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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.
18
19
20
21
22

Case No. 08-CV-0400 DMS (BLM)

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
RECEIVER'S MOTION FOR ORDER
(A) STAYING ARBITRATION
COMMENCED BY GLB TRADING, INC.;
AND (B) COMPELLING GLB
TRADING, INC. TO TURN OVER
PROPERTY OF THE RECEIVERSHIP
ESTATE**

Date: November 14, 2008
Time: 1:30 p.m.
Ctrm: 10
Judge: Hon. Dana M. Sabraw

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1 Thomas F. Lennon ("Receiver"), Court-appointed permanent receiver for Tuco Trading,
2 LLC ("Tuco"), submits this memorandum of points and authorities in support of his motion for
3 order (a) staying arbitration commenced by GLB Trading, Inc.; and (b) compelling GLB Trading,
4 Inc. to turn over property of the receivership estate ("Motion").

5 **I. INTRODUCTION**

6 While it was operating, Tuco's only income was commissions ("Commissions") that its
7 managing member, Douglas G. Frederick ("Frederick"), earned as an independent contractor of
8 broker-dealer GLB Trading, Inc. ("GLB"). As discussed in the Receiver's First Interim Report
9 ("First Report"), the Commissions were collected by the clearing broker, Penson Financial
10 Services ("Penson"), forwarded to GLB, paid to Frederick, and then deposited into Tuco's
11 accounts. At the outset of the case, the Court issued an Order in Aid of Receivership confirming
12 that the Commissions are property of the receivership estate.

13 In violation of that Order, GLB has refused to turn over approximately \$848,000 in
14 Commissions. While it continues to hold the entire amount, GLB has also improperly deducted
15 from these Commissions more than \$535,000 in purported legal fees and costs, the vast majority
16 of which pertain to investigations and proceedings in which neither Frederick nor Tuco are parties
17 ("Legal Fees"). The Court should order GLB to turn over the full amount of the Commissions
18 without offset or deduction. GLB should be required to submit a claim for amounts it contends it
19 is owed, and the Court can determine the allowed amount and priority of GLB's claim, if any, in
20 connection with a Court-approved claims process.

21 Instead of honoring this Court's prior Order, GLB commenced an arbitration against
22 Frederick, Tuco and the Receiver in Chicago with regard to the dispute over whether GLB is
23 entitled to withhold any portion of the Commissions. By doing so, GLB has violated the federal
24 statute governing the circumstances under which a receiver can be sued (28 U.S.C. § 959) and this
25 Court's Judgment, which enjoins all proceedings against Tuco. GLB filed its arbitration claim in
26 Chicago despite the receivership case pending before this Court and the fact that all of the parties
27 are located in Southern California. The arbitration is not the proper forum for resolution of these
28 issues between the Receiver and GLB, and should be stayed.

1 **II. PROCEDURAL BACKGROUND**

2 On March 5, 2008, the Court issued a Temporary Restraining Order and Orders:

3 (1) Appointing a Temporary Receiver; (2) Requiring Accountings; (3) Prohibiting the Destruction
4 of Documents, (4) Granting Expedited Discovery; and (5) Order to Show Cause re Preliminary
5 Injunction and Appointment of a Permanent Receiver ("TRO"). The Receiver, the SEC and the
6 Defendants sought clarification of the TRO, which was provided in the Court's Supplement to the
7 TRO ("Supplement"), entered on March 6, 2008.

8 On March 6, 2008, trading activity at Tuco was halted. Members were only permitted to
9 issue liquidating orders from that point forward. On March 14, 2008, the SEC filed the Consents
10 of Tuco and Frederick, and a Joint Motion for Judgment as to Defendants Tuco and Frederick and
11 Orders: (1) Freezing Tuco's Assets, (2) Appointing a Permanent Receiver for Tuco; and
12 (3) Prohibiting the Destruction of Documents ("Judgment"). The Court entered the Judgment on
13 March 17, 2008. The Judgment grants broad relief, including a blanket stay of all proceedings
14 against Tuco by creditors ("Blanket Stay").¹

15 On March 19, 2008, the Court entered an Order in Aid of Receivership: (1) Allowing
16 Notice by Email to Members; (2) Providing that Commissions Earned or Payable to Frederick are
17 Property of the Receivership Estate; (3) Authorizing the Receiver to Enter into a Temporary
18 Transaction with GLB Trading, Inc.; and (4) Granting Ancillary Relief ("Order in Aid"). On
19 June 2, 2008, the Receiver filed his First Report, including his Preliminary Accounting. The First
20 Report was approved by the Court by order entered on July 17, 2008.

21 On July 29, 2008, GLB commenced an arbitration proceeding against the Receiver, Tuco
22 and Frederick by submitting its Statement of Claim to FINRA. The Statement of Claim is
23 attached to the Declaration of Ted Fates in Support of the Motion ("Fates Declaration") as
24 Exhibit D.

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¹ Judgment ¶ XI.

1 **III. SUMMARY OF DISPUTE AND RECEIVER'S POSITION**

2 **A. Arbitration is Not the Proper Forum to Resolve this Dispute**

3 In an attempt to avoid this Court's jurisdiction, GLB commenced an arbitration against
4 Frederick, Tuco and the Receiver ("Arbitration") before the Financial Industry Regulatory
5 Authority ("FINRA"), purportedly pursuant to the arbitration provision contained in the
6 Independent Contractor Agreement ("ICA") between Frederick and GLB. However, the
7 Arbitration violates 28 U.S.C. § 959, requiring any party seeking to commence a proceeding
8 against a federal receiver to obtain leave from the court that appointed him. The Arbitration also
9 violates the Judgment, which enjoins all proceedings against Tuco. GLB's violations of
10 section 959 and this Court's orders warrant a stay of the Arbitration.

11 Furthermore, the Arbitration provision in the ICA does not cover the issues to be
12 determined. The fundamental issue here is whether GLB should be compelled to turn over assets
13 of the receivership estate, subject to any exceptions to turnover under federal receivership law and
14 bankruptcy law (by analogy).

15 This Court should exercise its discretion to stay the Arbitration. The Arbitration is simply
16 a tactic to avoid this Court's jurisdiction and to impose unnecessary costs on the receivership
17 estate. GLB is aware of the receivership case and knows that the Court is already familiar with the
18 background facts. GLB is also aware that the Receiver's costs of resolving the dispute must be
19 borne by Tuco's Members and other creditors. GLB is a California corporation. Its main offices
20 are in Irvine, California, and its president and owner, Robert Lechman, resides in Carlsbad,
21 California. Curiously, the ICA, which is expressly governed by California law, provides that
22 disputes between Frederick and GLB shall be arbitrated in Worcester, Massachusetts.²
23 Nevertheless, GLB filed for Arbitration in Chicago, Illinois.³ This forum shopping to avoid
24 turnover of the Commissions should be rejected.

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26 _____
27 ² There is no explanation of why Worcester, Massachusetts was used as the location for
arbitration in the ICA. Indeed, there are probably few less convenient locations for arbitration
between contracting parties located in Southern California.

28 ³ Since then, the Receiver received notice from FINRA that its initial determination for venue
for the Arbitration is Detroit, Michigan.

