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

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

RECEIVER'S POST-HEARING BRIEF ON PURPORTED SECURED INTERESTS IN PROCEEDS OF SALE OF RADIO STATION AND RELATED ASSETS

SNR DENTON US LLP
Gene R. Besen
State Bar No. 24045491
2000 McKinney Avenue, Suite 1900
Dallas, Texas 75201
(214) 259-0900
(214) 259-0910 - Fax
ATTORNEYS FOR THOMAS L. TAYLOR III, RECEIVER

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TO THE HONORABLE UNITED STATES DISTRICT COURT:

Thomas L. Taylor III, Court-appointed Receiver[1] in the above styled action, files this Post-Hearing Brief (the "Brief") regarding the Objectors'[2] purported secured interests in the proceeds of the sale of Radio Station KTEK and related assets (the "Radio Station Assets"), and would respectfully show the Court as follows:

I. PRELIMINARY STATEMENT

The Court asked the Receiver to address his tracing/commingling arguments and the Objectors' subrogation arguments. This brief addresses those issues by examining both the applicable law and evidence set forth at the October 3, 2011 hearing.

The uncontroverted evidence adduced at the October 3, 2011 hearing establishes the following facts:

- Albert Kaleta & Daniel Frishberg solicited investors to make loans to BusinessRadio Network, L.P. ("Network, L.P."). (David Wallace Testimony , October 3, 2011 ("Wallace Test."), 94:7-95:3, 105:14-19, 106:15-21).
- The loan investment was presented to Objectors (and other victims) by Frishberg & Kaleta – not by David Wallace or a representative of any Wallace Bajjali entity.
- The attributes of the investment were summarized in a two page memorandum that either Kaleta or Frishberg provided to investors (the "Offering Summary").
- The Offering Summary was a blind pool investment stating that the proceeds from the loan would be used to "acquire or finance certain assets consisting or real estate or other private equity investments." (STB Ex. 48).

[1] All capitalized terms not defined herein shall have the same meaning assigned to them in Receiver's Response to the Objections to the Sale of the Station (Doc. 81) (hereinafter, the "Receiver's First Response"). Other Documents referenced herein are Docs. 70-71 ("First Objection"), Doc. 123 ("Objectors' Outline"), and Doc. 132 ("Objector Breif"). Citations to admitted exhibits of South Texas, Objectors and the Receiver at the Hearing held October 3, 2011 shall be cited as "South Texas Ex. __," "Objectors' Ex. __" and "Receiver Ex. __," respectively.

[2] The objecting investors are 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, the "Objectors").

- The objectors neither read their transactional documents, nor knew where their specific funds would be directed until after they were utilized to make a loan to Network, L.P., acquire real estate, or fund another private equity investment. (Ron Ellisor Testimony, October 3, 2011 ("Ellisor Test."), 177:11-15, 178:23-25).
- The funds flowed into the 11% and 12% accounts from numerous investors (not only Objectors), other Wallace Bajjali entities, and receivership entities including Business Radio Network, L.P. ("Network, L.P.") and Kaleta Capital Management ("KCM"). (Wallace Test. 130:12-20, 131:8-24).
- Network, L.P. sent funds to Wallace Bajjali to make periodic payments of principal and interest to the investors on their notes.

There is no controversy that the Objectors were defrauded by Kaleta and Frishberg. Likewise, there can be no controversy that Kaleta and Frishberg pilfered their investment advisory clients (including the Objectors) to obtain funds needed to continue operating Firshberg's radio station, KTEK. Without funds to operate the station, DFFS, Frishberg, and Kaleta would not have had new clients, and more importantly, new clients' money to funnel back into the KTEK, and the entire scheme would have collapsed that much sooner. (Wallace Test. 130:21-131:2).

The offering that victimized these Objectors is merely the next evolution of raising money to perpetuate the fund. The financial fates of each and every victim of this expansive fraud have been forever altered. Sadly, this Receivership Estate is left with few assets to make all victims whole. In the face of these financially devastating facts, Objectors ask the Court to elevate their claims above the claims other investors who were victimized by the same people, in the same manner, and by the same nefarious scheme. They do so alleging they received security interests in the very Radio Station Assets Firshberg and Kaleta used to perpetuate the fraud and harvest new victims.

