IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	**Case No. 4:09-cv-3674**
	§	
ALBERT FASE KALETA and KALETA CAPITAL MANAGEMENT, INC.,	§	
	§	
and	§	
	§	
BUSINESSRADIO NETWORK, L.P., d/b/a BizRadio and DANIEL FRISHBERG FINANCIAL SERVICES, INC., d/b/a DFFS CAPITAL MANAGEMENT, INC.,	§	
	§	
Relief Defendants.	§	

INVESTORS' POST-HEARING BRIEF REGARDING PERFECTED SECURITY INTEREST IN PROCEEDS FROM SALE OF RADIO STATION ASSETS

Come now Ronald & Lavonne Ellisor, Richard Kadlick, Sailaja Uri Konduri, Robert Ficks, Larry Mullins, TR Dunn Family Trust, Diane & Paul Collings, Kohur Subramanian, Timothy Koehl, Martin Grosbol, Doug & Kay Shaffer, Alisa K. Jones, Kevin Deering, Ed & Helena Gray, Johnny & Betty Gauntt, Tony Huerta, Jacob Tsabar, Marcus Erickson, Kurt Everson, George & Marene Tompkins, Richard Burkhart, James Maas, James & Patricia Stewart, Bob & Kathy Horlander, Don Keil, Dr. Gerald Crouch, Paul & Simona Williams, Steve Cook, Florence Reiley, Carlos Barbieri, Ivan Curiel, Jack McElligot, Pamela McElligot, Raymond Warner, and John Willis (hereinafter "Investors") and file this Post-Hearing Brief Regarding Perfected Security Interest in Proceeds from

the Sale of the Radio Station Assets,[1] and in support thereof, would show the Court as follows:

SUMMARY

The Court has requested additional information about the viability of the Wallace Bajjali UCC-1 Financing Statement for preserving Investors' perfected security interest and on the issue of whether Investors are entitled to equitable subrogation with respect to the requirement that the transfers be "involuntary." Additionally, Investors offer clarification on the Receiver's argument regarding the "taint" on the Wallace Bajjali Investment Fund II 11% and 12% Noteholders bank accounts.

The Texas version of the Uniform Commercial Code, and Fifth Circuit opinions interpreting it, are clear that a secured party may be listed on a UCC-1 in a representative capacity, precisely as Wallace Bajjali is here. Nothing in the *Fretz* opinion or other cases changes that.

The requirement that a transfer be "involuntary" to qualify for equitable subrogation does not relate to whether the lender made the transfer voluntarily – it relates to whether the investor made an *unsecured* loan voluntarily. If a party pays off a loan of another with an understanding that a security interest would result, Texas law equitably subrogates that party to the position of the original lender. Even if there is no such understanding, Texas will equitably subrogate the new lender if they made the payment to protect some other interest. It is the second part of that rule that is causing confusion here. This Court need not consider whether Investors had another interest to protect because they had an understanding, through their agent, that they would stand in the shoes of the original lenders, IIR and STB.

Finally, the Receiver has produced no evidence that the Wallace Bajjali accounts at issue were tainted by Receivership funds. Likewise, there is no authority from the Fifth Circuit or Texas holding

[1] Investors have withdrawn their objection to the sale to South Texas Broadcasting (or another winning bidder)

that the Court cannot trace traceable funds merely because an account is tainted.

II.

ARGUMENT & AUTHORITIES

A. IIR's UCC-1 Sufficiently Identifies the Secured Parties Under the UCC.

Texas Business & Commerce Code, Section 9.502, provides in pertinent part that:

> (a) Subject to Subsection (b), a financing statement is sufficient only if it:
> (1) provides the name of the debtor;
> (2) provides the name of the **secured party** or a **representative** of the **secured party**; and
> (3) indicates the collateral covered by the financing statement.

TEX. BUS. & COMM. CODE ANN. §9.502 (West 2011). Section 9.502 was amended to include the representative language after the *Fretz* opinion was issued to clarify that a representative of a secured party can be identified as the secured party on a financing statement. There should be no discussion around whether IRR's UCC-1 filing covers Investors. It names IIR, which is the secured party in whose shoes Investors stand, and it names Wallace Bajjali Investment Fund II, which is a representative of Investors. We know that Fund II was a representative of Investors because David Wallace testified to that fact, and because Investors' funds were transferred to IIR and STB through an Investment Fund II bank account. As if that were not enough, the UCC-1 also refers to "other senior lenders," which is clearly a reference to the other senior lenders defined in the IIR promissory note and security agreement as those Investors who paid down the IIR and STB indebtedness.