1 **B. GLB is Not Entitled to Exercise Recoupment or Setoff**

2 As discussed in the First Report, GLB reported gross Commissions, amounts deducted
3 therefrom by GLB, and net Commissions payable in monthly reconciliation statements. The
4 reconciliation statements were not produced at month's end, however. Rather, it generally took
5 GLB approximately 90 days to produce reconciliation statements.⁴ From gross Commissions
6 earned in months prior to January 2008, statements for which months were issued pre-
7 receivership, GLB deducted approximately \$167,000 in Legal Fees.

8 Promptly after the Judgment as to Defendants Tuco and Frederick was entered, the
9 Receiver sought an Order in Aid to clarify that the Commissions were property of the receivership
10 estate. The Receiver noted that the Commissions were derived from the trading activities of
11 Tuco's class B members ("Members") and that, although they were paid to Frederick as the
12 licensed broker, they were deposited into Tuco's accounts upon receipt by Frederick. The SEC
13 and Frederick stated that they did not oppose the Order in Aid. On March 19, 2008, the Court
14 entered the requested Order in Aid, confirming that the Commissions were property of the
15 Receivership estate. Copies of the Judgment and Order in Aid were promptly provided to GLB.

16 Pursuant to the Order in Aid, the Receiver demanded payment of the Commissions from
17 GLB. After considerable delay, GLB produced monthly Commission reconciliation statements for
18 January, February⁵ and March 2008.⁶ These statements show that, in violation of the Judgment
19 (which prohibits creditors from exercising self-help remedies), GLB deducted Legal Fees totaling
20 approximately \$248,000 from the Commissions. Including Legal Fees GLB deducted for months
21 prior to January 2008, the aggregate Legal Fees deducted was approximately \$415,000.
22 Subsequently, GLB stated that it deducted another approximately \$120,000 in Legal Fees, and that
23 it will continue to withhold the remaining approximately \$312,000 in unpaid Commissions in
24 order to deduct Legal Fees it may incur in the future. In total, GLB has refused to turn over
25 \$847,898.95 as illustrated in the following chart:

	GLB statements received pre-	GLB statements received post-receivership for the	Totals
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27 ⁴ Receiver's First Report, p. 13.

28 ⁵ The January and February statements were produced on April 9, 2008.

⁶ The March statement was produced on May 23, 2008.

	receivership for the months 11/06-12/07	months 1/08-3/08	
Gross Commissions reported	\$9,481,131.62	\$4,644,943.67	\$14,126,075.29
Fees and charges deducted (other than Legal Fees) ⁷	(\$4,405,560.26)	(\$379,697.67)	(\$4,785,257.93)
Other adjustments (deductions and credits)	\$109,645.03	\$52,270.47	\$161,915.50
Net Commissions payable	\$5,185,216.39	\$4,317,516.47	\$9,502,732.86
Commissions paid	(\$4,880,714.44)	(\$3,774,119.47) ⁸	(\$8,654,833.91)
Commissions unpaid	\$304,501.95	\$543,397.00	\$847,898.95
Portion claimed as Legal Fees	(\$167,353.48)	(\$368,429.10) ⁹	(\$535,782.58)
Additional amount withheld	\$137,148.47	\$174,967.90	\$312,116.37

GLB should be compelled to turn over the Commissions, which this Court has already determined are property of the receivership estate. The proper procedure for establishing an offsetting claim against the Receivership estate is for GLB to submit a proof of claim as part of the Court approved claim process and the Court can then determine the priority the claim is entitled to and what amount, if any, should be allowed.

As discussed below, GLB has no right to immediately deduct or offset its claims. Indeed, GLB has little or no legitimate claim for recovery of Legal Fees from the estate at all. GLB's contract with Frederick limits GLB's right to recover expenses to circumstances in which GLB incurs legal expenses due to Frederick's violation of federal or state laws or the procedures of

⁷ The non-Legal Fees and charges deducted by GLB include trade-related fees and charges that are passed through to Frederick by GLB, as well as a flat monthly fee of \$15,000 deducted by GLB for its services. The Receiver's forensic accounting and investigation of these fees and charges is not complete. However, at this time, the Receiver is not requesting turnover of these fees and charges.

⁸ The reconciliation statements for January, February and March 2008 were all received post-receivership. A total of \$3,774,119.47 has been paid by GLB for these months. \$2,250,000 of the payments were made in February 2008. An additional \$1,524,119.47 was paid in multiple installments after the Receiver was appointed.

⁹ The reconciliation statements for January, February and March 2008 reflect Legal Fee deductions of \$247,961.66. However, on July 21, 2008, GLB produced to the Receiver a spreadsheet entitled "Frederick Offset July 15 2008" apparently reflecting additional Legal Fee deductions that GLB has made (or intends to make) in the total amount of \$120,467.44. Thus, the total Legal Fee deductions so far for the post-receivership period is \$368,429.10.

1 securities regulatory authorities. All but approximately \$80,000 of the Legal Fees are facially
2 unrelated to violations of any laws or procedures by Frederick. Moreover, the \$80,000 for Legal
3 Fees purportedly incurred in connection with this receivership case are grossly inflated due to
4 GLB's obstreperous conduct in resisting and refusing to provide the Receiver with information and
5 demanding that statements in the Receiver's First Report be retracted.

6 Finally, the Court will have to consider other factors which may impact the amount and
7 priority of GLB's claim. For example, as discussed in the Declaration of Douglas G. Frederick
8 filed in support of the Motion ("Frederick Declaration"), GLB was the broker-dealer that
9 "supervised" Frederick, shared offices with Frederick, advised Frederick regarding Tuco's
10 operations, assisted in almost all phases of Tuco's business, and profited from Tuco and
11 Frederick's activities. GLB's conduct may warrant subordination of its claims relative to the
12 claims of Class B member creditors.

13 **IV. ARGUMENT**

14 **A. The Arbitration Commenced by GLB Should Be Stayed**

15 Resolution of the Receiver's motion for turnover of Commissions and any claims asserted
16 by GLB against the Tuco receivership estate are the province of this Court and not the FINRA
17 Arbitration commenced by GLB. There is ample authority for the Court to order a stay of the
18 Arbitration.

19 This Court has broad discretion to enjoin proceedings that interfere with the administration
20 of the receivership estate. See SEC v. United Financial Group, Inc., 576 F.2d 217, 220 (9th Cir.
21 1978). Indeed, the Court entered the Judgment which includes the Blanket Stay of all proceedings
22 against Tuco. Even actions against the Receiver that would be permissible under 28 U.S.C.
23 § 959(a) can be stayed at the Court's discretion. See Id. at 221, n. 8; Diners Club, Inc. v. Bumb,
24 421 F.2d 396, 401 (9th Cir. 1970). As discussed below, the Arbitration also violates section 959
25 because the claims do not arise out of any acts or transactions by the Receiver in carrying on
26 business connected with Tuco.

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1 **1. The Arbitration Violates 28 U.S.C. § 959**

2 Section 959 of the Judicial Code proscribes the circumstances in which receivers may be
3 sued without leave of the court that appointed them. The statute provides:

4 Trustees, receivers or managers of any property, including debtors in
5 possession, may be sued, without leave of the court appointing them, with
6 respect to any of their acts or transactions in carrying on business
7 connected with such property. Such actions shall be subject to the general
8 equity power of such court so far as the same may be necessary to the ends
9 of justice, but this shall not deprive a litigant of his right to trial by jury.