II. ARGUMENT AND AUTHORITIES

A. Tracing, Commingling, and the Propriety of Pro Rata Distribution

Objectors purport to trace their investments directly to payments made to IIR and South Texas on behalf of BusinessRadio Houston, LLC ("Radio Houston"). Objectors, however, cannot establish tracing of their funds by a preponderance of the evidence. Given this fact, the Court need not further entertain their equitable and contractual subrogation claims. Objectors are not entitled to priority interest in, or lien on, the proceeds from the sale of the Radio Station Assets because (1) they cannot trace Objectors' funds to the payment of South Texas and IIR by a preponderance of the evidence; (2) to the extent funds from BizRadio Network, L.P. entered the same account as Objectors' funds, those accounts are commingled and tracing is no longer appropriate; (3) to the extent Objectors rely on the Initial Loan Documents as the basis for their purported priority, KCM (a receivership entity) also advanced funds to satisfy indebtedness of IIR on behalf of Radio Houston, and therefore, KCM investors have, at least, the same priority to the proceeds from the sale as do the Objectors; and (4) the assets of the Receivership Estate, including the proceeds from the sale of the Radio Station Assets, should be distributed pro rata in a manner consistent with existing Fifth Circuit precedent for Ponzi scheme receiverships.

1. ***Objectors Cannot Trace Their Funds Directly To South Texas or IIR***

Objectors' contractual and equitable subrogation claims are premised on their alleged ability to directly trace their funds to payments made to South Texas and IIR on behalf of Radio Houston. While Objectors' funds were deposited into Wallace Bajjali Fidelity Account Nos. 636-299189 (the "12% account") and 636-299103 (the "11% account") that funded transfers to South Texas and IIR, it is far from clear that Objectors can actually trace their individual funds directly to those payments. In many circumstances Objectors' funds are mixed with funds from other sources, including other non-objecting investors. In other instances, there is simply no evidence demonstrating that a specific Objector's funds were used to make the payment claimed by the Objectors.

Objectors informed the Court that their claims for priority and/or liens on the proceeds from the Radio Station Assets only related to the specific investors and transfers identified on page 16 of *Objectors' Outline*, Doc. No. 123-1 ("PG 16"), which is based on the work of David Wallace, Objectors' Ex. 10, Exhibit G (hereinafter "Wallace Summary"). (Wallace Test. 51:2-5). Objectors, however, cannot establish their asserted priority and/or liens by a preponderance of the evidence because they cannot trace their funds directly to the transfers they identify on PG 16.

Objectors purported tracing suffers from at least four different flaws. First, Objectors claim a priority interest and/or lien arising from transfers to South Texas or IIR that could not have included the specific Objectors' funds because the account balance reached virtually zero after the Objector's investment was received, but prior to the purported transfer to South Texas or IIR.[3] *See Vaughn Motors, Inc. v. Weathers*, No. 00-50358, 2001 WL 85918, at *2-3 (5th Cir.

[3] ***Martin Grosbol*** Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Martin Grosbol's $14,000 investment on August 11, 2008 that Objectors contend was included in the $472,947 transfer to IIR on September 30, 2008. Martin Grosbol's investment of $50,000 is made on July 28, 2008. The balance of the 12% account drops below $1,000 three times before it drops below $1000 again on September 3, 2008: (1) $631.73 on August 11, 2008; (2) $616.73 on August 13, 2008; and (3) $556.73 on August 26, 2008. Accordingly, there is no basis to trace Martin Grosbol's funds to the September 30, 2008 transfer to IIR.

James Stewart Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for James Stewart's $100,000 investment on August 11, 2008 that Objectors contend was included in the $472,947 transfer to IIR on September 30, 2008. On September 3, 2008, the balance of the 12% account drops to $577.20. Accordingly, there is no basis to trace James Stewart's funds to the September 30, 2008 transfer to IIR. In addition, the Wallace Summary does not attribute any of James Stewart's funds to a transfer to either IIR or South Texas.

