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8
9 UNITED STATES DISTRICT COURT
10 SOUTHERN DISTRICT OF CALIFORNIA

11
12 SECURITIES AND EXCHANGE
COMMISSION,

13 Plaintiff,

14 v.

15 TUCO TRADING, LLC and
16 DOUGLAS G. FREDERICK,

17 Defendants.

Case No. 08-CV-00400 DMS (BLM)

**FIRST INTERIM APPLICATION FOR
APPROVAL AND PAYMENT OF FEES
AND COSTS TO THOMAS F. LENNON,
RECEIVER**

Date: November 7, 2008

Time: 1:30 p.m.

Ctrm: 10

Judge: Hon. Dana M. Sabraw

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21 Thomas F. Lennon (the "Receiver"), the Court-appointed permanent receiver for Tuco
22 Trading, LLC ("Tuco"), submits his first interim application for approval and payment of fees and
23 reimbursement of expenses. This application covers fees and costs incurred during the period
24 March 3, 2008, through June 30, 2008 (the "Application Period").

25 Thomas Lennon incurred \$71,281 in fees and \$335.13 in costs for this Application Period,
26 and seeks interim approval and payment on an interim basis of \$57,024.80 in fees and \$335.13 in
27 costs. Detailed descriptions of the services rendered are contained in Exhibit A attached hereto.

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1 **I. PROCEDURAL BACKGROUND**

2 On March 4, 2008, the Securities and Exchange Commission ("SEC") filed its Complaint
3 and Ex Parte Motion for Temporary Restraining Order and Orders: (1) Freezing Assets;
4 (2) Appointing a Temporary Receiver; (3) Requiring Accountings; (4) Prohibiting the Destruction
5 of Documents, (5) Granting Expedited Discovery; and (6) Order to Show Cause re Preliminary
6 Injunction and Appointment of a Permanent Receiver. On March 5, 2008, the Court issued a
7 Temporary Restraining Order and Orders: (1) Appointing a Temporary Receiver; (2) Requiring
8 Accountings; (3) Prohibiting the Destruction of Documents, (4) Granting Expedited Discovery;
9 and (5) Order to Show Cause re Preliminary Injunction and Appointment of a Permanent Receiver
10 ("TRO"). The Receiver, the SEC and the Defendants sought clarification of the TRO, which was
11 provided in the Court's Supplement to the TRO ("Supplement"), entered on March 6, 2008.

12 The TRO and Supplement appointed the Receiver as temporary receiver with limited
13 powers. The Receiver was granted access to the company, but Tuco was permitted to continue
14 operations in the ordinary course of business. The Supplement also restricted the ability of
15 Members to withdraw funds.

16 On March 6, 2008, trading activity at Tuco was halted when Penson terminated clearing
17 service to Tuco's main broker accounts. Members were only permitted to issue liquidating orders
18 from that point forward. The Court held telephonic hearings on March 7 and March 10, 2008 to
19 address this change in circumstances. At those hearings, it was determined that Tuco could
20 continue to operate on a limited basis until the Receiver could provide an initial accounting and
21 the parties could brief the Order to Show Cause re Preliminary Injunction.

22 On March 11, 2008, Douglas Frederick and Tuco filed financial statements as required
23 under the TRO and Supplement ("Financial Statements"). On March 14, 2008, the SEC filed the
24 Consents of Tuco and Frederick, and a Joint Motion for Judgment as to Defendants Tuco and
25 Frederick and Orders: (1) Freezing Tuco's Assets, (2) Appointing a Permanent Receiver for Tuco;
26 and (3) Prohibiting the Destruction of Documents ("Judgment"). The Court entered the Judgment
27 on March 17, 2008.