8 28 U.S.C. § 959. Actions that do not arise from the acts or transactions of a receiver or trustee in
9 carrying on business connected to the estate property require leave of the appointing court. See
10 United Financial Group, 576 F.2d at 220.

11 The receivership started on March 5, 2008. At that time, the Receiver merely had access to
12 the company under the TRO and Supplement, but did not have control. The Court did not give the
13 Receiver authority to operate the company, and he did not. The Receiver was not appointed as
14 permanent receiver until March 17, 2008. The Receiver never carried on any business of Tuco.
15 Cessation of business operations and efforts to wind down the company commenced immediately
16 on March 17.

17 Mr. Lennon, in his capacity as receiver for Tuco, is named as a respondent in the
18 Arbitration. GLB's claims for recovery of Legal Fees (which are discussed in detail below) arise
19 from several different regulatory investigations and proceedings. A small portion relate to this
20 case. But, none of the Legal Fees arise from of the Receiver carrying on the Tuco business.
21 Accordingly, GLB must have obtained leave from this Court before commencing a proceeding
22 against the Receiver. GLB violated this statutory requirement.

23 **2. The Arbitration Violates the Blanket Stay**

24 Paragraph XI of the Judgment enjoins all "creditors . . . and all other persons seeking relief
25 of any kind, in law or in equity, from Tuco" from "commencing, prosecuting, continuing, or
26 enforcing any suit or proceeding (other than the present action by the Commission) against Tuco"
27 (emphasis added) and also prohibits:

28 doing any act or thing whatsoever to interfere with taking control,
possession, or management by the permanent receiver appointed

1 hereunder of the property and assets owned, controlled or in the
2 possession of Tuco, or in any way to interfere with or harass the
3 permanent receiver, or his attorneys, accountants, employees, or agents or
to interfere in any manner with the discharge of the permanent receiver's
duties and responsibilities hereunder.¹⁰

4 This provision is consistent with the Court's broad powers to enjoin actions that interfere
5 with the administration of the receivership estate. See United Financial Group, 576 F.2d at 220.
6 Tuco is named as a respondent in the Arbitration. The Arbitration clearly seeks relief against
7 Tuco, and therefore violates the Blanket Stay included in the Judgment.

8 **3. The Arbitration Interferes with Administration of the Estate**

9 This Court has presided over this action for approximately 6 months. It has issued orders
10 (a) appointing the Receiver on a temporary basis and allowing Tuco to operate temporarily in the
11 ordinary course of business; (b) granting injunctive and additional relief against Tuco and
12 Frederick, appointing the Receiver on a permanent basis, staying all actions against Tuco, and
13 freezing all assets of Tuco; (c) aiding the receivership by, among other things, clarifying that the
14 Commissions are property of the receivership estate; (d) approving the sale of certain Tuco assets;
15 (e) approving the Receiver's First Interim Report and Preliminary Accounting; and (f) granting the
16 Receiver authority to make an interim distribution to Members and other creditors.

17 As noted above, this Court has broad discretion to enjoin proceedings that interfere with
18 administration of the receivership estate. United Financial, 576 F.2d at 220. In order to minimize
19 the expenses of administration and delay in returning funds to Members and other creditors, the
20 Receiver hopes to have a plan of distribution at least filed, if not approved by the Court, by the end
21 of the year. The SEC has endorsed this estimated timetable.¹¹

22 If allowed to proceed, the Arbitration will impose unnecessary expense on the receivership
23 and delay the administration and distribution of estate assets. The parties to the Arbitration are all
24 located in Southern California. GLB's main offices are in Irvine, California, and its president
25 resides in Carlsbad, California. Determination of the issues involved (turnover of property of the
26 receivership estate and offset claims asserted by GLB) does not require any specialized securities

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¹⁰ Judgment ¶ XI.

28 ¹¹ See Plaintiff Securities and Exchange Commission's Response to Permanent Receiver's First
Interim Report, filed on July 3, 2008.

1 expertise. The Court is already familiar with the background facts and can more expeditiously
2 adjudicate the dispute.

3 **4. The Arbitration Provision in the ICA Does Not Apply**

4 In commencing the Arbitration, GLB relies on an arbitration provision in the ICA that
5 provides for arbitration under California law in Worcester, Massachusetts:

6 ARBITRATION. Any dispute arising under this Agreement shall be
7 submitted to binding arbitration in the city of Worcester, Massachusetts,
8 upon the award rendered may be entered and enforced in any court of
competent jurisdiction. The arbitrators shall follow California law....¹²

9 The ICA is an agreement between GLB and Frederick. Tuco is not a party to the
10 agreement. The Receiver is not a party to the agreement. The ICA's provisions which impose
11 burdensome and nonsensical obligations on Frederick (e.g. arbitration in Worcester,
12 Massachusetts between two contracting parties located in Southern California) should not be
13 enforced against the Receiver.

14 Nevertheless, even if the estate's right to the Commissions is governed by the ICA, the
15 arbitration provision does not apply to the issues to be decided here. The provision applies to
16 disputes that "arise under" the ICA. This language is considered narrow, as opposed to arbitration
17 clauses that cover disputes "related to" or "in connection with" the agreement, making the general
18 presumptions in favor of arbitration inapplicable. See In re Hagerstown Fiber Ltd. P'ship, 277
19 B.R. 181 (Bankr. S.D.N.Y. 2002) (there is no presumption of arbitrability with an "arising under"
20 clause). Indeed, issues such as priority of creditor claims, setoff rights and whether property
21 should be turned over to a trustee or receiver arise under federal law and are not subject to
22 arbitration. See In re Braniff Airways, Inc., 33 B.R. 33, 35-36 (Bankr. N.D. Tex. 1983);
23 Hagerstown Fiber, 277 B.R. 181; In re Transport Associates, Inc., 263 B.R. 531 (Bankr. W.D. Ky.
24 2001).

25 The issues to be decided here are whether GLB should be compelled to turn over the
26 Commissions and whether GLB has any legitimate claims against the receivership estate. These
27 issues arise under federal receivership law (with reference to bankruptcy law by analogy at the

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¹² Fates Decl., Exh. B (ICA § VI.D.).

1 Court's discretion).¹³ The issue of whether the Tuco receivership estate is entitled to the
2 Commissions could not arise under the ICA; the receivership estate did not exist at the time the
3 ICA was executed by Frederick. The receivership estate is a creation of federal law, and what
4 property is included in it is governed by federal law. These issues do not arise under the ICA, and
5 therefore are not subject to resolution by arbitration.