Geraldine Willis Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Geraldine Willis's $100,000 investment on August 12, 2008 that Objectors contend was included in the $472,947 transfer to IIR on September 30, 2008. Geraldine Willis' investment is transferred to the 12% account on August 12, 2008. On September 3, 2008, the balance of the 12% account drops to $577.20. Accordingly, there is no basis to trace Geraldine Willis's funds to the September 30, 2008 transfer to IIR. In addition, the Wallace Summary does not attribute any of Geraldine Willis's funds to a transfer to either IIR or South Texas.

Tompkins, Inc. Objectors do not claim a lien or priority interest in connection with this investment.

Tim Koehl Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Tim Koehl's $30,000 investment on August 12, 2008 that Objectors contend was included in the $472,947

Jan, 25, 2001) (applying the lowest intermediate balance rule to commingled funds); *U.S. v. McConnel*, 258 B.R. 869, 874 (N.D. Tex. 2001) (applying the lowest intermediate balance rule to commingled funds). Second, the bank records underlying other purported transactions are contradicted by Wallace's Summary.[4] Third, in several instances, Objectors' funds enter either the 11% or 12% accounts with substantial pre-existing balances or at a time that hundreds of thousands of dollars are transferred into the same account, and there is no meaningful way to distinguish the specific funds actually used to fund a transfer to South Texas or IIR.[5] Fourth, in

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transfer to IIR on September 30, 2008. Tim Koehl's investment is transferred to the 12% account on August 14, 2008. On September 3, 2008, the balance of the 12% account drops to $577.20. Accordingly, there is no basis to trace Tim Koehl's funds to the September 30, 2008 transfer to IIR. In addition, the Wallace Summary does not attribute any of Tim Koehl's funds to a transfer to either IIR or South Texas, but rather directly to Network, L.P.

[4] ***Ron Ellisor*** Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Ron Ellisor's purported $220,000 loan to BizRadio and South Texas. According to PG 16, Mr. Ellisor loaned $220,000 to Network, L.P. on April 14, 2008. While Mr. Ellisor's Promissory Note (South Texas Ex. 47) and Security Agreement (South Texas Ex. 48) in the amount of $250,000 are dated 4/14/2008, there are no bank statements for any Wallace Bajjali account for April 2008. Further, PG 16 seemingly contends that $200,000 of Mr. Ellisor's investment was transferred to South Texas/BizRadio. Any monies transferred directly to BizRadio do not give rise to a lien, nor could it be construed as giving rise to a priority position -- Objectors have conceded as much. Second, and more importantly, there are no statements for the 11% and 12% accounts reflecting a wire transfer in the amount of $200,000. To the extent there is any evidence in the record, it is contained in Exhibit G to Objectors' Ex. 9 -- the Wallace Summary. In this instance, the Wallace Summary only reflects evidence of a $200,000 payment to Network, L.P., not South Texas, on May 15, 2008. Further, exhibit E to Objectors' Ex. 9 ("Ex. E") only reflects a $200,000 transfer to Network, L.P. on May 15, 2008. There are no bank records in evidence demonstrating that any portion of Ron Ellisor's funds were used to make a $200,000 payment to South Texas on behalf of Network, L.P. Moreover, David Wallace testified that he reviewed bank records and additional accounting and customer documents to prepare the Wallace Summary (Wallace Test., pg. ln.,) and he concluded Mr. Ellisor's funds were loaned directly to Network, L.P., not South Texas.

Larry Mullins Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Mr. Larry Mullins' $100,000 investment on July 15, 2008 and allege that his funds were also included in the $865,000 transfer to South Texas on July 8, 2008. Mr. Mullins Promissory Note and Security Agreement are date July 7, 2008. (See South Texas Exs. 74 and 75). In addition the 11% account does show a $100,000 deposit hitting the account on July 8, 2008. Moreover, the Wallace Summary does not identify Mr. Mullins in any capacity whatsoever. Thus, Mr. Wallace's review of the Wallace Bajjali records did not demonstrate that Mr. Mullin's funds were used to make a payment or transfer to South Texas on July 8, 2008 in the amount of $865,000. Finally, Objectors cannot demonstrate that Mr. Mullins' funds and not the other funds entering the 11% account on July 8, 2008, were actually used to make the payment to South Texas on July 8, 2008. The flow of money in and out of the account on July 7 and 8, 2008 is substantial. There is no evidence adequately demonstrating that Mr. Mullin's funds, not the funds from other unidentified investors or other Objectors, were included in the July 8, 2008 transfer to South Texas.