Courts around the country have routinely upheld security interests where agents of the secured party were identified. A financing statement's designation of "[secured party's attorney], Agent" as secured party did not prevent perfection of secured party's security interest under UCC § 9-

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and are asserting their security interest against the proceeds of the sale.

402(1), as potential creditor seeing word "agent" following attorney's name on financing statement would be put on notice that he was acting on behalf of another person or agent as actual secured party; listing of "[secured party's attorney], Agent" as secured party was not misleading within meaning of UCC § 9-402(8). *Matter of Confabco, Inc.*, 178 B.R. 421, 26 U.C.C. Rep. Serv. 2d 577 (Bankr. E.D. La. 1995) (applying Louisiana law).

A financing statement naming as the secured party the principal creditor's nominee rather than the principal creditor itself was held *In Re Cushman Bakery*, 526 F.2d 23, 18 U.C.C.R.S. 1 (1st Cir. 1975), *cert denied*, 425 U.S. 937, 48 L.Ed 2d 178, 96 S.Ct 1670 (applying Maine law), to be a sufficient compliance with the provision of the UCC that a financing statement give the name and address of the secured party. The Uniform Commercial Code does not require that the secured party as listed in a financing statement be a principal creditor and not an agent. Because the purpose of a financing statement is to give notice that the secured party may have a security interest in the collateral described, it makes no difference whether the secured party listed in the financing statement is a principal or an agent, reasoned the court. *Id.*

A financing statement naming a trust company as secured party was held in *Industrial Packaging Products Co. v. F. Pitt Packaging International, Inc.*, 399 Pa. 643, 161 A.2d 19, 1 U.C.C.R.S. 634 (1960), sufficient to perfect a security interest even though the trust company acted in a subsequent transaction covered by the financing statement as agent for another rather than as principal creditor. The purpose of filing the financing statement is to give notice to potential future creditors of the debtor or purchasers of the collateral, the court said, and it makes no difference as far as such notice is concerned whether the secured party listed in the financing statement is a principal or an agent; moreover, no provision in the UCC draws such a distinction.

In *Heights v Citizens Nat. Bank*, 463 Pa. 48, 342 A.2d 738, 17 U.C.C.R.S. 337 (1975), it was

held that a secured creditor who had already filed a financing statement perfecting its security interest was under no obligation to file a new financing statement naming an additional secured creditor when it subsequently entered into an agreement whereby another creditor participated in the financing arrangement and the original secured party became, as to a part of the secured interest, the agent of the subsequent creditor. The Uniform Commercial Code does not require that the secured party as listed in such statement be a principal creditor and not an agent, commented the court.

The Receiver relies on the authority of *In re E.A. Fretz Co.*, a 1978 opinion, in his effort to invalidate the security interest of the Priority Secured Noteholders, a subset of the "Investors" as denominated in Investors' Objection to Sale. As outlined herein, the reliance on *Fretz* is misplaced, and the Priority Secured Noteholders indeed hold a perfected security interest in the assets of BusinessRadio and the proceeds thereof.

First, the Receiver oversimplifies the holding of *Fretz* to the point of misstating it. *Fretz* is cited here for the proposition that related entities, such as the subsidiaries of a secured creditor, may not rely on the parent company/original lender's financing statement in order to perfect or establish the priority of its claim against the debtor unless they are expressly named in the financing statement. *See* STB Summ. Br. at n 4. However, the express holding in *Fretz* is that the Uniform Commercial Code, construed in light of the Bankruptcy Act, does not permit the use of post-petition assignment of claims to achieve secured status among such related entities. *See Fretz*, 565 F.2d at 367, 374-75 (noting that giving effect to the assignment of claims after the debtor entity's bankruptcy filing would violate the cardinal principle of equality of distribution in bankruptcy and would create floating secured parties).

Second, the *Fretz* case is factually distinct from the instant one. *Fretz* involved two Revlon subsidiaries that assigned a *separate* debt to their parent company. *See Fretz*, 565 F.2d at 367-68.