6 **5. The Court Has Discretion to Deny Arbitration**

7 Even if the arbitration provision in the ICA did apply to the issues to be decided here, the
8 Court has discretion to deny arbitration. In the bankruptcy context, courts have discretion to deny
9 enforcement of arbitration clauses against bankruptcy trustees when the issues to be determined
10 are considered "core", meaning that they directly impact administration of the estate. See In re
11 White Mountain Mining, Co., 403 F.3d 164 (4th Cir. 2005); 28 U.S.C. § 157(b)(2) (providing a
12 non-exclusive list of core matters). One court has explained:

13 When determining whether an otherwise enforceable arbitration clause
14 should be enforced, 'a bankruptcy court retains significant discretion to
15 assess whether arbitration would be consistent with the purpose of the
16 Code, including the goal of centralized resolution of purely bankruptcy
17 issues, the need to protect creditors and reorganizing debtors from
18 piecemeal litigation, and the undisputed power of a bankruptcy court to
19 enforce its own orders.' In re Startec, 292 B.R. at 253 (citing In re
20 National Gypsum, 118 F.3d 1056 (5th Cir.1997)). The Court may also
21 consider factors such as: '(1) Whether the issue can be resolved more
22 expeditiously by the bankruptcy judge as opposed to through the
23 arbitration process; (2) Whether or not special expertise is necessary in
24 deciding the issue; (3) The impact on creditors of the debtor who were
25 never parties to the agreement containing the arbitration clause; and
26 (4) Whether arbitration threatens the assets of the estate.' In re Slipped
27 Disc, 245 B.R. 342, 345 (Bankr. N.D. Iowa 2000); In re Dunes Hotel
28 Associates, 194 B.R. 967, 993 (Bankr. D.S.C. 1995) .

29 In re Winstar Communications, Inc., 335 B.R. 556, 565-566 (Bankr. D. Del. 2005).

30 Here, the issues to be decided have a direct impact on the administration of the estate. This
31 Court has already decided that the Commissions are property of the estate. Whether they will be
32 turned over to the Receiver for distribution to Tuco's Members and other creditors or GLB will be

33 ¹³ Federal courts supervising equity receiverships often look to bankruptcy law for guidance,
34 especially where federal statutes and case law do not provide clear answers. See e.g. SEC v.
35 Capital Consultants, LLC, 397 F.3d 733, 745 (9th Cir. 2005); SEC v. American Capital
36 Investments, Inc., 98 F.3d 1133, 1140 (9th Cir. 1996); SEC v. Basic Energy & Affiliated
37 Resources, 273 F.3d 657, 665 (6th Cir. 2001).

1 permitted to retain them directly impacts the administration of the estate. Therefore, the issues to
2 be determined are "core", and the Court has discretion to deny enforcement of the arbitration
3 provision.

4 Furthermore, the factors discussed in Winstar Communications weigh heavily in favor of
5 staying the Arbitration. The disputes with GLB can be resolved more expeditiously by this Court,
6 which is already familiar with the background facts and can promptly issue an order. There is no
7 specialized securities expertise required; the resolution of the dispute requires only application of
8 federal law, and perhaps interpretation of the ICA. Allowing the Arbitration to proceed in
9 Chicago or Detroit will alienate Tuco's Members and creditors, most of whom are familiar with
10 this action and the orders issued by the Court, and have received interim distributions. Finally, the
11 Arbitration clearly threatens assets of the estate; there is approximately \$848,000 in receivership
12 estate funds at stake.

13 Additionally, having a panel of FINRA arbitrators located in Chicago or Detroit determine
14 the rights of the parties, all of whom are located in Southern California, makes no practical sense
15 and imposes unnecessary costs on the receivership estate. Tuco's offices were in La Jolla.
16 Frederick resides in San Diego. The Receiver is located in San Diego. GLB is a California
17 corporation. Its main offices are located in Irvine. Its owner and president, Lechman, resides in
18 Carlsbad. Even if the ICA, which is governed by California law, listed Chicago or Detroit as the
19 location for arbitration, it would not make sense to have all of the parties travel there. And in fact,
20 the ICA lists Worcester, Massachusetts as the venue for arbitration. GLB's forum shopping in
21 Chicago in an attempt to make recovery of the Commissions unduly burdensome and expensive
22 should be rejected. For all of these reasons, the Receiver requests an order staying the Arbitration.

23 **B. GLB Should Be Compelled to Turn Over the Commissions**

24 This Court has already determined that the Commissions are property of the receivership
25 estate.¹⁴ This Court has ordered all persons in possession of receivership estate property to turn
26 such property over to the Receiver, and has also enjoined all creditors from using self-help
27

28 _____
¹⁴ Order in Aid of Receivership ¶ 3.

1 remedies when seeking relief from Tuco.¹⁵ GLB's actions in withholding Commissions and
2 deducting Legal Fees therefrom violate these orders. This conduct, by itself, warrants an order
3 compelling GLB to turn the Commissions over.

4 In response to demands from the Receiver, GLB has asserted a right under the ICA with
5 Frederick to exercise recoupment with respect to the Legal Fees.¹⁶ However, GLB does not have a
6 right to unilaterally recoup these claims in the context of a Federal Receivership Case.

7 The orderly submission, review and determination of claims is critical to the administration
8 of receivership estates. Blanket stays of creditor actions (like the Blanket Stay included in the
9 Judgment) are used to ensure that no creditors improperly receive priority over other creditors, and
10 that the receivership estate is not consumed by litigation costs. SEC v. Wencke, 622 F.2d 1363,
11 1369-1373 (9th Cir. 1980) (blanket stay necessary to achieve purposes of receivership). Blanket
12 stays also serve the critical purpose of giving receivers "time to explore all the complex
13 transactions and aspects of the receivership estate" to avoid further harm to investors and creditors.
14 Id. at 1373.

15 The Receiver filed his claims procedures motion on September 22, 2008, which is
16 scheduled to be heard on November 7, 2008. Like all other creditors, GLB will have the
17 opportunity to submit a claim against the receivership estate as part of a Court-approved claims
18 process. The Receiver will review, and if appropriate, object to the claim. GLB will have the
19 opportunity to respond and the Court can determine the proper amount and priority, if any, of the
20 claim. In connection with the Court's determination of GLB's claim, it may be appropriate for
21 some formal discovery to be conducted and for the Court to hear testimony. At the very least, the
22 parties can fully brief the Court on the relevant issues.

23 As described in the Receiver's First Report, the volume of shares traded through Tuco's
24 accounts was enormous. During the months leading up to commencement of the receivership,
25 approximately 2 billion shares were being traded through its accounts each month. The gross
26 monthly Commissions generated from this trading activity exceeded \$2 million for the months of
27

28 ¹⁵ Judgment ¶¶ IX, XI.

¹⁶ Fates Decl., Exh. B. (letter from Jim Barber to Ted Fates, dated June 5, 2008).

1 October 2007 through January 2008. The Receiver's forensic accounting and investigation is not
2 complete. His First Report, including his Preliminary Accounting, was approved by order entered
3 on July 17, 2008. The Order provides that the Receiver shall submit his Second Interim Report to
4 the Court in approximately 120 days (i.e. mid-November). The Receiver will do so, including an
5 update on his investigation and forensic accounting analysis.

6 The Receiver's ongoing investigation and accounting may well produce data and analysis
7 that bears on GLB's claim for Legal Fees, and may reveal other potential claims for recovery held
8 by the receivership estate against GLB. The determination of GLB's claim at this time, therefore,
9 is premature. Nevertheless, the Commissions are property of the estate and GLB should not be
10 permitted to hold more than \$848,000 hostage, including the interest earned thereon. The funds
11 should be turned over to the Receiver to be segregated and held in an interest-bearing account,
12 pending determination of GLB's claim.

