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9 UNITED STATES DISTRICT COURT
10 SOUTHERN DISTRICT OF CALIFORNIA

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12 SECURITIES AND EXCHANGE
COMMISSION,

13 Plaintiff,

14 v.

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

17 Defendants.

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

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
RECEIVER'S MOTION FOR ORDER
AUTHORIZING INTERIM DISTRIBUTION**

Date: July 25, 2008
Time: 1:30 p.m.
Ctrm: 10
Judge: Hon. Dana M. Sabraw

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20 Thomas F. Lennon ("Receiver"), Court-appointed permanent receiver for Tuco Trading,
21 LLC ("Tuco"), submits this memorandum of points and authorities in support of his motion for
22 order authorizing an interim distribution to the class B members ("Members") and other creditors
23 of Tuco. Since his appointment as temporary receiver on March 5, 2008, the Receiver has
24 received numerous requests and inquiries from Members regarding withdrawals and interim
25 distributions. The Members' concerns are not only with being able to use the funds for trading
26 activities, but also with paying monthly bills and other obligations. The Receiver is also conscious
27 of concerns of certain Tuco non-Member creditors that a distribution from the receivership estate
28 not be made without their participation.

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

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

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

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

23 On March 19, 2008, in response to the Receiver's application, the Court entered an Order
24 in Aid of Receivership: (1) Allowing Notice by Email to Members; (2) Providing that
25 Commissions Earned or Payable to Frederick are Property of the Receivership Estate;
26 (3) Authorizing the Receiver to Enter into a Temporary Transaction with GLB Trading, Inc.; and
27 (4) Granting Ancillary Relief ("Order in Aid"). The Order in Aid provides, among other things,
28 that the Receiver's initial report may be filed in conjunction with the accounting due under Part

1 VIII.E. of the Judgment, and that interim reports shall be filed by the Receiver approximately
2 every 120 days thereafter.

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

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

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

17 On June 2, 2008, the Receiver filed his First Interim Report, including his Preliminary
18 Accounting of Tuco ("Report"). The Report was served by email and mail on the parties, and by
19 mail on all non-Member creditors. Notice of the Report was emailed to all Members and the
20 Report itself was posted on the Receiver's website. A hearing on the Report is scheduled for
21 July 18, 2008.

22 **II. RELIEF REQUESTED**

23 This Motion should be read in conjunction with the Report, which provides detailed,
24 preliminary accounting analysis of Tuco, including its assets, liabilities, and Member account
25 balances. As discussed in the Report, the accounting analysis thus far by the Receiver and his
26 forensic accountant, William H. Ling ("Ling"), is preliminary only. The Receiver and Ling
27 continue to review and analyze records of Tuco's operations. The Receiver is confident, however,
28 that under the worst case scenario, the Members and other creditors of Tuco would receive a

1 distribution of at least 40%. Again, 40% is not an estimate of what Members and creditors will
2 ultimately receive. This is only a conservatively-calculated, interim distribution.

3 If this application is approved, a distribution form will be emailed to all Members and
4 mailed to all other creditors, instructing each to provide wiring or mailing instructions for
5 transmission of their distribution from the estate. The Receiver will work to resolve any name
6 and/or address issues with the Members and other creditors to ensure that all parties receive an
7 interim distribution promptly.² As the distribution forms are returned, the Receiver will process
8 interim distribution payments.

9 To the extent that the Receiver determines that a Member or creditor (a) has unresolved
10 amounts pertaining to his/her Preliminary Claim, or (b) has a relationship with Tuco or Frederick
11 other than as a Member or other creditor, the Receiver, in his sole discretion, will decide whether
12 such Member or other creditor's interim distribution will be reserved pending additional
13 investigation.

14 This is not the appropriate time for Members and other creditors to dispute Preliminary
15 Claims. In the next several weeks, the Receiver will seek approval from the Court of a process for
16 receiving and administering claims. The Receiver will ask the Court to set a bar date by which all
17 claims must be submitted. The Receiver will then review the claims submitted and, where
18 appropriate, file objections. Members and other creditors will have the opportunity to respond to
19 the Receiver's objections, and the Court will resolve claim disputes. Claims that have been
20 submitted to the Receiver and resolved by agreement or by the Court are referred to herein as
21 "Final Claims". In due course, the Receiver will also seek approval from the Court of a plan of
22 distribution, providing for distribution of the assets of the receivership estate to Members and
23 other creditors with allowed Final Claims.