Here, the security interest at issue arises from the *same* debt (IIR's and STB's original loans). Additionally, the Priority Secured Noteholders acquired their security interest from IIR and STB, the original secured parties, which is opposite of the *Fretz* scenario. In the instant case, all financing instruments mentioned "other senior lenders". *See* UCC-1. While the subsidiaries in the *Fretz* case had to assign their interest to invoke the security agreement, the loan documents between the parties did not require as much of the Priority Secured Noteholders. The Priority Secured Noteholders immediately succeeded to the rights of IIR in BusinessRadio Houston's assets by the terms of the IIR Promissory Note (signed by BusinessRadio Houston, LLC) and the STB Promissory Note (signed by STB), which agreements did not require the filing of a new financing statement or the execution of any documents for contractual subrogation to occur. Being that the assignment essentially ran from original secured party to assignee, continuous perfection applies under Texas Business & Commerce Code § 9.310(c). No filing of a new or amended financing statement was required by contract or statute.

Also in contrast to *Fretz,* the identity of the Priority Secured Noteholders was easily ascertainable from the original financing statement on record. The concerns raised in the *Fretz* opinion about "floating secured parties" would not present an obstacle to an outside party in evaluating an intended transaction involving BusinessRadio or its assets, because a transactional agency relationship existed between WB Fund II and WB Partners as agents of the original secured party and the Priority Secured Noteholders, and because IIR, as the original secured party, and its agents had updated records at all relevant times sufficient to identify all successors to the IIR security interest. As the *Fretz* court states, a lender should be able to determine what secured parties claim a prior interest in the same collateral through financing statements on record. *See Fretz*, 565 F.2d at 372. Particularly in light of the agency relationships among the parties, and because WB Fund II and

WB Partners are related entities, any outsider to the transaction could have found, through WB Fund II, all relevant information on outstanding loan balances and parties to the transaction, including the Priority Secured Noteholders and anyone else who had provided replacement funding and thereby owned a stake in the original IIR position. It does not create an instance of "floating secured parties" such as to frustrate reasonable diligence in evaluating a secured transaction involving the BusinessRadio assets as collateral. On that basis, the actions of the Priority Secured Noteholders satisfy the intention of the UCC filing provisions. A financing statement that is not "seriously misleading" is sufficient to perfect a security interest. Tex. Bus. & Comm. Code §9.506(a). Official Comments to the UCC manifest the intent to enact a system of "notice filing" and to avoid the harsh effects of formal defects in financing statements.

BusinessRadio Houston, LLC, the debtor, cannot complain about whether the UCC-1 gave notice to non-existent third parties anyway. BusinessRadio Houston, LLC, represented here by the Receiver, had actual knowledge of the identity of the Noteholders – they were named in the BizRadio QuickBooks file.

For these reasons, the Priority Secured Noteholders are perfected by the financing statement filed by WB Fund II, and therefore hold a senior security interest in the radio station assets. As such, the Priority Secured Noteholders ask the Court to enter an Order confirming their priority security interest in the proceeds of the radio station sale based on Noteholders' contractual subrogation to the priority security interest of IIR.

B. Investors' Transfers Were "Involuntary."

The latest Texas Supreme Court case upholding the doctrine of equitable subrogation as the law of the State of Texas states:

"Over a century ago, we declared that 'the courts of no state have gone further' than Texas 'in applying the doctrine of subrogation' because 'our decisions recognize the doctrine …to the fullest extent.'" *Frymire Engineering Co., Inc. v Jomar Int'l, Ltd.*, 259 S.W.3d 140, 141 (Tex. 2008) *quoting Faires v Cockerell*, 88 Tex. 428 (1895). As further explained by the Texas Supreme court, in the *Frymire* case,

> The doctrine of equitable subrogation allows a party who would otherwise lack standing to step into the shoes of and pursue the claims belonging to a party with standing. Texas courts interpret this doctrine liberally. Although the doctrine most often arises in the insurance context, equitable subrogation applies 'in every instance in which one person, not acting voluntarily, has paid a debt for which another was primarily liable and which in equity should have been paid by the latter.'

Id at 142 (citations omitted). The Receiver's first contention that equitable subrogation only applies in real estate transactions must be dismissed by the Court as the case law specifically holds that the doctrine of equitable subrogation applies "in every instance" and not just real estate transactions.

The only elements that must be shown for equitable subrogation to apply are that (1) the debt was paid involuntarily and (2) the debt was owed by another. *Id*.