13 **1. GLB Has No Claim for Legal Fees Against the Receivership Estate**

14 The ICA provides that GLB has the right to recover from Frederick and offset from the
15 Commissions reasonable Legal Fees in certain limited circumstances:

16 In the event that through willfulness, negligence or carelessness,
17 [Frederick] fails to comply with the provisions of applicable federal or
18 state laws, or the procedures of [GLB], NASD, SEC or state securities
19 [GLB], [Frederick] agrees that [GLB] may assess against [Frederick] such
20 expenses as [GLB] incurs in the resolution of any action, including
21 without limitations attorney's fees and expenses.

22 Fates Declaration, Exhibit B (ICA, Section II.C.(5)) (emphasis added). Accordingly, the ICA
23 provides for recovery by GLB of expenses incurred in resolving any action, including attorney's
24 fees, only if the action arises out of Frederick's failure to comply with federal or state laws, or
25 procedures of GLB, the NASD, the SEC or a state securities commission. The Legal Fees
26 claimed by GLB relate to four distinct regulatory matters (including the receivership case) and
27 one arbitration filed by a GLB account holder. They are summarized as follows:
28

Matter	Approximate Amount Deducted
Nasdaq Proceeding	\$248,000
NYSE Investigation	\$46,000
Chan FINRA Arbitration	\$29,000
SEC Investigation of GLB	\$96,000
The Receivership Case	\$80,000
Unidentified Legal Fees ¹⁷	\$36,000
Total	\$535,000

10 Before discussing the specifics of each of the above matters, it is important to note that
11 under FINRA/NASD rules, broker-dealers have an affirmative obligation to supervise their
12 registered representatives. FINRA/NASD Rule 3010. Broker-dealers are required to "establish
13 and maintain a system to supervise the activities of each registered representative . . . that is
14 reasonably designed to achieve compliance with applicable securities laws and regulations, and
15 with applicable NASD rules. Final responsibility for proper supervision shall rest with the
16 [broker-dealer]." Id. Broker-dealers are required to establish, maintain and enforce written
17 procedures regarding the supervision of registered representatives.¹⁷ Id. The supervisory system
18 is required to include "the designation . . . of an appropriate registered principal(s) with authority
19 to carry out the supervisory responsibilities of the [broker-dealer]" Accordingly, GLB had an
20 affirmative duty to supervise Frederick and to maintain and enforce procedures reasonably
21 designed to achieve compliance with securities laws and regulations, and applicable NASD rules.
22 Lechman was the designated principal with responsibility to supervise Frederick's activities as a
23 registered representative of GLB. Frederick was never disciplined, reprimanded or issued any
24 warnings by GLB or Lechman.

25 The details of each matter to which the Legal Fees pertain are as follows:

27 ¹⁷ GLB has not provided any information regarding these Legal Fees.

28 ¹⁸ Despite several requests, GLB refused to provide a copy of its written supervisory procedures to the Receiver.

1 (a) *The Nasdaq Proceeding*

2 GLB was named in a proceeding initiated by the Nasdaq Stock Market ("Nasdaq") before
3 the FINRA in or about November 2007. The Nasdaq proceeding followed an investigation into
4 trade orders by GLB that allegedly violated NYSE rules and policies regarding the use of partial
5 or odd-lots, resulting in Nasdaq issuing a notice of termination of GLB's access to the Nasdaq
6 stock market. GLB identified the trade orders at issue as coming from Tuco. The trade orders
7 were placed by a Tuco member using a trading platform provided by Sterling Financial Services
8 ("Sterling"), which was authorized by GLB.

9 In December 2007, GLB and Nasdaq agreed to settle and dismiss the proceeding on
10 certain terms and conditions, including (a) that GLB permanently terminate all customers known
11 to have engaged in the trades at issue, (b) that GLB retain, at its own expense, an independent
12 consultant to evaluate, examine and audit GLB and its preventative systems and processes, (c) that
13 the independent consultant again conduct a review at GLB's expense 120 days after his initial
14 review, and (d) that GLB fully cooperate with the independent consultant (the "Settlement").

15 GLB deducted from the Commissions \$248,000 in Legal Fees incurred in connection with
16 the Nasdaq Proceeding and the Settlement, including the costs of the independent consultant.¹⁹
17 However, GLB had no right to deduct these fees from the Commissions because they were not
18 incurred in connection with an action resulting from Frederick's wrongful conduct.

19 Neither Nasdaq nor GLB alleged in connection with the Nasdaq Proceeding that Frederick
20 violated any laws or procedures. Nasdaq alleged that GLB violated NYSE rules and policies by
21 executing the trades at issues. GLB stated that the "trades at issue were caused by a software error
22 in [Sterling]'s program . . . and by customers in China who were circumventing the system without
23 [GLB]'s knowledge."²⁰ As further evidence that Frederick was not at fault in connection with the
24 Nasdaq Proceeding, GLB and Lechman, as Frederick's supervisor and registered principal under
25 NASD Rule 3010, never disciplined, reprimanded or even issued a warning to Frederick with
26 respect to this matter. Frederick Decl. ¶ 21. Indeed, GLB had approved the use of the Sterling

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28 ¹⁹ Fates Decl., Exh. E. (correspondence between Nasdaq and GLB regarding the Nasdaq
Proceeding, including terms of the Settlement).

²⁰ Fates Decl., Exh. E. (Nasdaq letter to James Barber dated December 1, 2007)

1 platform by the relevant Tuco Member. Frederick Decl. ¶¶ 9, 11. Therefore, GLB has no claim
2 against Frederick or the receivership estate for recovery of Legal Fees related to this matter the
3 Nasdaq Proceeding.

4 *(b) The NYSE Investigation*

5 NYSE Arca Equities Inc. ("NYSE") initiated an investigation of certain trades executed by
6 GLB during the months of June, July and August 2006. Specifically, NYSE determined that GLB
7 improperly marked the trades as "short sell exempt" (as opposed to long sell or short sell), and in
8 doing so violated NYSE rules and regulations. In response to the investigation, GLB stated that
9 the trade orders had been placed using the "Hydra" trading platform provided by Spartan Equities
10 ("Spartan"). GLB explained that not only was Spartan responsible for the improper markings, but
11 it actively concealed them from GLB.²¹

12 The trade orders at issue were placed by GLB customer Monterey Trading Group
13 ("Monterey"). Although Frederick was the registered representative of GLB for Monterey's
14 account, Monterey was not associated with Tuco, and GLB approved the use of the Hydra
15 platform by Monterey. GLB deducted \$46,000 from the Commissions for Legal Fees incurred in
16 connection with this NYSE Investigation.

17 Again, neither NYSE nor GLB alleged in connection with the NYSE investigation that
18 Frederick violated any laws or procedures. NYSE alleged that GLB violated certain NYSE rules
19 and regulations. GLB stated emphatically in its letter to NYSE that the improper markings at
20 issue were entirely the fault of Spartan.²² As further evidence that Frederick was not at fault in
21 connection with the NYSE investigation, GLB never disciplined, reprimanded or even issued a
22 warning to Frederick with respect to this matter. Frederick Decl. ¶ 21. Indeed, GLB itself
23 approved the use of the Hydra platform by Monterey. Frederick Decl. ¶¶ 9, 11. Accordingly,
24 GLB has no claim against Frederick or the receivership estate for recovery of Legal Fees related
25 to this NYSE investigation.