24 The claims process will be the appropriate time for Members and other creditors to provide
25 evidence indicating that their Final Claim amounts should be something other than what the
26 Receiver's records show. Allowing Members and other creditors to dispute Preliminary Claim
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28 ² Shortly after the Receiver's appointment as permanent receiver, Members and other creditors
were instructed to contact the Receiver with any changes to their contact information.

1 amounts will duplicate the claims process, and unnecessarily complicate and delay the proposed
2 interim distribution.

3 **III. ARGUMENT**

4 "The power of a district court to impose a receivership or grant other forms of ancillary
5 relief does not in the first instance depend on a statutory grant of power from the securities laws.
6 Rather, the authority derives from the inherent power of a court of equity to fashion effective
7 relief." SEC v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980). The "primary purpose of equity
8 receiverships is to promote orderly and efficient administration of the estate by the district court
9 for the benefit of creditors." SEC v. Hardy, 803 F.2d 1034, 1038 (9th Cir 1986). As the
10 appointment of a receiver is authorized by the broad equitable powers of the court, any distribution
11 of assets must also be done equitably and fairly. See S.E.C. v. Elliot, 953 F.2d 1560, 1569 (11th
12 Cir. 1992).

13 District courts have the broad power of a court of equity to determine the appropriate
14 action in the administration and supervision of an equity receivership. See SEC v. Capital
15 Consultants, LLC, 397 F.3d 733, 738 (9th Cir. 2005). The Ninth Circuit explained:

16 A district court's power to supervise an equity receivership and to
17 determine the appropriate action to be taken in the administration of the
18 receivership is extremely broad. The district court has broad powers and
19 wide discretion to determine the appropriate relief in an equity
20 receivership. The basis for this broad deference to the district court's
21 supervisory role in equity receiverships arises out of the fact that most
22 receiverships involve multiple parties and complex transactions. A district
23 court's decision concerning the supervision of an equitable receivership is
24 reviewed for abuse of discretion.

25 Id. (citations omitted); see also Commodities Futures Trading Comm'n. v. Topworth Int'l,
26 Ltd.; 205 F.3d 1107, 1115 (9th Cir. 1999) ("This court affords 'broad deference' to the court's
27 supervisory role, and 'we generally uphold reasonable procedures instituted by the district court
28 that serve th[e] purpose' of orderly and efficient administration of the receivership for the benefit
of creditors.").

29 This Court has broad equitable powers and discretion in the administration of this equity
30 receivership estate, including the discretion to authorize an interim distribution. An interim
31 distribution will allow the Members to pay their bills and continue with their livelihood (trading).

1 The Receiver's preliminary accounting shows that 40% of Preliminary Claims can be distributed at
2 this time without jeopardizing an equitable final distribution.

3 It is important that the Receiver have discretion to reserve an interim distribution if there
4 are unresolved issues pertaining to Preliminary Claims such that additional investigation can be
5 done. In some cases, unresolved fees, charges or disputes could substantially reduce Preliminary
6 Claims. An interim distribution should not be made if such distribution might result in a Member
7 or other creditor receiving more than it ultimately should as part of an equitable final distribution.
8 The Receiver will exercise his business judgment under the specific circumstances to determine
9 when, and in what amount, an interim distribution will be made.

10 Finally, allowing Members and other creditors to dispute their Preliminary Claim amount
11 would cause the estate to incur the expenses associated with administering claims twice. The
12 proposed interim distribution has been conservatively calculated to account for the likelihood that
13 some adjustments to Preliminary Claims will have to be made. As noted above, the Receiver will
14 seek approval of a process for receiving and administering claims in the next several weeks. The
15 claims process will be the appropriate time for Members and creditors to provide evidence
16 indicating that their Final Claim amounts should be something other than what the Receiver's
17 records show. The claims process will also provide the opportunity for Members and other
18 creditors to have their Final Claims reviewed and determined by the Court to the extent there is an
19 unresolved dispute.

20 The goal of an interim distribution is to get money into the hands of Members and other
21 creditors sooner rather than later. Disputes over Preliminary Claims will unnecessarily delay and
22 complicate this process.

23 As discussed in the Declaration of Ted Fates in Support of the Motion, the Motion, in
24 substantially final form, was circulated to the SEC, Douglas Frederick and Tuco's largest non-
25 Member creditor, Lightspeed, before filing. The SEC and Lightspeed have stated that they do not
26 oppose the Motion. Frederick has not stated a position with respect to the Motion.

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IV. CONCLUSION

Based on the foregoing, the Receiver requests entry of an order granting the Motion, authorizing an interim distribution to the Members and other creditors of Tuco in the amount of 40% of their Preliminary Claims, and granting such other relief as the Court deems just and proper.

Dated: July 10, 2008

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By: /s/ David L. Osias

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