The Receiver does not dispute that the second element has been satisfied but disputes that the payments made to IIR and STB to pay off, or reduce, the indebtedness, owing by Business Radio to both of these Lenders were made involuntarily by Wallace Bajjali, as agent for the Investors.

The *Frymire* case discussed the involuntary standard and states, "A payment is voluntary when the payor acts 'without any assignment or agreement for subrogation, without being under any legal obligation to make payment, and without being compelled to do so for the preservation of any rights or property.'" *Id*. at 145 (emphasis added). Further, "Texas courts are 'liberal in their determinations that payments were made involuntarily.'" *Id.* If a party pays the debt with an understanding that the payor will stand in the shoes of a creditor, that is sufficient to make the

payment an involuntarily unsecured payment. Particularly if there is a fraud on the payor, courts have, for more than 120 years, applied equitable subrogation to protect the party paying the debt.

The most analogous case to the facts at hand is the 5th Circuit case of *Rubarts v First Gibraltar Bank, FSB*, 896 F.2d 107 (5th Cir. 1990), which found a right of equitable subrogation when monies were loaned to pay off a previous valid lien on property, even though the loan documents of the new claimant were fraudulent and did not properly affix a lien to the property in question. In the *Rubarts* case, First Texas loaned money to Diversified, a corporate entity of Borrowers, secured by the Borrowers' homestead, which was used, in large part, to pay off a prior first lien held by First Texas. Because the property at issue was always the homestead of the Borrowers, the Fifth Circuit held that the new lien was unenforceable and could not be foreclosed. However, "this does not end the matter. First Texas claims that even if it cannot foreclose its lien on the Rubartses' home, it is entitled to subrogation. We agree." *Id*. at 114. In holding that First Texas would enjoy equitable subrogation, the Fifth Circuit held that the payment was involuntary because, "it is well established in Texas that '[one] who advances money to pay off an incumbrance on realty at the instance of …the owner…, *either on the express understanding* ***or under circumstances from which an understanding will be implied***, that the advance made is to be secured by a first lien, is not a mere volunteer, and in the event for any reason the security is not a first lien…the holder of such security, if not chargeable with culpable or inexcusable neglect, will be subrogated to the rights of the prior incumbrances…'". *Id*. (emphasis added).

The documents executed by all parties clearly evidence this intent. The testimony of David Wallace and Ron Ellisor also establishes that the Investors had an express understanding (individually and through their agent) they would have first secured liens when their funds were used to pay IIR and STB. They each testified that the payments would not have been made if a security interest had

not been granted. Accordingly, they should be entitled to subrogation to effectuate this intent, even if there may have been fraud or defects in documents involved.

The Texas Supreme Court's *Frymire* decision also supports the Investors' contentions that their payments were involuntary. Just as in the instant case, Jomar argued that the Frymire's payments were voluntary because Frymire paid the claim to fulfill its own contractual obligation into which Frymire had allegedly voluntarily entered. The Texas Supreme Court rejected this argument, stating, "Jomar correctly argues that Frymire's contractual payment fulfilled a debt owed by Frymire to the hotel; however, the satisfaction of this contractual debt does not foreclose the existence and satisfaction of another debt owed by Jomar to the hotel. We have previously permitted subrogation-based claims to proceed under similar circumstances." *Id.* at 143. Moreover, in rejecting this argument, the Texas Supreme Court dismissed the argument that subrogation was limited to certain factual scenarios when reiterating its holding that subrogation applied to "'every instance in which one person…has paid a debt for which another was primarily liable.'" *Id.* at 144.

In addition, the *Frymire* case expressly rejects the identical contentions raised by the Receiver that a party who voluntarily enters into a contract and pays a party pursuant to that contract loses its right of subrogation. As stated by the *Frymire* Court,

> According to Jomar, Frymire voluntarily entered the contract and voluntarily satisfied the hotel owner's demands for payment, so it is not entitled to equitable subrogation. We do not read *Smart* as foreclosing equitable subrogation to any party that pays a debt pursuant to the requirements of a contract.
> …
> Jomar's argument that Frymire cannot assert equitable subrogation because its indemnity payment was under a voluntary contract would, if accepted and applied to other contracts, be a radical departure from long settled Texas subrogation law.

Id. at 145.