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1 On March 19, 2008, in response to the Receiver's application, the Court entered an Order
2 in Aid of Receivership: (1) Allowing Notice by Email to Members; (2) Providing that
3 Commissions Earned or Payable to Frederick are Property of the Receivership Estate;
4 (3) Authorizing the Receiver to Enter into a Temporary Transaction with GLB Trading, Inc.; and
5 (4) Granting Ancillary Relief ("Order in Aid"). The Order in Aid provides, among other things,
6 that the Receiver's initial report may be filed in conjunction with the accounting due under Part
7 VIII.E. of the Judgment, and that interim reports shall be filed by the Receiver approximately
8 every 120 days thereafter.

9 On May 1, 2008, the Receiver applied for approval of a sale of Tuco's office furniture and
10 equipment to Frederick for \$21,000. The Court entered an order approving the sale on May 5,
11 2008.

12 On May 15, 2008, new counsel representing Frederick filed a Stipulation for Substitution
13 of Counsel ("Stipulation"). The Stipulation states that Frederick's new counsel is substituted as
14 counsel of record for Tuco and Frederick. With the assistance of Allen Matkins, the Receiver
15 contacted Frederick's new counsel and advised that Frederick's former counsel was not employed
16 by the Receiver or Tuco at any time after entry of the Judgment. The Stipulation is therefore
17 improper to the extent that Frederick's new counsel purports to represent Tuco.

18 On May 19, 2008, new counsel for Frederick, again purporting to represent Tuco, filed a
19 Notice of Appeal of the Judgment ("Notice of Appeal"). On May 29, 2008, the Ninth Circuit
20 Court of Appeals issued a Time Schedule Order for the appeal that was entered on this Court's
21 docket. As of the filing of this report, Frederick has not sought a stay of the Judgment pending
22 appeal or filed any other papers with the Court of Appeals.

23 On June 2, 2008, the Receiver filed his First Interim Report ("First Report"), including a
24 Preliminary Accounting of Tuco provided by the Receiver's forensic accountant, William Ling,
25 and 27 detailed exhibits thereto. The 26-page First Report was approved by order entered on
26 July 17, 2008.

27 On July 10, 2008, the Receiver filed a Motion for Order Authorizing an Interim
28 Distribution. The motion requested that the Receiver be authorized to distribute 40% of member

1 account balances and 40% of amounts owed to creditors according to Tuco's books and records.
2 The motion also requested that the Receiver have discretion to reserve some or all of an interim
3 distribution if there were unresolved issues pertaining to member or creditor accounts, or a
4 relationship existed between the parties other than as member of the LLC or creditor of the
5 company. The motion was granted by order entered on July 24, 2008.

6 On July 29, 2008, GLB submitted a Statement of Claim against Frederick, Tuco and the
7 Receiver, in his capacity as receiver for Tuco Trading, to the Financial Industry Regulatory
8 Authority ("FINRA") requesting arbitration of the Receiver's dispute with GLB regarding GLB's
9 exercise of recoupment against property of the receivership estate (commissions earned by
10 Frederick). The dispute arises from GLB's deduction of more than \$540,000 in legal fees and
11 related costs from commissions otherwise payable to the receivership estate. Shortly, the Receiver
12 will seek relief from this Court regarding the Statement of Claim which, among other things,
13 violates 28 U.S.C. § 959, requiring parties intending to initiate proceedings against a receiver to
14 obtain leave of the appointing court before doing so. The Statement of Claim and request for
15 arbitration should be stayed by the Court for this and other reasons.

16 **II. RECEIVER'S ACTIVITIES**

17 The Receiver's services during the Application Period are categorized and described in
18 detail further below. This application should be read in conjunction with the Receiver's First
19 Interim Report, which details the Receiver's activities through June 2, 2008. The following is a
20 summary of those activities, updated through June 30, 2008:

21 **A. Employment of Professionals**

22 Pursuant to authority granted under Section VIII of the Permanent Injunction Order, the
23 Receiver retained the law firm of Allen Matkins Leck Gamble Mallory & Natsis LLP ("Allen
24 Matkins") to represent him in this matter, including in connection with discovery and investigation
25 efforts, as well as potential recovery and avoidance actions to recover assets and funds for the
26 benefit of the receivership estate and its creditors.

