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

**RECEIVER'S APPLICATION FOR ORDER IN
AID OF RECEIVERSHIP:**

**(1) ALLOWING NOTICE BY EMAIL TO
MEMBERS OF DEFENDANT TUCO
TRADING;**

**(2) PROVIDING THAT COMMISSIONS
EARNED OR PAYABLE TO DEFENDANT
FREDERICK ARE PROPERTY OF THE TUCO
RECEIVERSHIP ESTATE;**

**(3) AUTHORIZING THE RECEIVER TO
ENTER INTO A TEMPORARY
TRANSACTION WITH GLB TRADING, INC.;
AND**

(4) GRANTING ANCILLARY RELIEF

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1 Thomas F. Lennon ("Receiver"), Court-appointed permanent receiver for Tuco Trading,
2 LLC ("Tuco"), applies for an order in aid of the receivership seeking the following procedural and
3 substantive relief: (1) allowing notice by email to all Class B members of Tuco ("Members");
4 (2) providing that all commissions earned or payable to Douglas Frederick on account of trading
5 activity are property of the Tuco receivership estate; (3) authorizing the Receiver to enter into a
6 temporary transaction with GLB Trading, Inc.; and (4) granting ancillary relief. This relief will
7 promote the efficient administration of the Tuco receivership estate, maximize the assets available
8 for distribution, and minimize expenses.

9 I. BACKGROUND FACTS

10 In November 2006, Frederick began operating a day trading firm under the name Tuco
11 Trading, LLC. Tuco is a Nevada limited liability company. It is the Receiver's understanding that
12 Tuco and/or Frederick acquired a day trading firm called Evolution Financial ("Evolution") around
13 the time Tuco was formed.¹ Tuco's main offices are located at 909 Prospect Street, Suite 224,
14 La Jolla, California (the "Tuco Premises").

15 Each Member of Tuco had an oral agreement with Frederick regarding the commission
16 Tuco would charge to the Member, the leverage or margin at which Tuco would allow the
17 Member to trade, and other details. The majority of the Members would execute trades through
18 Tuco's accounts at its broker-dealer, GLB Trading, Inc. ("GLB"). A small number of Members
19 would use Tuco's accounts at other broker-dealers, such as ViewTrade. GLB and ViewTrade used
20 Penson Financial Services ("Penson") as the clearing firm for all trades made by Tuco's Members.
21 Tuco's sole source of income was commissions earned from the trading activities of its Members
22 and commissions earned by Frederick for referrals of traders to GLB ("Commissions"). The
23 Commissions would be paid to Frederick as the registered representative of Tuco. Frederick
24 would deposit the Commissions into Tuco accounts.

25 On March 4, 2008, the Securities and Exchange Commission ("SEC") filed its Complaint
26 and Ex Parte Motion for Temporary Restraining Order and Orders: (1) Freezing Assets;

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28 ¹ Evolution was owned by Jonathan Kirkland and Michael Kestler. Kirkland later moved to
China. Mike Kestler remained with Tuco and served as its head trader.

1 (2) Appointing a Temporary Receiver; (3) Requiring Accountings; (4) Prohibiting the Destruction
2 of Documents, (5) Granting Expedited Discovery; and (6) Order to Show Cause re Preliminary
3 Injunction and Appointment of a Permanent Receiver. On March 5, 2008, the Court issued a
4 Temporary Restraining Order and Orders: (1) Appointing a Temporary Receiver; (2) Requiring
5 Accountings; (3) Prohibiting the Destruction of Documents, (4) Granting Expedited Discovery;
6 and (5) Order to Show Cause re Preliminary Injunction and Appointment of a Permanent Receiver
7 ("TRO"). The Receiver, the SEC and the Defendants sought clarification of the TRO, which was
8 provided in the Court's Supplement to the TRO ("Supplement"), entered on March 6, 2008. The
9 Supplement provided that Tuco could continue to operate in its ordinary course of business, but
10 that immediate withdrawals by Tuco Members would only be allowed in certain limited
11 circumstances.