[5] ***Martin Grosbol*** Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Martin Grosbol's $36,000 investment on August 1, 2008 that was purportedly included in the $136,231 transfer to IIR on August 1, 2008. Grosbol's $50,000 investment is part of the $200,000 that is transferred into the 12% account in the days prior to August 1, 2008. There is no way to determine if Grosbol's funds are included in

the $136,231 transferred to IIR on August 1, 2008. Moreover, Wallace's Summary indicated that only $14,000 is included in this transfer to IIR. There is not sufficient evidence before the Court to establish by a preponderance of the evidence that Grosbol's $36,0000 was included in the August 1, 2008 transfer to IIR.

Doug and Kathy Shaffer Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Doug & Kay Shaffer's purported $100,000 loan to Network, L.P. that was allegedly included in a $130,000 transfer to South Texas on July 3, 2008. The Shaffer's actually sent money to Wallace Bajjali in June 2008. (See Ex. A to Objectors Ex. 9). The July 11% account statement establishes that a wire transfer was made to South Texas on July 3, 2008 in the amount of $130,000. However, that same day $400,000 from other sources -- not the Shaffers -- are transferred into the 11% account. A review of the "Additions and Subtractions" section of this bank statement shows just $269,970 being deposited into the account on July 3, 2008, i.e., $400,000 in additional deposits less the $130,000 transfer and the $30 transfer fee. Thus, there is no basis, and no evidence to determine that the Shaffers' funds and not funds belonging to another investor that transferred funds on July 3, 2008, were the funds sent to South Texas on this date. Indeed Wallace's Summary reflects $300,000 from Daniel Gunderson on July 3, 2008, but attributes no use whatsoever for his funds. Moreover, the bank statement reflects an additional $100,000 transferred to the account on July 3, 2008 from an unknown investor or entity. (See Ex. A to Objectors Ex. 9). Objectors simply have not established by a preponderance of the evidence that the Shaffer's funds, and not the funds of other different investors, were transferred to South Texas on July 3, 2008.

Richard Kadlick Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Mr. Kadlick's purported $400,000 investment on July 8, 2008. Objectors contend that also on July 8, 2008, Mr. Kadlick's $400,000 was transferred to South Texas. The Wallace Summary contends that the Mr. Kadlick's $400,000 was used for a subsequent later payment to South Texas and not the July 8, 2008 payments. Indeed, the "Additions and Subtractions" section of the July 11% account statement demonstrates that the account balance on 7/3/2008 was $400,331.61, comprised of some portion of the investments by the Shaffers, Mr. Gunderson's $300,000, and an additional $100,000 investment from an unidentified investor or entity. In addition, the $400,000 transfer to South Texas took place on July 7, 2008, the same day Mr. Kadlick's funds were transferred to the 11% account. Given that in excess of $400,000 was already in the account on that day, there is no basis to contend that Mr. Kadlick's funds were used for that transfer. Objectors cannot establish by a preponderance of the evidence that Mr. Kadlick's $400,000 was transferred to South Texas on July 7, 2008.

Steve Cook Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Steve Cook's investment in the amount of $200,000 on July 8, 2008 that was purportedly included in a July 8, 2008 transfer to South Texas in the amount of $865,000. On July 8, 2008 the 11% account has deposits of $555,000, including deposits of $355,000 from investors or entities not identified in the Wallace Summary. In addition, the balance of the 11% account on July 7, 2008 was $565,316.61. Included in that existing balance are funds from Mr. Gunderson, and over $400,000 that flowed into the account from other unidentified investors. There is no basis or evidence from which this Court could determine that Mr. Cook's funds, and not the funds of another unknown investor or entity were included in the $865,000 transfer to South Texas on July 8, 2008.