27 The Receiver retained William H. Ling, Certified Public Accountant ("Ling"), to conduct a
28 forensic accounting analysis of Tuco and to perform whatever other accounting services are

1 necessary and appropriate. Finally, the Receiver retained the services of Investigative
2 Technologies LLC ("IT") as information and technology consultants to assist in the preservation,
3 organization, and analysis of electronic data.

4 **B. Securing of Premises**

5 Immediately after his appointment, the Receiver took control of the La Jolla office space.
6 The Receiver determined that it was in the best interest of the estate and its creditors to maintain
7 the La Jolla office for a short period of time. The Receiver terminated the lease effective May 10,
8 2008. Tuco also subleased office space in Chicago and Dallas. Those leases were terminated by
9 the Receiver in April and May 2008 respectively.

10 **C. Recovery of Assets and Electronic Data**

11 With respect to the cash assets of Tuco, the Receiver opened an interest-bearing, money
12 market account at California Bank & Trust for the receivership estate, closed the bank and broker
13 accounts of Tuco, and had the balances wired to the receivership account. Tuco had servers
14 located in La Jolla and Dallas that supported the back office system ("Titans System"). Tuco also
15 had a website supported by a server in La Jolla. IT took an initial and final image of the servers
16 supporting the Titans System. IT also imaged the website server. These servers were all wiped
17 (i.e. all data erased) before being turned over to Frederick in connection with the sale.

18 **D. Gathering of Documents and Witness Interviews**

19 The Receiver gathered information from Frederick and Tuco, Tuco's former employees
20 and independent contractors, GLB Trading, Tuco's other broker-dealers, Penson, NYFIX,
21 Alchemy Ventures, LLC, and various Tuco members and creditors. The process of interviewing
22 and gathering documents from these various persons and entities is discussed in considerable
23 detail in the First Interim Report.

24 **E. Winding Down the Business**

25 As noted above, all trading activity stopped immediately after the Receiver was appointed
26 as temporary receiver. Market positions held by various Tuco members remained open, however.
27 These positions were ultimately liquidated by the members that held them and the Receiver by
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1 issuing an instruction to GLB. As noted above, the office leases were terminated, as were the
2 company's employees. The company furniture and equipment was sold to Frederick for \$21,000.¹

3 **F. The Receiver's Website**

4 Prior to the Receiver's appointment, Tuco maintained a website at www.tucotrading.com.
5 On March 12, 2008, the Receiver created a webpage for this case at his website, www.tflinc.com.
6 After entry of the Judgment, the Receiver caused the Tuco website to be shut down and redirected
7 all traffic to his website. The webpage for this case at the Receiver's website includes the TRO,
8 Supplement, Judgment, Order in Aid, Notice of Appeal, First Report, Order Authorizing Interim
9 Distribution, Distribution Form and other notices to investors, all of which can be viewed and
10 printed. The Receiver will continue to update the SEC v. Tuco Trading page on his website with
11 all pertinent Receiver's Reports, Court filings and Orders.

12 **G. Communications with Members**

13 The Receiver has sent various notices to members and creditors advising them of the status
14 of the case and pending motions. The Receiver has instructed all members to update their email
15 addresses with his office should they change. The Receiver's staff has maintained and updated a
16 Member email list and creditor mailing list. The Receiver, with the assistance of his staff and
17 Allen Matkins, has also returned numerous telephone calls and emails from Tuco members and
18 creditors.

19 **III. FEES**

20 The Receiver has incurred a total of \$71,281.00 in fees during this Application Period.
21 Time records for the Receiver and his staff are attached hereto as Exhibit A. A summary of the
22 time and fees organized by timekeeper is attached hereto as Exhibit B. The Receiver has
23 organized his services into the following categories:²
24

25 _____
26 ¹ The \$21,000 payment from Frederick had not been received as of the filing of the First Interim
27 Report. Since that time, the full payment was received from Frederick.

