim To A Presumption  
2 Of Irreparable Injury

3 The Government seeks to invoke the doctrine of presumed irreparable injury available in  
4 statutory injunction proceedings. Govt. Memo at 22; see *Odessa Union Warehouse*, 833 F.2d at  
5 174-75. Although courts have on occasion recognized such a presumption, e.g. *United States v.*  
6 *Barnes*, 912 F.Supp. at 1195, the Government does not acquire a right to claim it simply by filing  
7 a civil action. Rather, the Government must make a sufficient showing on the merits. Indeed,  
8 some courts have noted the relationship between the Government's showing of success on the  
9 merits and irreparable injury as a sliding scale, such that a strong submission on one may offset a  
10 weaker showing on the other. *Odessa Union Warehouse*, 833 F.2d at 176. But when the  
11 Government has not demonstrated a prospect of success on the merits, as in this case, the  
12 consequence is "no presumption."

13  
14 In the specific context of a §1345 action, the *Barnes* court noted that subsection (b) of the  
15 statute required a showing that an injunction was "warranted to prevent a continuing and  
16 *substantial* injury to the United States or to any person or class of persons." 912 F. Supp. at 1195  
17 (emphasis in original). The Government has failed to make any such showing in this case; there  
18 simply is no credible evidence that an injunction against the Foundation is required to protect the  
19 United States or any third parties. Accordingly, this factor weighs decisively against the granting  
20 of any preliminary relief.

21  
22 E. The Foundation and Third Parties Will Be Harmed By A Preliminary Injunction That  
23 Freezes All Of The Foundation's Assets

24 The exercise of this Court's equity power to order a preliminary injunction freezing *all* of a  
25 corporation's assets requires particularly careful consideration by this Court. The freezing of *all* of  
26 the Foundation's assets will harm not only the Foundation itself but it will also harm all the well-  
27 respected charities and institutions that benefit from monthly, quarterly, and annual distributions  
28 made by the Foundation. Indeed, the seizure of all of the Foundation's assets, over \$42 million,

1 by the temporary restraining order has already harmed the Foundation and its charities as the  
2 Foundation's operations have been effectively shut down. The Foundation is unable to pay all  
3 reasonable and necessary administrative and legal expenses. If the asset freeze continues, the  
4 Foundation will be denied the most fundamental elements of justice by not having legal counsel.  
5 As a result of the asset freeze, considerable harm to third parties has also occurred because  
6 charitable distributions have stopped, and no annuity payments can be made to persons who  
7 obtained annuities as part of their charitable contribution to the Foundation.  
8

9         The Local Rules of this Court states that a corporation must be represented by counsel. It  
10 cannot appear *pro se* (see D.C. Cal. L.R. 83.3(K)). Furthermore, it is well settled that a  
11 corporation has a Sixth Amendment right to be represented by counsel. *See United States v.*  
12 *Unimex, Inc.*, 991 F.2d 546 (9<sup>th</sup> Cir. 1993); *America Airways Charters, Inc. v. Regan*, 746 F.2d  
13 865, 873 (D.C. Cir. 1984); *United States v. Rad-O-Lite of Philadelphia, Inc.*, 612 F.2d 740, 743  
14 (3d Cir. 1979). Moreover, "it appears beyond sensible debate that corporations, in our society, do  
15 indeed enjoy the right to retain counsel. Corporations may not assert 'purely personal' rights but,  
16 no less than natural persons, they are entitled to due process and the equal protection of the laws."  
17 *See America Airways*, 746 F.2d at 873 (citing *Grosjean v. American Press Co.*, 297 U.S. 233  
18 (1936). Indeed, "the right to effective assistance of counsel is not so peculiarly applicable to  
19 individuals that corporations should not be entitled to it." *Rad-O-Lite of Philadelphia*, 612 F.2d at  
20 743. In fact, denying a corporation the right to retain counsel may be tantamount to stripping the  
21 corporation of its right to defend itself in court, for "it is established that a corporation, which is an  
22 artificial entity that can only act through agents, cannot proceed *pro se*." *America Airways*, 746  
23 F.2d at 873 (citing *Jones v. Niagara Frontier Transp. Auth.*, 722 F.2d 20, 22 (2d Cir. 1983).  
24 Therefore, freezing of *all* of the Foundation's assets effectively strips the Foundation from the  
25 ability to retain counsel for its defense. The Government should not be allowed to artificially  
26 increase its chances of winning a case by merely eliminating the opposition. We have an  
27 adversary system. The court must hear from the defense in order to meet the needs of due process.  
28