12 Also on March 6, 2008, Penson stopped clearing trades for the Tuco accounts at GLB.
13 Members with open positions in the market were permitted to close out or liquidate those
14 positions, but no new trade orders could be placed. Only those Members that had been trading
15 through Tuco's account at ViewTrade were able to continue trading.

16 Telephonic hearings addressing this change in circumstances were held on March 7 and
17 March 10, 2008. At those hearings, the Court determined that the TRO and Supplement would
18 remain in effect. Tuco and Frederick represented to the Receiver and the Court that Tuco had
19 sufficient income to cover Tuco's operating expenses in the short-term. The Court set a schedule
20 for the filing of the Receiver's accounting and the parties' briefs regarding the Order to Show
21 Cause. Also discussed at the March 10 hearing was a potential transaction between Tuco and
22 GLB in which, for a limited period of time, GLB would pay the operating expenses of Tuco,
23 including rent, employees and other costs, in exchange for the temporary use of the Tuco
24 Premises, software, and employees.

25 On March 14, 2008, the SEC filed the Consents of Tuco and Frederick, and a Joint Motion
26 for Judgment of Permanent Injunction and Orders: (1) Freezing Tuco's Assets, (2) Appointing a
27 Permanent Receiver for Tuco; and (3) Prohibiting the Destruction of Documents ("Judgment").
28 The Court entered the Judgment on March 17, 2008.

1 On March 17, 2008, the Receiver and his professionals, Frederick and his counsel, and
2 Robert Lechman of GLB met to discuss the material terms of the temporary transaction that was
3 discussed at the March 10 telephonic hearing. The parties came to agreement on the material
4 terms, subject to documentation and Court authorization.

5 **II. RELIEF REQUESTED**

6 **A. Service of Notice on Tuco Members by Email**

7 Local Civil Rule 66.1(f) requires that at least ten days notice be provided to all interested
8 parties of the time and place of certain hearings. There are approximately 295 Tuco Members.
9 Tuco has provided the Receiver with an email list for its Members. Notices from Tuco have
10 historically been provided to Members by email. Using email for required notices in this case will
11 substantially reduce administrative expenses, especially considering that a significant portion of
12 Tuco's Members are located overseas. The Receiver has also created a website with information
13 about the case and the Receiver's activities. The website address is
14 http://www.tflinc.com/cases_tuco.html. The website will be updated regularly with pleadings and
15 orders filed in the case, notices to investors and related information. Accordingly, good cause
16 exists to allow all required notices, pleadings, orders and related documents to be served on
17 Members by email.

18 **B. Commissions as Property of the Receivership Estate**

19 The Judgment provides in Part VIII that the Receiver has full powers over all assets of
20 Tuco and its subsidiaries and affiliates. As noted above, the Commissions earned for all trading
21 activity of the Members and others that Tuco and/or Frederick referred to GLB are paid directly to
22 Frederick as the registered representative of Tuco. Frederick deposited the Commissions into
23 Tuco accounts. In order to avoid any confusion and to assist the Receiver in any efforts to collect
24 outstanding Commissions, the Receiver requests an order clarifying that the Commissions are
25 property of the Tuco receivership estate under Part VIII of the Judgment.² Consistent with the

26 _____
27 ² The Receiver understands that Tuco had a unique relationship with one of its Members named
28 T3. Although T3 was treated as one Member for Tuco's purposes, it consists of numerous individual traders or trader groups ("Sub-Members"). T3 charged the Sub-Members commissions which would get processed the same way as commissions earned by Tuco and would be paid directly to Frederick. T3 did a high volume of trading through Tuco's accounts.

1 Judgment, Frederick should be required to turn over all Commissions immediately upon receipt,
2 and the Receiver is also authorized to collect unpaid Commissions directly.

3 **C. Authority to Enter into Temporary Transaction with GLB**

4 The Receiver requests authority to enter into a temporary transaction with GLB on the
5 following material terms:

6 1) The transaction will terminate after the 60th day from entry of the order granting
7 the Receiver authority to enter into the proposed transaction ("Termination Date").