TR Dunn Family Trust Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for T.R. Dunn Family Trust's investment of $300,000 on July 16, 2008 (see South Texas Ex. ___) that was purportedly transferred to South Texas on the same day in the amount of $276,824. The TR Dunn Family Trust Promissory Note and Security Agreement indicate that $300,000 was invested on July 15, 2008. (South Texas Ex. ____). Contrary to the Objectors' claim, the Wallace Summary indicates that the TR Dunn Family Trust funded $276,824 of July 16, 2008 and that $100,000 of that investment was transferred directly to Network, L.P. The Wallace Summary does not indicate that any of the TR Dunn Family Trust's funds were transferred to South Texas. David Wallace attributed a $300,000 transfer on July 15, 2008 to the TR Dunn Family Trust. (Objectors' Ex. 9 – Ex. A). Nevertheless, the Wallace Summary does not reflect any portion of the TR Dunn Family Trust's funds being transferred to South Texas. Indeed, $535,000 of new money is transferred into the 11% account on July 15, 2008. Those funds are mixed with the existing account balance of $110,256.61, for an account balance of $645,256.61 on the close of business July 15, 2008. Only $300,000 of which could have come from the TR Dunn Family Trust. On July 16, 2008, $376,913.76 is transferred from the 11% account, including a transfer of $276,520.60 to South Texas. There is no way to know for what purpose the TR Dunn Family Trust's investment

was used and Wallace's Summary indicates that $100,000 of TR Dunn Family Trust's funds were transferred directly to BizRadio, precluding its ability to fund the entire transfer to South Texas. Accordingly, Objectors have failed to establish by a preponderance of the evidence that TR Dunn Family Trust's funds were included in the July 16, 2008 transfer to South Texas in the amount of $276,520.60.

Objectors also seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for the TR Dunn Family Trust for an alleged additional $20,000 investment July 18, 2008 that was purportedly included in the July 21 transfer to IIR in the amount of $265,000. Objectors have provided no basis and no evidence supporting their position that the TR Dunn Family Trust made a separate $20,000 loan to Network, L.P. to pay off Radio Houston's indebtedness to IIR. The Wallace Summary does not attribute any funds from the TR Dunn Family Trust to payments made to IIR. Likewise there is no Promissory Note, Security Agreement or bank transfer reflecting TR Dunn Family Trust's funds inclusion in the $265,000 transfer to IIR on July 21, 2008. Accordingly, Objectors have not established by a preponderance of the evidence that $20,000 invested by the TR Dunn Family Trust was included in the $265,000 transfer to IIR on July 21, 2008.

Florence Reiley Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for the Ms. Florence Reiley's $235,000 investment on July 18, 2008 that was purportedly included in a July 21, 2008 transfer to IIR in the amount of $265,000. The 11% account reveals that Ms. Reiley's $235,000 is transferred to the 11% account on July 15, 2008. In total $535,000 is transferred into the 11% account on July 15, 2008. Those funds are mixed with the existing account balance of $110,256.61 for an account balance of $645,256.61 on the close of business July 15, 2008. From July 15 through July 21 all but $3,327.85 is transferred out of the 11% account for BizRadio, South Texas and IIR. There is simply no way to determine which investors fund were transferred to which entity and in what amounts. Objectors cannot establish by a preponderance of the evidence that Ms. Reiley's funds were actually included in the transfer to IIR.

Ed Gray Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Ed Gray's $75,000 investment on July 24, 2008 that was purportedly included in the $95,000 transfer to IIR on July 24. The balance on the 12% account at the close of business on July 18, 2008 was $892.13. (Objectors' Ex. 9, Ex. B). On July 22, $295,000 is transferred to the 12% account, including $75,000 from Ed Gray. (*Id.*). On July 23, 2008, two different transfers, each of $100,000 leave the 12% account. (*Id.*). On July 24, 2008, the remaining $95,000 is transferred to IIR. (*Id.*). In addition, the Wallace Summary does not attribute any of Ed Gray's funds to the $95,000 transfer to IIR. Finally, to the extent that Objectors equitable and contractual subrogation claims are based on the Objectors' purported understanding that they would receive a first priority security interest, that position is belied by Ed Gray's documents which only provide for a junior security interest "subordinate and inferior to any liens claims or encumbrances of a senior nature." (STB Ex. 60). Ed Gray's funds cannot be traced to the July 24, 2008 payment to IIR in the amount of $95,000. At best only $25,000 of Ed Gray's investment remained in the account on July 24, 2008. In addition, there is no way to know which investor's money was actually transferred to IIR.