28 ² While every effort is made to be consistent and accurate in the allocation of activities to the
various categories, certain activities may lend themselves to more than one category, or may
simply be difficult to categorize. Nevertheless, Exhibit A reflects the actual time spent on any
given activity and an accurate description of the services provided.

- 1 (1) Accounting and Cash Management;
- 2 (2) Business Operations;
- 3 (3) Claims Administration Creditor;
- 4 (4) Claims Administration Investor;
- 5 (5) Fee Applications;
- 6 (6) General Receivership Matters;
- 7 (7) Investor Creditors;
- 8 (8) Sale of Assets;
- 9 (9) Tax Issues; and
- 10 (10) Trade Creditors/Vendors.

11 A summary of the Receiver's fees organized by category is attached hereto as Exhibit C.
12 The following is a description of the Receiver's services by category for this Application Period:

13 **A. Accounting and Cash Management**

14 The Receiver's time spent closing Tuco's bank and brokerage accounts, setting up the
15 receivership bank accounts, and having the balances wire transferred is included in this category.
16 Also included is time spent monitoring, handling and processing deposits and disbursements from
17 the receivership accounts. The Receiver processed payroll, including the necessary payroll tax
18 filings, for the period of time post-receivership that the former employees and independent
19 contractors remained employed. Several checks had been written on the Tuco accounts but not yet
20 deposited when the Receiver was appointed, which checks had to be handled by the Receiver. The
21 Receiver also monitors the receivership accounts and maintains summaries of cash activity. Such
22 summaries were included as Exhibit B to the First Report. All services relating to these matters
23 are included in this category.

Hours	Fees	Average Billing Rate
64.5	\$10,455.00	\$162

1 **B. Business Operations**

2 Time in this category includes handling specific issues related to processing payroll for the
3 former Tuco employees and independent contractors during their post-receivership employment,
4 including taking steps to notify the former employees and independent contractors of a duplicate
5 payroll issued inadvertently by payroll processor ADP, and taking corrective action regarding the
6 same. The information ADP had regarding the location of one Tuco employee in Texas was
7 inaccurate and also required correction.

8 This category also covers the termination of the former employees and independent
9 contractors, including processing their final payroll and cash out of unused vacation time.

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Hours	Fees	Average Billing Rate
20.9	\$3,135.00	\$150

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13 **C. Claims Administration Investor**

14 This time relates to drafting the distribution request form to be used by investors in
15 connection with the Interim Distribution Motion.

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Hours	Fees	Average Billing Rate
.2	\$30.00	\$150

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19 **D. Fee Applications**

20 This time relates to planning and preparing this fee application.

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Hours	Fees	Average Billing Rate
.2	\$30.00	\$150

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24 **E. General Receivership Matters**

25 This category includes the services of the Receiver and his staff in gaining an
26 understanding of Tuco's business, securing the company's assets, winding down the business,
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1 recovering, organizing and reviewing records, investigating claims, and reporting to the Court on
2 his activities.

3 As discussed in the First Report, Tuco Trading was a day trading firm with many
4 members, creditors, service providers, lenders, affiliated persons and other complex relationships.
5 The volume of shares traded through its accounts was tremendous, all of which was done in
6 automated format, using sophisticated electronic trading platforms and tracking software.
7 Immediately after the Receiver's temporary appointment, all of this automated trading activity
8 stopped when Penson terminated clearing services to Tuco's accounts. To further complicate
9 things, the books and records of the company were in poor condition and many key documents
10 were not kept by Tuco or Frederick. Finally, with an Order to Show Cause re Preliminary
11 Injunction pending, the Receiver needed to be able to advise the Court regarding his preliminary
12 findings in a very short period of time.