8 2) GLB will pay in advance to the Receiver on the first and thirtieth day on a pro rata
9 basis calculated for a 60-day period all operating expenses of Tuco, including rent, utilities,
10 insurance (property and general liability), maintenance of the Tuco Premises and all equipment
11 located thereon, and expenses for ancillary Tuco operations in Chicago, Illinois, and Dallas, Texas
12 ("Ancillary Sites"), which expenses do not include payments to the former Tuco
13 employees/consultants. GLB's obligation to pay these expenses shall not to exceed \$40,000 per
14 month.

15 3) GLB will have full use of the Tuco Premises and Ancillary Sites. The Receiver
16 and his professionals shall also continue to have unrestricted access to the Tuco Premises and
17 Ancillary Sites.

18 4) Tuco's employees and consultants will be terminated by the Receiver and hired as
19 consultants by GLB. Notwithstanding that arrangement, the Receiver may utilize former Tuco
20 employees/consultants Jarrod Vrazel, Adam Korsin and Ben Ball as needed. The Receiver will
21 reimburse GLB from the Tuco receivership estate a pro rata amount based on historical Tuco
22 salaries/compensation for the actual time that the Receiver uses these employees/consultants.

23 5) GLB will be added as an additional insured party on Tuco's existing property and
24 general liability insurance policies.

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26 Tuco did not charge any commissions to T3; Tuco simply benefited from the reduced rates its
27 software vendor Light Speed charged due to T3's trading volume. The relief requested would
28 not alter Tuco and/or Frederick's agreement with T3. Frederick will be required to promptly
turnover all Commissions and the Receiver will continue to pay to T3 the commissions it
earned from its Sub-Members. Frederick's personal responsibility for Receivership expenses
is not modified by the payment of commissions to T3.

1 6) Within 30 days of entry of the order, GLB must notify the Receiver whether it
2 wishes to propose any other longer term arrangement for the Tuco Premises, Ancillary Sites, or
3 other assets of the Receivership Estate.

4 7) GLB will use the Tuco Premises and Ancillary Sites only for the purposes of GLB's
5 business and will not operate any part of Tuco's former business, or in any way use the name
6 "Tuco" in conducting its GLB business.

7 This temporary transaction will minimize administrative expenses while preserving the
8 Receiver's continued access to the Tuco Premises, Ancillary Sites, and Tuco former
9 employees/consultants to assist the Receiver in conducting his investigation and accounting.

10 **D. Ancillary Matters**

11 The Receiver requests an order modifying certain requirements under Local Civil
12 Rule 66.1 and establishing certain procedures for the administration of the case. Specifically, the
13 Receiver requests that:

14 1) The Receiver's initial report required under Rule 66.1.e be filed in conjunction with
15 the accounting required by Part VIII.E. of the Judgment, which is to be filed as soon as practicable
16 and is estimated by May 30, 2008, and that interim reports be filed thereafter by the Receiver
17 approximately every 120 days;

18 2) The requirements under Rule 66.1.d. be modified to permit the Receiver to use any
19 depository on the approved lists of depositories prepared by the United States Trustee's Office for
20 the Southern District of California and that the Receiver's initial and interim reports to the Court
21 be considered sufficient reporting on the status of receivership bank accounts;

22 3) That to fulfill the equity receivership purposes, the provisions of the Bankruptcy
23 Code and Bankruptcy Rules governing the disposition of assets and liabilities be incorporated for
24 administering assets and liabilities of the receivership estate; and

25 4) That the Receiver and his professionals be permitted to file applications for interim
26 payment of fees and costs approximately every 120 days.

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1 **III. ARGUMENT**

2 **A. This Court Has Broad Discretion in Issuing Orders to Promote the Efficient**
3 **Administration of the Receivership Estate**

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
supervisory role in equity receiverships arises out of the fact that most
receiverships involve multiple parties and complex transactions. A district
court's decision concerning the supervision of an equitable receivership is
reviewed for abuse of discretion.

21 Id. (citations omitted); see also Commodities Futures Trading Comm'n. v. Topworth Int'l, Ltd.;
22 205 F.3d 1107, 1115 (9th Cir. 1999) ("This court affords 'broad deference' to the court's
23 supervisory role, and 'we generally uphold reasonable procedures instituted by the district court
24 that serve th[e] purpose' of orderly and efficient administration of the receivership for the benefit
25 of creditors."). Accordingly, this Court has broad equitable powers and discretion in formulating
26 procedures, schedules and guidelines for administration of the Tuco receivership estate.