1           In *United States v. Unimex*, a corporation in the business of exchanging Mexican pesos for  
2 dollars, transmitting funds abroad for thousands of customers, and operating a travel agency, was  
3 convicted of conspiring to launder drug money at trial without being represented by legal counsel.  
4 *Id.* at 547. All of Unimex's assets had been seized prior to the trial, and the United States District  
5 Court for the Central District of California denied Unimex's motion seeking a release of some of  
6 its untainted money for its legal defense without deciding whether the business was entirely,  
7 partially, or not legitimate. *Id.* Unimex's motion was supported with an affidavit from one of its  
8 30 employees demonstrating that much or all of its assets were untainted and that Unimex engaged  
9 in lawful activities for thousands of legitimate customers. *Id.* at 550. The government's affidavit,  
10 which was submitted *ex parte* in support of the seizure of all of Unimex's assets, broadly stated  
11 that Unimex in its entirety was a front for money laundering. *Id.* The Ninth Circuit held that the  
12 denial of Unimex's motion effectively meant that Unimex could not defend itself. Accordingly,  
13 the Ninth Circuit reversed the conviction against Unimex because taking away all of its property  
14 violated its right to counsel under the Sixth Amendment and denied it an opportunity to present its  
15 evidence to the district court that some if not all of its money and assets were untainted violated its  
16 right to due process under the Fifth Amendment. *Id.* at 551.

17  
18           The Ninth Circuit's decision in *Unimex* is instructive, for in the present case the  
19 government has broadly asserted that **all** of the Foundation's assets are tainted and that **all** of the  
20 Foundation's assets should be frozen. If the Foundation is unable to use its own funds to hire its  
21 attorneys, it will confront the untenable prospect of having no legal representation whatsoever. As  
22 the Ninth Circuit noted in its decision, counsel is essential for a corporation because a corporation  
23 cannot appear in any action or proceeding pro se. *Id.* at 549. The Southern District of California  
24 Civil Local Rules also state that "whenever a corporation desires or is required to make an  
25 appearance in the Southern District, the appearance shall be made only by an attorney of the bar of  
26 this court or an attorney permitted to practice pursuant to Civil Local Rule 83.3." *See* S.D.Cal.L.R.  
27 83.3(k). The Supreme Court also noted "it has been the law for the better part of two centuries, for  
28 example, that a corporation may appear in the federal courts only through licensed counsel."

1 *Rowland v. California Men's Colony*, 506 U.S. 194, 201-202 (1993)(citing a long line of cases  
2 from several circuits holding that a corporation may only be represented by licensed counsel).

3  
4 Like Unimex, the Foundation is left with no recourse if *all* of its assets remain frozen.  
5 First, the Foundation cannot hire legal counsel on a contingency basis to defend the current action  
6 and any forthcoming criminal investigation and potential trial, because to do so would violate  
7 California's ethical rules. See *Caplin & Drysdale v. United States*, 491 U.S. 617, 632 n. 10  
8 (1989)("contingent fees in criminal cases are generally considered unethical") and *Unimex*, 991  
9 F.2d at 551 (citing Cal.R.Prof.Conduct 4-200(A)). Second, the Foundation cannot be appointed  
10 legal counsel because neither the Criminal Justice Act nor the Sixth Amendment provide for  
11 appointment of legal counsel for corporations who cannot retain counsel on their own. See  
12 *Unimex*, 991 F.2d at 551. Given that no one may represent the Foundation in any proceeding or  
13 action in the Southern District of California other than its own legal counsel, the Foundation must  
14 have the ability to use its own assets to hire legal counsel or go unrepresented throughout the  
15 investigation and potential trial. If this were to occur, the Ninth Circuit has held that the denial of  
16 the right to counsel at trial never constitutes harmless error. See *Id.* (citing *United States v. Bohn*,  
17 890 F.2d 1079, 1082 (9<sup>th</sup> Cir. 1989).

18  
19 Besides being prevented from hiring its own legal counsel, the Foundation is unable to run  
20 its operations because it cannot pay any reasonable and necessary administrative expenses and is  
21 unable to continue any of its lawful charitable activities. These charity programs are not  
22 challenged by the IRS and are completely lawful will suffer harm by the total freeze of the  
23 Foundation's assets. For the past seven years, the Foundation has made lawful distributions to a  
24 number and a variety of charitable organizations including churches, hospitals, medical schools,  
25 universities, YMCA's, and hospice organizations, among others. In particular, the Foundation has  
26 donated approximately \$11 million to other Section 501(c)(3) organizations, many of which are  
27 well-respected, charities or institutions, including but not limited to: Campus Crusade for Christ;  
28 Brown University; St. Mary's Hospital; Boys & Girls Club; Creighton University; Boy Scouts of

1 America; Medical College of VA; Leukemia & Lymphoma Society; Duke University Medical  
2 Center; Food for the Poor, Inc.; Cornell University; and the Juvenile Diabetes Research  
3 Foundation. (Wakefield Dec. ¶ 11).