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27
28 ²¹ Fates Decl., Exh. F. (correspondence between NYSE and GLB regarding the NYSE Investigation).

²² Fates Decl., Exh. F. (Barber letter to NYSE dated August 20, 2007).

1 (c) *Chan FINRA Arbitration*

2 In March 2008, Angela K. Chan filed a Statement of Claim and Demand for Arbitration
3 against GLB, Penson, Stephanie Chooi, Frederick, Gus Katsafaros and Robert Lechman ("Chan
4 Claim"). The claim alleges that Chan opened an account with GLB at the recommendation of a
5 friend, Stephanie Chooi. Frederick was the registered representative for Chan's account, but the
6 Chan Claim states that Chan "never met or spoke to him and further believes that she would not
7 know who he was if she literally ran into him."²³ The Chan Claim goes on to allege that Chooi
8 obtained access to Chan's account and placed trade orders in a reckless and irresponsible manner,
9 resulting in Chan incurring losses of approximately \$41,000.

10 On June 2, 2008, GLB, Katsafaros, and Lechman filed an answer to the Chan Claim
11 ("Answer"), along with a declaration of attorney Keith Butler and affidavits signed by Katsafaros
12 and Lechman.²⁴ The Answer states that (a) Chan opened an account at GLB only after
13 electronically checking a box stating that she had reviewed its risk disclosure statement; (b) Chan
14 was issued a username and password; (c) GLB did not give Chan's username or password to
15 anyone else; (d) in opening her account with Penson, Chan checked a box indicating that her
16 "Investment Objectives" were "Speculative" or "High Risk"; (e) Chan signed a Penson
17 authorization form giving Chooi full authority to execute trades on her behalf; (f) GLB did not
18 advise Chan on trades or execute any trades on her behalf; and (g) to the best of GLB's
19 knowledge, Frederick did not advise Chan on trades or execute trades on her behalf. The Answer
20 requests that GLB, Katsafaros and Lechman be dismissed from the action.²⁵

21 GLB deducted \$29,000 from the Commissions for Legal Fees incurred in connection with
22 the Chan Claim. However, the focus of the Chan Claim is Chooi's conduct and GLB's failure to
23 take any action to protect Chan. Frederick is named only as the registered representative of GLB
24 for Chan's account. Chan acknowledges that she never met or spoke to Frederick. There are no
25 allegations that Frederick violated any laws or procedures. Frederick's liability on the Chan

26 _____
27 ²³ Fates Decl., Exh. G. (Chan Claim p. 6).

28 ²⁴ The Chan Claim was filed in Southern California. GLB is represented by counsel located in
Southern California in connection with the Chan matter. Accordingly, GLB already has
counsel here.

²⁵ Fates Decl., Exh. G. (Answer to Chan Claim).

1 Claim, if any, would necessarily arise from his relationship with GLB, not his own conduct. GLB
2 never disciplined, reprimanded or even issued a warning to Frederick with respect to this matter.
3 Frederick Decl. ¶ 21. Accordingly, GLB has no claim against Frederick or the receivership estate
4 for recovery of Legal Fees related to the Chan Arbitration.

5 *(d) SEC Investigation of GLB*

6 On March 22, 2008, the SEC commenced a formal investigation of GLB ("GLB
7 Investigation"). On March 25, the SEC sent a letter to GLB requesting that GLB not destroy,
8 conceal or alter any documents that relate to GLB's activities or business for the period January 1,
9 2006 to the present. On May 2, the SEC issued GLB a voluntary request for documents. The
10 request did not ask GLB to provide an image of its servers. On May 29, 2008, GLB responded to
11 the SEC's voluntary request and produced 556 pages of documents. GLB stated that it would
12 produce approximately 18,000 emails.²⁶

13 GLB deducted \$96,000 from the Commissions for Legal Fees incurred in connection with
14 the GLB Investigation. Approximately \$42,000 of this amount represents costs GLB incurred in
15 connection with imaging its own servers.²⁷

16 The Judgment as to Defendants Tuco and Frederick was entered in the receivership case
17 before the GLB Investigation was commenced by the SEC. The only issue left to be determined
18 thereafter was the amount of disgorgement and civil penalty against Tuco and Frederick.
19 Furthermore, if the SEC wanted to obtain evidence from GLB regarding Tuco or Frederick's
20 conduct, it could simply have subpoenaed GLB in connection with the Tuco case, without opening
21 a separate formal investigation. The facts suggest, therefore, that the GLB Investigation is
22 focused on whether GLB violated securities laws or regulations, not Tuco or Frederick.

23 Nothing under the ICA grants GLB the right to recover Legal Fees it incurs as a result of
24 its own violations (or potential violations) of securities laws and regulations. Accordingly, GLB
25 has no claim against Frederick or the receivership estate for recovery of Legal Fees related to the
26 GLB Investigation.

27 _____
28 ²⁶ Fates Decl., Exh. H. (correspondence between the SEC and GLB regarding the GLB
Investigation).

²⁷ Frederick Declaration ¶ 20.

1 (e) *The Receivership Case*

2 GLB had a relationship with Tuco as its broker-dealer, through Frederick as principal and
3 agent under the ICA. GLB worked hand-in-hand with Tuco and Frederick in almost all aspects of
4 Tuco's business. As a result, GLB had possession of and access to information relevant to the
5 Receiver's investigation and forensic accounting. The Receiver and his forensic accountant
6 requested information directly from GLB. The Receiver's requests never exceeded the scope of
7 information that would normally be exchanged by a broker-dealer and its client in researching and
8 attempting to resolve fees and charges incurred by the client. Nevertheless, GLB insisted that all
9 communications from the Receiver and his forensic accountant go through the Receiver's counsel
10 to GLB's counsel. On other occasions, GLB insisted that questions the Receiver had be submitted
11 in writing to GLB counsel prior to GLB participating in a brief conference call. This conduct
12 increased attorney fees incurred by GLB and the Receiver.

13 The Receiver attempted in good faith to resolve the dispute with GLB regarding the unpaid
14 Commissions without litigation. On May 28, 2008, the Receiver advised GLB in writing that by
15 withholding Commissions and deducting Legal Fees therefrom it violated the Judgment and Order
16 in Aid.²⁸ The Receiver and GLB, through their respective counsel, exchanged several letters and
17 emails, and participated on several telephone calls. Unfortunately, efforts to resolve the dispute
18 consensually were unsuccessful.

19 As of July 15, 2008, when GLB reported its additional \$120,000 of deductions, GLB had
20 deducted \$80,000 in Legal Fees supposedly incurred in connection with the receivership case.
21 This amount is shocking considering GLB's very limited participation in this case, most of which
22 required little or no legal expertise. Indeed, GLB has yet to make an appearance in this case. On
23 its face, the amount is unreasonable, and the Receiver suspects that the lion's share of these fees
24 were incurred in connection with resisting the Receiver's requests for information and a frivolous
25 request that the Receiver retract portions of his First Interim Report,²⁹ and should therefore be

26 _____
27 ²⁸ Fates Decl., Exh. A.