Kevin Deering Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Kevin Deering's $100,000 investment on August 1, 2008 that purportedly was included in the $136,231 transfer to IIR on August 1, 2008. From July 28 through July 31, 2008, $200,000 is transferred into the 12% account. There is no way to determine whether Kevin Deering's funds were used in the transfer to IIR or if that transfer primarily included the additional $100,000 that entered the 12% account along with Deering's $100,000. Finally, to the extent that Objectors equitable and contractual subrogation claims are based on the Objectors' purported understanding that they would receive a first priority security interest, that position is belied by Ed Gray's documents which only provide for a junior security interest "subordinate and inferior to any liens claims or encumbrances of a senior nature." (STB Ex. 73).

one instance the Objector's funds were deposited into an account that did not even make the transfer to South Texas or IIR for which the Objectors claim credit.[6] Finally, in other instances there are no bank records or any other documents, including David Wallace's Summary, evidencing the Objector's funds being utilized in the identified transfer.[7]

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[6] ***Ed Gray*** Objectors also seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Ed Gray's $50,000 investment on August 1, 2008 was purportedly included in the September 30, 2008 transfer to IIR in the amount of $472,947 from the 12% account. As a threshold matter, Ed Gray's investment of $50,000 enters the 11% account on July 25, 2008. Accordingly, there is no evidence sufficient to trace Ed Gray's fund to the $472,947 transfer to IIR from the 12% account.

[7] ***Ron Ellisor*** Objectors also seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Ron Ellisor's purported $30,000 investment on July 3, 2008 that constituted the remainder of the July 3, 2008 transfer to South Texas in the amount of $130,000. This transfer is highly speculative for all the reasons discussed in connection with the claim of Doug and Kathy Shaffer. Here, there is no basis or evidence (only counsel's unadmitted and unproven summary exhibit) that Mr. Ellisor's money went to South Texas. There are no bank records verifying this purported transfer and no wire transfer documents. Objectors have not established by a preponderance of the evidence that $30,000 attributable to Ron Ellisor were transferred to South Texas on July 3, 2008.

Objectors also seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Ron Ellisor's $10,00 investment on July 18, 2008 that Objectors claim was included in the $265,000 transfer to IIR on July 21, 2008. Ron Ellisor has a Promissory Note dated July 18, 2008 in the amount of $10,000. (STB Ex. 49). The Wallace Summary indicates that Ron Ellisor invested $30,000 on July 3, 2008 and that those fund were included in the July 21 transfer to IIR. The 11% account documents, however, do not reflect a deposit of $30,000 or $10,000. There are hundreds of thousands of dollars in the 11% account prior to the transfer to IIR on July 21 and it is impossible to determine if Mr. Ellisor's funds were in fact transferred to IIR. Moreover, to the extent Objectors argue this investment corresponds to the residual amounts from Mr. Ellisor's April investment, such an argument is unavailing. Mr. Ellisor made his initial investment in April 2008, there is no viable argument that some portion of Mr. Ellisor's funds remained in the account until this transfer on July 21, 2008.

Phillip Jones Objectors seek a priority interest in and/or lien on the proceeds from the Sale of the Radio Station Assets for Phillip Jones' $165,000 investment on July 15, 2008 that was purportedly included in the $865,000 transfer made to South Texas on July 8, 2008. Objectors have utterly failed to prove their tracing by a preponderance of the evidence. There are no promissory notes or security agreements in evidence demonstrating the date of Mr. Jones' investment. Moreover, the Wallace Summary does not identify Mr. Jones, in fact the $165,000 transfer reflected on July 11% statement was not highlighted by Mr. Wallace while preparing his summary. David Wallace testified that he reviewed Wallace Bajjali records in addition to bank statements. Mr. Jones absence from the Wallace Summary is contrary to what Objectors contend on PG 16. There is no evidence demonstrating or otherwise linking Mr. Jones to any funds in the 11% account. In addition, Objectors claim a July 15, 2008 loan date relating to a transfer made on July 7, 2008. Objectors have not established by a preponderance of the evidence that Mr. Jones $165,000 was included in the $865,000 transfer to South Texas on July 8, 2008.