4  
5 These charities, among others, benefit from distributions made by the Foundation,  
6 however, the total asset freeze of over \$42 million has shut down the Foundation's operations and  
7 stopped all charitable contributions and distributions. The following are just two examples of real  
8 meaningful charitable ends that have come to a halt because of the restraining order.

9  
10 Dr. Donald Hedrick has a Foundation donor advised fund that demonstrates the benefits of  
11 such a fund. Hedrick Dec. ¶ 3. Through the donor advised fund, Dr. Hedrick has helped  
12 impoverished children in Russia through donations via Whittier Hills Baptist Church to a school in  
13 Russia. *Id.* ¶ ¶ 3,5. The school currently has a \$30,000 annual budget, which includes the costs of  
14 teacher salaries, taxes, maintenance, books, and supplies. *Id.* ¶ 14. The fund currently provides  
15 \$24,000 of the \$30,000 needed by the school to operate. *Id.* ¶ 15. If the funds remain frozen, Dr.  
16 Hedrick believes the school would have to close its doors within approximately three months. *Id.*

17  
18 Beyond the potential closure of the school for impoverished children in Russia, however,  
19 are the thirty-five monthly distributions that will be halted including donations to the Cala Figuera  
20 Foundation, Wycliffe Bible Translators, Gospel Rescue Mission, Grace United Methodist Church,  
21 The Navigators Ministry, Faith Family Baptist Church, St. Elizabeth Ann Seton Church, World  
22 Vision Foundation, Mom-In-Touch International, Campus Crusade for Christ, Greater Europe  
23 Mission, Food for the Poor, AIM International, Mercy Ships, Children In Need, Inc., among  
24 others. Distributions that will be stopped by the asset freeze include donations to the Hospital  
25 Chaplain's Ministry of America, Inc., OC international, Whittier Baptist Church, Association of  
26 Christian Schools, among others. In addition to the monthly and quarterly distributions that will  
27 be stopped by the asset freeze, there are a thirty-three annual payments by the Foundation that will  
28 also be in jeopardy such as annual donations to the Habitat for Humanity, Santa Maria Catholic

1 Church, Diocese of Pueblo BDF Fund, Mobile Symphony Inc., Glendale Community College,  
2 United Way, among others. A number of third party organizations that rely on monthly, quarterly,  
3 and annual donations from the Foundation will be harmed by the blanket asset freeze.

4  
5 As stated earlier, the Foundation offers charitable gift annuities, which are unassailable.  
6 Yet, with all of the Foundation's assets frozen, no monthly, quarterly, or annual annuity payments  
7 to persons who obtained annuities as part of their charitable contribution to the Foundation are  
8 being made. (Flatley Dec. ¶ 7). An example in real human terms is that of widow Janet Burgess  
9 who relies on the monthly gift annuity payments of \$979.88. (Burgess Dec. ¶ 3). Ceasing annuity  
10 payments to Mrs. Burgess and others clearly would be a hardship for donors and their families.  
11 (Flatley Dec. ¶ 7). Moreover, the IRS has not alleged any wrongdoing with respect to the  
12 Foundation's numerous permanent endowments, which have been established for the benefit of  
13 educational, medical, and state institutions, yet the Foundation is unable to continue with its  
14 efforts to promote the endowment program. Mr. Flatley explains that he initially setup an  
15 endowment for the dental society. *Id.* ¶ 9. After the death of his daughter, he changed the focus  
16 of his endowment to fight against sepsis. The endowment account currently holds approximately  
17 \$28,000.00 in cash and two \$1 million life insurance policies to be used to research and fight  
18 sepsis. *Id.* Hence, the church, the Russian child, who needs reconstructive surgery, these not for  
19 profit organizations, persons owed annuity payments, and endowment programs will all be harmed  
20 as long as the asset freeze continues.