28 ²⁹ In response to a request by the Receiver that GLB authorize NYFIX, a trade routing firm, to
produce information directly to the Receiver to assist in the Receiver's investigation and
forensic accounting work, GLB denied the request and accused the Receiver of making false
allegations and intentionally defaming GLB, Lechman and Katsafaros with statements in the

1 disallowed as a claim against the estate. GLB's right to attorney fees is limited to fees incurred in
2 the resolution of an action arising from violations of securities laws by Frederick. See Fates
3 Declaration, Exhibit B (ICA, Section II.C.(5)) (quoted above). Attorney's fees that do not pertain
4 to the resolution of the receivership case are not recoverable by GLB. In reviewing any claim by
5 GLB against the estate for Legal Fees, the Court should require GLB to produce billing
6 statements, so that the reasonableness of the fees and whether they fall within the limited scope of
7 the attorney fee provision in the ICA can be determined.

8 *(f) Unidentified Legal Fees*

9 GLB deducted an additional \$36,000 in Legal Fees from the Commissions without
10 identifying any particular investigation or proceeding. If these fees apply to one of the matters
11 discussed above, they should be disallowed for the reasons stated. If they pertain to a different
12 matter, GLB should be required to produce evidence (a) showing to what they pertain,
13 (b) showing why GLB has a claim against the receivership estate for them, and (c) supporting the
14 reasonableness of the amount. Absent such evidence, these unidentified Legal Fees should be
15 disallowed.

16 **2. The Amount Ordered to be Turned Over Should Include Prejudgment**
17 **Interest**

18 When issuing judgments based on federal law, federal courts have broad discretion to
19 award prejudgment interest. Home Savings Bank, F.S.B. v. Gillam, 952 F.2d 1152, 1161 (9th Cir.
20 1991); Monsanto Co. v. Hodel, 827 F.2d 483, 485 (9th Cir. 1987). In Gillam, the Ninth Circuit
21 approved the district court's award of prejudgment interest where the Resolution Trust
22 Corporation, as conservator for a bank, sued a former officer to recover improper severance
23 payments. Gillam, 952 F.2d at 1161. The court stated that the purpose of the award was to make
24 the plaintiff whole for money removed during a critical shortage of capital, and that failure to

25 Receiver's First Report. See email from Jim Barber to Ted Fates dated July 20, 2008, Fates
26 Declaration, Exhibit C. The statements in the Receiver's First Report that GLB apparently
27 believes to be defamatory are that "[t]he inability to communicate directly with
28 Mr. Katsafaros, Mr. Lechman and others at GLB has delayed the process of obtaining
information and increased administrative expense" and that "GLB has generally been slow to
respond to document requests, including Commission reconciliation statements" (First
Report, p. 13). These statements are true and accurate.

1 award interest would have amounted to a windfall to the defendant. Id.; see also Monsanto, 827
2 F.2d at 485 (noting that the effect of refusing to grant prejudgment interest is to allow an interest-
3 free loan of funds belonging to another, and that disallowance of prejudgment interest creates an
4 incentive to prolong litigation). The rate for federal prejudgment interest is calculated based on
5 the federal treasury bond rate. 28 U.S.C. § 1961(a); Western Pac. Fisheries, Inc. v. SS President
6 Grant, 730 F.2d 1280, 1289 (9th Cir. 1984).

7 Here, in order to fully compensate the receivership estate for the lost time value of money
8 and to avoid GLB receiving a windfall from withholding the Commissions, the Court should
9 award prejudgment interest calculated at the federal rate under section 1961(a). To the extent that
10 the Court determines that the dispute is governed by California law, prejudgment interest on the
11 amount withheld would be mandatory. Section 3287(a) of the California Civil Code provides:

12 Every person who is entitled to recover damages certain, or capable of
13 being made certain by calculation, and the right to recover which is vested
14 in him upon a particular day, is entitled also to recover interest thereon
15 from that day, except during such time as the debtor is prevented by law,
16 or by the act of the creditor from paying the debt.

17 Cal. Civ. Code § 3287(a). Where the contract does not specify a rate, section 3289 provides that
18 the rate shall be 10% per year. Id. at § 3289.

19 Under section 3287(a), prejudgment interest is mandated where the amount of damages is
20 certain, or capable of being made certain by calculation. This means that where the amount or
21 method of calculation of damages is essentially not in dispute, such that the dispute centers on
22 liability rather than amount, interest is available. See e.g., Wisper Corp. N.V. v. California
23 Commerce Bank, 49 Cal. App. 4th 948, 958 (Cal. Ct. App. 1996). The ability to calculate
24 damages precisely is not required, as long as they are reasonably certain in amount. See KGM
25 Harvesting Co. v. Fresh Network, 36 Cal. App. 4th 376, 391 (Cal. Ct. App. 1995).

26 Here, the amount withheld by GLB is capable of being accurately calculated. Indeed, there
27 should not be any dispute regarding the amount at issue. The Receiver has used amounts reflected
28 on the monthly Commission reconciliation statements, as well as a subsequent breakdown of the
29 additional \$120,000 in deductions provided by GLB. The Receiver, through his forensic
30 accountant, and GLB, through Katsafaros, have discussed the unpaid Commissions and agreed

1 upon the amount. The ICA does not specify a rate of interest. Accordingly, the appropriate rate
2 under California law is 10% per year.

3 **3. Other Matters May Bear on the Determination of GLB Claims**

4 There may be other factors for the Court to consider in determining the extent and priority
5 of any GLB claim, further negating any immediate offset or recoupment right. For example,
6 based on GLB's own conduct or complicity in securities violations by Frederick and Tuco, it may
7 be appropriate to subordinate any allowed GLB claim to the claims of Members and other
8 creditors. If a GLB claim were allowed in any amount and permitted to be offset against the
9 Commissions, GLB would effectively be paid 100 cents on the dollar on its claim, whereas the
10 assets of the receivership estate may only be sufficient to pay other creditors of the same or
11 superior priority fewer cents on the dollar. This would be an inequitable result based on GLB's
12 conduct.

13 The Court has broad powers in the administration and supervision of equity receiverships.
14 SEC v. Capital Consultants, LLC, 397 F.3d 733, 738 (9th Cir. 2005). These powers include the
15 discretion to subordinate claims of creditors. See SEC v. Hardy, 803 F.2d 1034, 1040 (9th Cir.
16 1986) ("receivership courts have the general power to use summary procedure in allowing,
17 disallowing, and subordinating claims of creditors"); United States v. Arizona Fuels Corp., 739
18 F.2d 455, 458 (9th Cir. 1984) (same).