1 **B. Service on Tuco Members by Email Should be Deemed Sufficient**

2 As noted above, service by email on Tuco's approximately 295 Members will provide a
3 substantial savings to the receivership estate. A significant portion of the Members are located
4 overseas, and all Members have historically received notices and other communications from
5 Tuco by email. Tuco has provided an email list which the Receiver will maintain and update
6 throughout the case. Furthermore, the Receiver's website will provide an up to date resource for
7 Members seeking information about specific matters or the case generally. Accordingly, the
8 Receiver requests an order permitting service on the Members of all required notices, pleadings,
9 orders and other documents by email.

10 **C. The Commissions Paid to Frederick Are Properly Deemed Property of the**
11 **Receivership Estate Requiring Turnover Promptly by Frederick**

12 The Receiver understands that commissions earned on trading securities cannot be paid by
13 a clearing firm or a broker-dealer to an unlicensed person or entity. Accordingly, the
14 Commissions have been paid directly to Frederick, rather than to Tuco. Frederick then deposits
15 the Commissions into Tuco accounts. To avoid any confusion or difficulty in collecting
16 Commissions, the Receiver requests an order clarifying that the Commissions are property of the
17 Tuco receivership estate under Part VIII of the Judgment. The Commissions have historically
18 been treated as Tuco property and are derived from the trading activity of Tuco's Members and
19 those that Tuco and/or Frederick have referred to GLB.

20 **D. The Receiver Should Be Granted Authority to Enter into the Temporary**
21 **Transaction with GLB**

22 Until the documents and electronic data located at the Tuco Premises can be reviewed and
23 analyzed, the Receiver must continue to have access thereto and to the employees of Tuco that are
24 familiar with Tuco's operating and accounting systems. The temporary transaction with GLB will
25 relieve the receivership estate of the obligation to pay rent and expenses associated with the Tuco
26 Premises and Ancillary Sites for the 60-day period following entry of the requested order. The
27 agreement, the material terms of which are described above, will minimize administrative
28 expenses while allowing the Receiver and his professionals sufficient time to secure critical data,

1 and gain a more complete understanding of Tuco's business, accounting systems and financial
2 condition. Accordingly, the temporary transaction with GLB is in the best interests of the
3 receivership estate and its creditors.

4 **E. Ancillary Matters Regarding Administration of the Receivership Estate**

5 The Receiver requests an order establishing the following procedures, schedules and
6 guidelines to assist in the efficient administration of the receivership estate:

7 **1. Reporting**

8 The Receiver's suggests that the initial report required under Rule 66.1.e be filed in
9 conjunction with the accounting required by Part VIII.E. of the Judgment, which is to be filed as
10 soon as practicable. Rule 66.1.e states that a receiver's initial report shall be filed within 30 days
11 of appointment. The Receiver estimates that he will be able to file the accounting by May 30,
12 2008, only approximately 45 days after the initial report would be required under Rule 66.1.e.
13 The accounting will be accompanied by a report from the Receiver. Filing the initial report and
14 the accounting together will eliminate the expense of generating two reports.

15 The Receiver also proposes that interim reports be filed by the Receiver approximately
16 every 120 days thereafter, such that the Court and other interested parties can be kept informed of
17 the Receiver's activities while keeping expenses associated with generating reports to a reasonable
18 amount.

19 **2. Banking**

20 The Receiver requests that the requirements under Rule 66.1.d. be modified to permit him
21 to use any depository approved by the United States Trustee's Office for the Southern District of
22 California for bankruptcy cases. The list of approved depositories can be viewed at
23 http://www.usdoj.gov/ust/r15/Forms/authorized_depositories.pdf. The Receiver's also requests
24 that his initial and interim reports to the Court be considered sufficient reporting on the status of
25 receivership bank accounts (in lieu of having to present bank statements and cancelled checks to
26 the clerk every month). This measure will also help reduce administrative expenses.