21  
22 The Government has only pointed to very few aspects of the Foundation such as the  
23 terminated Student Loan Program in which most of the donors of the Foundation never  
24 participated. Undeniably, the district court may only freeze those assets related to the alleged  
25 fraud that might be forfeitable to the United States in the event that a fraud is established at trial.  
26 *See U.S. v. Brown*, 988 F2d at 664 (remanding decision where district court inappropriately froze  
27 all of the defendant's funds held at any financial institution except for an allowed withdrawal of  
28 \$10,000 per month for business expenses when the district court failed to distinguish between the

1 proceeds from the alleged Medicare fraud and untainted funds from the seventy-five percent of the  
2 defendant's business that was unrelated to the government's claims). Moreover, an injunction that  
3 freezes all of the Foundation's assets at this stage would serve as a punitive measure instead of a  
4 protective measure. Accordingly, an injunction that freezes all of the Foundation's assets is  
5 wholly unwarranted. It would deny the Foundation its right to retain counsel and force the  
6 termination of a number of charitable activities and distributions that benefit numerous individuals  
7 and organizations.

8  
9 F. The Public Interest Weighs Heavily Against Issuance Of An Injunction

10 Clearly, the public interest will not be best served by issuing an injunction and a freeze of  
11 *all* of the Foundation's assets in this instance, given that the government has been unable to link  
12 much if any of the Foundation's assets to the fraudulent tax scheme allegations. Here, the public  
13 interest in maintaining the Foundation's operations clearly outweighs the government's interest in  
14 freezing all of the Foundation's assets because even the Government's own evidence, the  
15 Foundation only amounts to a very small percentage of the total alleged scheme. Indeed, within  
16 the last seven years, the IRS has twice reviewed and certified the Foundation as a 501(c)(3)  
17 charitable organization.<sup>7</sup>

18  
19 Certainly, with the miniscule evidence provided by the Government with respect to any  
20 alleged improper activity by the Foundation, terminating all of these meaningful charitable  
21

22  
23 <sup>7</sup> Although this Court has been provided with many examples of the Foundation's work, it is  
24 important to note the Foundation's funding to the National Foundation for Dentistry of the  
25 Handicapped ("NFDH") and the many donor advised funds that exist. (Coffee Dec. ¶ 7).  
26 The Foundation's funding to the NFDH helped save a very important free dentistry  
27 program for the handicapped in the United States. *Id.* ¶¶ 2,7. The fact that approximately  
28 11,700 dentists volunteer their time to provide dentistry to the handicapped in the United  
States. *Id.* ¶ 2. The Foundation's contribution paved the way for the dental program's  
national expansion so that disabled persons in all fifty states and the District of Columbia  
can be connected with dentists willing to provide volunteer dental services. *Id.* ¶ 8. Five  
donors to the Foundation contributed a total of \$250,000 to the NFDH and thereby "saved  
the program." *Id.*

1 projects through the issuance of an injunction and freeze order is completely at odds with serving  
2 the public interest.

3  
4 II. Should The Court Nevertheless Be Inclined To Issue A Preliminary Injunction, It Should  
5 Apply To Only A Limited Portion Of The Foundation's Assets

6 Should the Court determine, notwithstanding the foregoing, that a preliminary injunction  
7 in the form of a freeze order is warranted, that order should apply only to a limited portion of the  
8 Foundation's assets. As discussed above, the Government's evidence identifies only a tiny portion  
9 of Foundation transactions, out of all those reviewed, that are questionable. There is no basis in  
10 law to tie up the entirety of the assets of a going charitable concern on such scant evidence. Even  
11 if the Court concluded somehow that the IRS had a right to attach the assets of the Foundation to  
12 satisfy the debts of the donors, the allegations presented could be more than satisfied with a  
13 "freeze" of \$500,000. Those funds could be held in escrow or in the Court Registry. There is no  
14 need for a Receiver to maintain those funds if they are in an escrow controlled by Court Order.  
15 Such an order also accommodates the significant concerns described above that indispensable  
16 charity work continue and that the Foundation have legal counsel in ongoing proceedings.

17  
18 IV.

19 CONCLUSION

20 For all of the foregoing reasons, the Foundation respectfully submits that the Order To  
21 Show Cause should be discharged and that the motion of the United States for a preliminary  
22 injunction, an order freezing assets, appointing a temporary receiver and mandating an accounting  
23 should be denied.

24 DATED: November 19, 2004

25  
26 By



PAMELA J. NAUGHTON

FRANK J. JOHNSON

Attorneys for xélan Foundation, Inc.

3  
4 PROOF OF SERVICE

5 STATE OF CALIFORNIA, COUNTY OF SAN DIEGO

6 I am employed in the County of San Diego; I am over the age of eighteen  
7 years and not a party to the within entitled action; my business address is 12544 High Bluff  
8 Drive, Suite 300, San Diego, CA 92130-3051.