19 As noted above (fn. 9), in its discretion, the Court may apply bankruptcy law by analogy.
20 Bankruptcy law provides a standard for equitable subordination of creditor claims. In re
21 Filtercorp, Inc., 163 F.3d 570, 583 (9th Cir. 1998); 11 U.S.C. § 510(c). "Equitable subordination
22 requires that: (1) the claimant who is to be subordinated has engaged in inequitable conduct;
23 (2) the misconduct results in injury to competing claimants or an unfair advantage to the claimant
24 to be subordinated; and (3) subordination is not inconsistent with bankruptcy law." Filtercorp,
25 163 F.3d at 583; In re Lazar, 237 F.3d 967, 985 n.19 (9th Cir. 2001). Equitable subordination is
26 commonly applied when a fiduciary or other person in a position of trust and confidence with
27 respect to the debtor misuses its position to its advantage. Matter of U.S. Abatement Corp., 39
28 F.3d 556, 561 (5th Cir. 1994); Wardley Intern. Bank, Inc. v. Nasipit Bay Vessel, 841 F.2d 259,

1 263-64 (9th Cir. 1988) (claim of bank that used position of control to obtain advantage over other
2 creditors subordinated).

3 Here, GLB engaged in inequitable conduct that unfairly advantaged itself and harmed
4 Tuco's other creditors. As discussed in the Frederick Declaration, GLB knew exactly how Tuco
5 operated.³⁰ GLB advised Frederick and worked with him regarding Tuco matters on a daily
6 basis.³¹ The relationship between Lechman, Katsafaros and Frederick was more than just
7 professional. They were very close friends.³² Lechman's and Frederick's families also became
8 very close.³³ It was contemplated among them that Frederick would become a co-owner of GLB
9 with Lechman and Katsafaros.³⁴ Through its role as Tuco's broker-dealer, its intimate knowledge
10 of the business, and the close personal relationships of Lechman, Katsafaros and Frederick, GLB
11 clearly held a position of trust and confidence with respect to Tuco.

12 GLB misused its position of trust and confidence to its advantage and to the detriment of
13 Tuco's other creditors. GLB knew that Tuco needed cash loans to meet margin calls and knew
14 that Tuco could not survive without them.³⁵ Indeed, when Penson ultimately terminated clearing
15 services to Tuco's accounts, Tuco had been unable to meet a margin call because a cash loan had
16 been disallowed.³⁶ GLB arranged numerous short-term loans to Tuco when Tuco needed cash.³⁷
17 Some of these loans came from Lechman's own company, Back Office Lending. Back Office
18 Lending was paid interest on these loans.³⁸ Without these loans, Tuco's ability to trade would
19 have been terminated sooner, at less losses to members. Accordingly, GLB was instrumental in
20 prolonging Tuco operations. Keeping Tuco running was also to GLB's advantage. Tuco was
21 GLB's largest customer and GLB profited from Tuco in substantial sums.³⁹ GLB deducted a
22

23 ³⁰ Frederick Decl. ¶ 11.

24 ³¹ Frederick Decl. ¶ 11.

25 ³² Frederick Decl. ¶¶ 3, 13.

26 ³³ Frederick Decl. ¶ 13.

27 ³⁴ Frederick Decl. ¶ 15.

28 ³⁵ Frederick Decl. ¶ 17.

29 ³⁶ See Receiver's First Report, pp. 10-11.

30 ³⁷ Frederick Decl. ¶ 17.

31 ³⁸ Frederick Decl. ¶ 17; see also Receiver's First Report, Exhibit A (Preliminary Accounting,
32 Exhibit XXI) (listing loans received from and payments made to Back Office Lending).

33 ³⁹ Frederick Decl. ¶¶ 16, 19.

1 monthly fee of \$15,000 from the Commissions.⁴⁰ GLB also took a share of Commissions
2 generated from certain Tuco Members and other accounts for which Frederick was the registered
3 representative. GLB's share of these Commissions totaled approximately \$25,000 per month.⁴¹
4 Additionally, Back Office Lending generated interest revenue from the short-term loans it made to
5 Tuco.⁴²

6 GLB's conduct with respect to Tuco and Frederick constitutes aiding and abetting
7 violations of securities laws, and violates FINRA/NASD Rule 3010 for failure to properly
8 supervise. Although the SEC is prohibited from discussing the pending, non-public investigation
9 of GLB, it found evidence of possible securities violations by GLB sufficient to warrant a formal
10 investigation. Furthermore, as discussed above, GLB had an affirmative duty to supervise
11 Frederick and to maintain and enforce procedures reasonably designed to achieve compliance with
12 securities laws and regulations, and applicable NASD rules. Lechman was designated principal of
13 GLB responsible for supervising Frederick.⁴³ Frederick was never disciplined, reprimanded or
14 even issued any warnings by GLB or Lechman.⁴⁴ In failing to take any action with respect to
15 Frederick and Tuco, GLB neglected its supervisory obligations under FINRA/NASD Rule 3010.

16 Nevertheless, the Court need only find that GLB engaged in inequitable conduct that
17 unfairly advantaged GLB or harmed Tuco's creditors. The evidence of inequitable conduct is
18 overwhelming. The misconduct unfairly advantaged GLB and Lechman to the tune of hundreds
19 of thousands of dollars.⁴⁵ Furthermore, GLB's inequitable conduct harmed the Members and other
20 creditors of Tuco by perpetuating Tuco's business, resulting in a substantial increase in the
21 shortfall that exists with respect to Tuco's net assets over liabilities and total positive member
22 balances.⁴⁶ The shortfall grew substantially from Tuco's inception to the time that it ceased
23

24 ⁴⁰ Frederick Decl. ¶ 16.

25 ⁴¹ Frederick Decl. ¶ 16.

26 ⁴² Frederick Decl. ¶ 17.

27 ⁴³ Frederick Decl. ¶ 5.

28 ⁴⁴ Frederick Decl. ¶ 21.

⁴⁵ Frederick Decl. ¶ 12 (stating that GLB received approximately \$40,000 per month from Tuco and Frederick).

⁴⁶ See Receiver's First Interim Report, Exhibit A (Preliminary Accounting, Exhibit XVI) (showing the increase in the shortfall from \$1,507,881 as of December 31, 2006 to \$3,026,373 as of May 5, 2008).

1 operations. The shortfall directly harms Members and other creditors in that it makes the amounts
2 available to distribute insufficient to satisfy Member and creditor claims.

3 Finally, there is nothing about subordinating GLB's claim that is inconsistent with
4 receivership or bankruptcy law. The paramount goal of a federal equity receivership is to
5 administer the receivership assets in a fair, equitable and efficient manner. Here, equity demands
6 that the claims of Tuco's Members and other creditors be paid before any amount is distributed to
7 GLB.

8 **V. CONCLUSION**

9 For the foregoing reasons, the Receiver requests entry of an order:

- 10 1. Granting the Motion;
- 11 2. Staying the Arbitration, pending this Court's determination of GLB's claim against
12 the Tuco receivership estate (both amount and priority);
- 13 3. Compelling GLB to turn over to the Receiver the Commissions in the amount of
14 \$847,898.95, without deduction of Legal Fees, to be segregated and deposited into an interest-
15 bearing account, pending this Court's determination of GLB's claim against the Tuco receivership
16 estate;
- 17 4. Awarding prejudgment interest on the amount to be turned over, calculated starting
18 from May 23, 2008.

19
20 Dated: October 3, 2008

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

21
22 By: /s/ Jeffrey R. Patterson
23 JEFFREY R. PATTERSON
24 Attorneys for Receiver Thomas F. Lennon