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1 3. Bankruptcy Law as Guideline for Administration of Estate

2 In the absence of controlling authority, district courts supervising equity receiverships
3 often look to bankruptcy law for guidance. S.E.C. v. American Capital Investments, Inc., 98 F.3d
4 1133, 1140 (9th Cir. 1996) abrogated on other grounds by Steel Co. v. Citizens for a Better
5 Environment, 523 U.S. 83 (1998) (applying bankruptcy authority by analogy to determine the
6 mootness effect of a sale's closing upon an appeal from a sale confirmation order in an equity
7 receivership); Topworth, 205 F.3d at 1116 ("The local rules of the Central District of California
8 direct receivers, unless ordered otherwise by the court, to 'administer the estate as nearly as
9 possible in accordance with the practice in the administration of estates in bankruptcy."); Fleet
10 Nat'l Bank v. H & D Entertainment, 926 F. Supp. 226, 240 n.56 (D. Mass. 1996) ("what is
11 permitted under the Bankruptcy Code, generally is, therefore, *a fortiori*, permissible under
12 receivership law.").

13 This receivership case, although pending before the District Court and not the bankruptcy
14 court, will operate much as a liquidation of a business would under the Bankruptcy Code. Assets
15 must be liquidated, claims reviewed and funds distributed. The Receiver requests that the
16 Bankruptcy Code and Bankruptcy Rules governing property of the estate, including sales of assets,
17 treatment of executory contracts and unexpired leases, and related matters be governed by the
18 Bankruptcy Code and Rules to the extent that Ninth Circuit federal equity receivership law does
19 not specifically address these issues. The Bankruptcy Code, Rules, and cases interpreting them
20 provide additional clarity and certainty that will assist in the orderly and efficient administration of
21 the estate.

22 4. Fee Applications of the Receiver and His Professionals

23 The Receiver requests that he and his professionals be permitted to request interim
24 payment of their fees and costs approximately every 120 days. This is the time frame for
25 professional fee applications provided under section 331 of the Bankruptcy Code. 11 U.S.C.
26 § 331. As always, the Court can review the fee applications and determine what amounts to
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1 approve.³ This will keep fees and costs associated with generating fee applications to a reasonable
2 amount without unfairly delaying compensation of the Receiver and his professionals.

3 **IV. CONCLUSION**

4 Based on the foregoing, the Receiver requests entry of an order in aid of receivership
5 specifically providing as follows:

- 6 1) Service on all Members of Tuco by email shall be deemed proper and effective
7 service of all required notices, pleadings, orders and related documents;
- 8 2) The Commissions are property of the Tuco receivership estate under Part VIII of
9 the Judgment, subject to immediate turnover to the Receiver upon receipt by Frederick;
- 10 3) The Receiver is authorized to enter into a temporary transaction with GLB on the
11 terms and conditions described herein;
- 12 4) The Receiver's initial report required under Local Civil Rule 66.1.e. may be filed in
13 conjunction with the accounting required under Part VIII.E. of the Judgment. Interim reports of
14 the Receiver shall be filed approximately every 120 days thereafter;
- 15 5) The Receiver may use any depository approved by the United States Trustee's
16 Office for the Southern District of California for all banking needs in connection with this case.
17 The Receiver shall report on the status of all receivership bank accounts in his initial and interim
18 reports, but is not required to deliver to the clerk bank statements and/or cancelled checks on a
19 monthly basis;
- 20 6) To the extent that Ninth Circuit federal receivership law does not address issues
21 that arise in the administration of the Tuco receivership estate, the Bankruptcy Code, Bankruptcy
22 Rules and cases interpreting them shall govern;
- 23 7) The Receiver and his professionals may apply to the Court for interim payment of
24 fees and costs approximately every 120 days; and

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28 ³ As is customary in bankruptcy cases, the Receiver and his professionals will be requesting
payment of 80% of their fees and 100% of their costs in their interim fee applications, with the
balance of fees reserved for approval until the final fee application.

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8) Granting such other relief as the Court deems just and proper.

Dated: March 19, 2008

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

By: /s/ David L. Osias
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Attorneys for Permanent Receiver Thomas F.
Lennon