13 Accordingly, the Receiver devoted substantial time during the first few weeks of the case
14 to, among other things, (a) reviewing case filings and attending hearings, (b) learning how the
15 business operated, (c) understanding the various relationships, (d) interviewing Frederick and
16 Tuco's former employees, (e) obtaining and reviewing documents, accounting records and other
17 financial information, (f) evaluating Tuco's assets and liabilities, (g) taking preliminary steps to
18 preserve such assets and minimize liabilities, and (h) preparing to advise the Court regarding his
19 preliminary findings. All of these services are included in this category.

20 Ultimately, Tuco and Frederick consented to judgment and the Order to Show Cause
21 hearing was taken off calendar. The Judgment, which appointed Mr. Lennon as permanent
22 receiver, was entered on March 17, 2008. From that point forward, the Receiver focused his
23 efforts on implementing the Judgment, including providing notice thereof to banks, brokerage
24 firms, service providers, creditors and members, and taking necessary steps to obtain compliance
25 therewith. The Receiver analyzed the best way to minimize short-term operating expenses and
26 determined that use of the Tuco offices in La Jolla would serve that goal for the first
27 approximately 60 days of the receivership. The Receiver negotiated the terms of a transaction
28 whereby GLB would assume the rent and employee salaries for a short period of time while

1 making the employees and offices available to the Receiver. After the terms were negotiated and
2 the proposed agreement was drafted, GLB elected not to enter into the transaction.

3 The Receiver inventoried the records located at the Tuco offices and requested missing
4 records from the applicable banks, broker-dealers and other parties in possession of them. The
5 Receiver set a deadline for members to liquidate remaining market positions and advised them of
6 the same. Positions that were not liquidated by members as of the deadline were liquidated by the
7 Receiver by instruction to GLB. The Receiver accommodated the request of one member to
8 transfer a stock position out of the Tuco accounts to another broker account in his name in
9 exchange for a payment in the amount of the market value of the position at the time of the
10 transfer. The Receiver supervised the former employees and independent contractors in
11 reconciling and making the appropriate adjustments to the back office trader accounts in
12 connection with the liquidation of remaining positions.

13 With the landlord's permission, the Receiver changed the locks at the La Jolla offices to
14 secure the equipment and furniture located there. Certain members that used the Tuco offices to
15 conduct their trading activity had brought in desk and computer equipment. The Receiver
16 arranged to have this non-Tuco equipment and furniture removed from the office space by its
17 owners.

18 The Receiver terminated the office leases in La Jolla, Chicago and Dallas, and also
19 terminated the employment of the former employees and independent contractors. The Receiver
20 met with the former employees and independent contractors, and handled all issues pertaining to
21 their termination.

22 The Receiver consulted with Allen Matkins, Ling and IT regarding legal, accounting and
23 data analysis issues. He investigated various aspects of the company's operations, assets of the
24 receivership estate and potential claims for recovery of the same, including consulting with Ling
25 and Allen Matkins regarding the unpaid commissions owed from GLB, participating in calls with
26 Penson, researching Tuco's use of the Shiller, LLC account at Southwest Clearing, and consulting
27 with Investigative Technologies regarding the unresolved NYFIX charges. The Receiver has also
28 conducted a preliminary investigation into certain related parties and monies they received from

1 Tuco. The Receiver assisted in providing information contained in the First Report and consulted
2 with Allen Matkins regarding the same before the report was filed.

3 The time spent by the Receiver and his staff on all of the above tasks and matters is
4 included in this category.

Hours	Fees	Average Billing Rate
154.4	\$34,916.00	\$226

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8 **F. Investor Creditors**

9 The bulk of the services in this category is responses to emails and calls from Tuco
10 members regarding any and all aspects of the case, the asset freeze, their accounts, their dealings
11 with Tuco and/or Frederick, liquidation of open positions, distributions from the estate, and other
12 specific issues. These calls and emails are received everyday and, as laid out in the detailed
13 billing records attached hereto as Exhibit A, the Receiver's staff promptly responds to each
14 inquiry. Also included is time spent maintaining and updating the member contact list, and
15 recording withdrawal requests from members received early in the case. Members were given
16 email notice by the Receiver of motions and other pleadings filed with the Court. The Receiver's
17 time spent sending mass emails to members and maintaining his website for the case is also
18 included herein.