Applying the law to the facts of this case requires the Court to find that the Investors and their agent, Wallace Bajjali, who made the payments to retire the IIR debt and to reduce the STB debt did not make the payments voluntarily solely because they voluntarily entered into their contractual arrangements with the other parties. In a nutshell, if a party pays the debt of another without having any understanding as to subrogation, and without protecting some legal issue, equitable subrogation would not apply. However, when a party makes a payment voluntarily or pursuant to a voluntary contract *but they have an understanding that they will have a security interest*, then the unsecured nature of the loan was not voluntary, and equitable subrogation is applied to effectuate the intent of the transaction.

This is not a novel rule. In *Oury v. Sanders*, still good law as cited by the *Frymire* Court, as well as by the Fifth Circuit in the *Vogel* case, the Texas Supreme Court said it plainly:

> It is said by the same author that "the doctrine of subrogation is not applied for the mere stranger or volunteer who has paid the debt of another, without any assignment or agreement for subrogation, without being under any legal obligation to make payment, and without being compelled to do so for the preservation of any rights or property of his own." Such a payment would extinguish the debt. Sheld. on Sub., secs. 240, 241. But the same authority adds that "one who pays a debt at the instance of the debtor under such circumstances that it appears to have been contemplated by the parties that he should become entitled to the benefit of the security for the debt held by the creditor from the debtor, may as against the debtor be subrogated to the benefit of such security and of the debt which he has discharged. A party who has paid the debt at the request of the debtor, and under circumstances which would operate a fraud upon him if the debtor were afterwards allowed to insist that the security for the debt was discharged by his payment, may also be subrogated to the security as against the debtor." *Id.*, 247; 2 Lead. Cases in Eq., 287.

Oury v. Sanders, 13 S.W. 1030 (Tex. 1890) (citations in original). Thus, equitable subrogation also applies to prevent fraud, as just as in the *Oury* case, the IIR and STB debt was paid "under such circumstances as would lead to the belief that it was the intention of [the Borrower] at the time to fully protect them. It would be a fraud against them if an obligation could not be implied on his part to subrogate them at least to the debt and lien." *Id*. Similarly, in our case, all of the documents and

testimony establishes that the debt was paid at the Borrower's instance and that it was the parties' intentions that the Investors would be protected by a first lien to the extent the funds were utilized to pay IIR, as well as the lien of STB, to the extent paid with their funds. Further, just as in the *Oury* case, equitable subrogation can be applied even if the investor was not consulted as to the payment as long as the payment was made with their funds.

C. Investors' Funds Are Traceable Regardless of Other Deposits.

The Receiver cites a number of cases from outside of the Fifth Circuit for the proposition that if tainted funds come into the account they eliminate the ability to trace investor funds. Aside from the fact they are not binding authority, the Receiver grossly overstates the holdings of those cases. It is only when funds are so commingled that they cannot be segregated that the Court should refuse to trace them. Additionally, when there are systematic deposits from tainted sources, Courts need not agree to trace the funds.

The situation here is very different – these were special purpose bank accounts set up specifically for these loans. A quick view of the accounts shows that the transfers are easily traced. Additionally, here there is strong evidence from David Wallace confirming that it was investors' funds that were transferred out, and there is no countervailing evidence to show otherwise.

Several cases in the Fifth Circuit approve tracing of funds in commingled accounts or tainted accounts if tracing is possible without significant burden on the Court. *See, e.g.*, *US v. Davis*, 226 F.3d 346 (5th Cir. 2000); *In re Flying Boat, Inc.*, 24 B.R. 241 (N.D. Tex. 1999); *US v. Loe*, 49 F.Supp. 514 (E.D. Tex. 1999); *US. v. McConnell*, 258 B.R. 869 (N.D. Tex. 2001). Here, even if there were deposits of BizRadio funds into the accounts at issue, they were insignificant in comparison to Investors' deposits, and therefore Investors' funds may be traced to IIR and STB.

Further, if the forthcoming Wallace Bajjali bank statements show that interest payments were

made by BizRadio to WB, that doesn't end the inquiry. The Receiver must show either that the payments were fraudulent transfers or that the payments were made after the initiation of the Receivership.

PRAYER

For the reasons stated above, Investors ask that the Court approve their priority security interest in the proceeds of the radio station sale.

RESPECTFULLY SUBMITTED,

THE SCHMIDT LAW FIRM

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CERTIFICATE OF SERVICE

This is to certify that the above and foregoing instrument was submitted to the clerk of the court using the electronic case filing system of the court. I hereby certify that the parties below have been served electronically, on this the 7th day of October 2011:

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Electronically

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