9 On November 19, 2004, I served the following documents described as:

10 SEE ATTACHMENT

11 on the interested party(ies) in this action by placing true copies thereof enclosed in sealed  
12 envelopes and/or packages addressed as follows:

13 SEE ATTACHMENT

14  BY EMAIL. VIA MAIL UPON REQUEST

15  BY MAIL: I am "readily familiar" with the firm's practice of collection and  
16 processing correspondence for mailing. Under that practice it would be deposited  
17 with the U.S. postal service on that same day with postage thereon fully prepaid at  
18 San Francisco, California in the ordinary course of business. I am aware that on  
19 motion of the party served, service is presumed invalid if postal cancellation date or  
20 postage meter date is more than one day after date of deposit for mailing in  
21 affidavit.

22  BY OVERNIGHT DELIVERY: I served such envelope or package to be delivered  
23 on the same day to an authorized courier or driver authorized by the overnight  
24 service carrier to receive documents, in an envelope or package designated by the  
25 overnight service carrier.

26  BY FACSIMILE: I served said document(s) to be transmitted by facsimile  
27 pursuant to Rule 2008 of the California Rules of Court. The telephone number of  
28 the sending facsimile machine was 858-509-3691. The name(s) and facsimile  
machine telephone number(s) of the person(s) served are set forth in the service list.  
The sending facsimile machine (or the machine used to forward the facsimile)  
issued a transmission report confirming that the transmission was complete and  
without error. Pursuant to Rule 2008(e), a copy of that report is attached to this  
declaration.

BY HAND DELIVERY: I caused such envelope(s) to be delivered by hand to the  
office of the addressee(s).

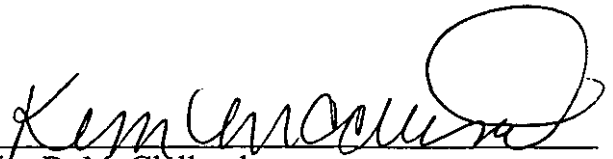
STATE: I declare under penalty of perjury under the laws of the State of California  
that the foregoing is true and correct.

FEDERAL: I declare that I am employed in the office of a member of the bar of  
this Court at whose direction the service was made. I declare under penalty of

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on **November 19, 2004**, at San Diego, California.

  
\_\_\_\_\_  
Kim B. McClelland



**Service List Attachment to Proof of Service**

November 19, 2004

Darrell Hallett  
John Colvin Chicoine & Hallett  
1011 Western Ave., Ste. 803  
Seattle, WA 98117

Michael Lipman  
Barbara Murray  
Coughlan, Semmer & Lipman, LLP  
501 West Broadway, Ste. 400  
San Diego, CA 92101-3564

**Counsel for Donald Guess  
xelan Investment Services, Inc.  
xelan Annuity Co. Ltd.  
xelan Administrative Services, Inc.**

Thomas Pollack  
Irell & Manella LLP  
1800 Avenue of the Stars, Ste. 900  
Los Angeles, CA 90067-4276

**Counsel for Doctor's Benefit Insurance Company  
Monte Mellon  
Doctor's Benefit Holding Company**

Jim Frush, Esq.  
Gordon Thomas Honeywell  
One Union Square  
600 University, 21<sup>st</sup> Floor  
Seattle, WA 98101

**Counsel for David Jacquot**

Miriam Fisher, Esq.  
James Mastracchio  
Morgan, Lewis, Bockius, LLP  
1111 Pennsylvania Ave., NW  
Washington, DC 20004

**Counsel for Les Buck  
G. Thomas Roberts  
Doctor's Insurance Services, Inc.**

Bruce Zagaris  
Berliner Corcoran & Rowe  
1011-17<sup>th</sup> Street NW, Ste. 1100  
Washington, D.C. 20036-4798

**Counsel for Chris Evans**

**United States of America, v. L. Donald Guess, et al., United States District Court for the Southern District of California, Case No. 04-cv-2184 LAB (AJB)**

**Attachment to Proof of Service**

November 19, 2004

Response of Xélan Foundation, Inc. to Order to Show Cause

Declaration of Robert Appleman

Declaration of Janet Burgess

Declaration of Larry Coffee

Declaration of Donald Devlin

Declaration of John Farrington

Declaration of Carl Flatley

Declaration of Donald Hedrick

Declaration of Holly Paternoster

Declaration of Sheryl Wakefield

Xélan, the Economic Association of Health Care Professionals, Inc.'s Joinder in Memoranda of Points and Authorities in Response and Opposition File by L. Donald Guess, Xélan Investment Services, Inc., Xélan Annuity Company, Inc., Xélan Administrative Services, Inc., and Xélan Foundation, INC.