Hours	Fees	Average Billing Rate
92.5	\$16,610.00	\$180

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22 **G. Sale of Assets**

23 This category includes time spent arranging to have the Tuco office equipment and
24 furniture inventoried and appraised by a licensed appraiser and auctioneer. After doing so, the
25 Receiver determined that the limited value of the equipment and furniture did not warrant the time
26 and expense associated with a public auction. The Receiver then negotiated the terms of a sale of
27 the Tuco equipment and furniture to Frederick. After consideration of other offers, the Receiver
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1 determined that the \$21,000 offer from Frederick was the highest and best price the receivership
2 estate could obtain. The Receiver provided email notice of the sale motion to members. The sale
3 to Frederick was approved by the Court on May 5, 2008.

Hours	Fees	Average Billing Rate
11.7	\$2,355.00	\$201

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7 **H. Tax Issues**

8 This time relates to the handling of notices received from the IRS regarding payroll taxes.

Hours	Fees	Average Billing Rate
.2	\$30.00	\$150

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12 **I. Trade Creditors/Vendors**

13 This category includes time spent drafting and sending letters to all creditors at the outset
14 of the receivership. Also included herein are the Receiver's services in handling specific creditor
15 issues pertaining to software platform Lightspeed, La Jolla landlord Prospect Plaza Holdings,
16 internet service NextLevel Internet, Dallas landlord Sam Yang, Culligan water service, the Keesal
17 Young & Logan law firm, ADT security, AT&T telephone service, the Internal Revenue Service,
18 and the Nevada Department of Taxation.

Hours	Fees	Average Billing Rate
23.1	\$3,720.00	\$161

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22 **IV. COSTS**

23 The Receiver's costs during the Application Period are \$335.13. The costs incurred are for
24 photocopies, long distance telephone charges, postage and parking. The costs are summarized on
25 Exhibit D hereto.

1 **V. RECEIVERSHIP ACCOUNTS**

2 A summary of the receivership accounts as of August 31, 2008, is attached hereto as
3 Exhibit E. As of that date, there was approximately \$5,647,805 in cash on hand in the estate.

4 The Receiver's Motion for Order Authorizing Interim Distribution was granted by order
5 entered on July 24, 2008. The order authorizes the Receiver to distribute 40% of member and
6 creditor preliminary claims, an amount that totals approximately \$5,175,000. Since that time, the
7 Receiver has issued interim distributions to almost all of the members and other creditors,
8 reducing the amount in the receivership accounts on daily basis. Interim distributions are
9 processed promptly upon receipt of distribution request forms, unless there are unique, unresolved
10 issues with respect to a member or creditor account. After all interim distributions are processed,
11 the estate will hold at least \$4,800,000.

12 **VI. CONCLUSION**

13 During the Application Period, the Receiver has rendered valuable services to the
14 receivership estate and its members and creditors. Wherefore, the Receiver requests an order
15 approving first interim fees and costs as follows:

16 1. Approving and allowing fees and costs for this Application Period of \$71,281.00
17 and \$335.13 respectively.

18 2. Authorizing the Receiver to pay 80% of the allowed fees in the amount of
19 \$57,024.80, and 100% of costs in the amount of \$335.13 from available sources of the
20 receivership estate assets on an interim basis.

21 3. For such other and further relief as is appropriate.

22
23 Dated: September 23, 2008

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

24
25 By: /s/ David L. Osias

26 David L. Osias
27 Attorneys for Receiver Thomas F. Lennon
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