Kohur Subramanian Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Kohur Subramanian's $500,000 investment on December 26, 2008 that Objectors contend was used to fund the $315,000 transfer to IIR on January 5, 2009. The 12% account's balance on December 31, 2008 was $317,821.18. Objectors, however, have not produced the 12% account January statement in their Exhibit 9. Accordingly, there is no basis to determine if Kohur Subramanian's funds were transferred out of the 12% account prior to the January 5, 2009 transfer to IIR.

While in three instances the funds claimed by objectors appear to be directly traceable,[8] the vast majority of transfers claimed by Objectors cannot be traced by a preponderance of the evidence. In virtually every case for virtually every individual Objector, there is not sufficient evidence to trace their funds directly to South Texas or IIR. Objectors funds are commingled with funds from other unidentified investors, and it is consistently unclear which investor's funds are actually utilized to make the transfers to South Texas or IIR. To the extent Objectors' rely upon Objectors' exhibit 10, David Wallace indicated he had no confidence in the records of Network, L.P. (Wallace Test. 68:20-22). Objectors cannot establish their purported liens and/or priority claims by a preponderance of the evidence, and accordingly, Objectors claims of contractual and equitable subrogation should be denied.

2. ***KCM Investors Are Entitled to the Same Priority and Should Not Be Subordinated to the Objectors***

The undisputed evidence adduced at the October 3, 2011 hearing established that Objectors do not have a perfected security interest in the Radio Station Assets. But to the extent the Objectors have any superior interests in the proceeds from the Radio Station Assets they are derived solely from the Objectors' reliance on the language contained in the IIR Senior Secured Promissory Note (Objectors' Ex. 6) and Security Agreement (Objectors' Ex. 2). The Senior

[8] ***Marcus Erickson*** Objectors seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Marcus Erickson's $150,000 investment on September 24, 2008 that Objectors contend was included in the $472,947 transfer to IIR on September 30, 2008 from the 12% account. Based upon the bank records and the Wallace Summary it appears that Marcus Erickson's funds were included in the September 30, 2008 transfer to IIR.

Objectors also seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Marcus Erickson's $150,000 investment on September 24, 2008 that Objectors contend was included in the $248,000 transfer to IIR on September 30, 2008 from the 11% account. Based upon the bank records it appears Marcus Erickson's funds were transferred to IIR on September 30, 2008. However, Wallace's Summary indicates that Marcus Erickson's funds in the 11% account were transferred to Network, L.P.

Robert Ficks Objectors also seek a priority interest and/or lien on the proceeds from the Sale of the Radio Station Assets for Robert Fick's $100,000 investment on September 24, 2008 that Objectors contend was included in the $248,000 transfer to IIR on September 30, 2008 from the 11% account. Based upon the bank records it appears Robert Fick's funds were transferred to IIR on September 30, 2008.

Secured Promissory Note states that any party that pays off the indebtedness of IIR would stand in IIR's shoes in right of payment and security: "Replacement Financing shall be *pari passu* in right of payment and security with this Note and shall be secured by the Collateral . . . ." (Objectors' Ex. 6, pg. 2). Likewise, the Security Agreement provides that "additional senior secured promissory notes that are secured by this Agreement[9] on a *pari passu* basis with the IIR Note . . . and that are senior in right of payment and priority to the subordinated secured promissory notes issued by the Borrower to South Texas Broadcasting, Inc." (Objectors' Ex. 2, pg. 1). Thus, Objectors contend that if they trace their funds to IIR they are entitled to stand in the shoes of IIR. (Wallace Test. 120:21-23, 121:7-9, 122:16-23).

Even assuming Objectors could trace their funds to IIR and South Texas, Objectors' purported priority would be equal to—but not superior to—the interests of KCM in the proceeds from the sale of the Radio Station Assets. The undisputed evidence establishes that KCM advanced $1,158,890.00 to directly retire IIR indebtedness. (Objectors' Ex. 10, Wells Fargo Account No. 981-1008877, 01/01/09-01/31/09). Thus, under Objectors' theories, KCM also stands in the shoes of IIR and shares the Objectors' alleged priroity interest in the proceeds from the sale.[10]

3. ***Objectors Funds Are Commingled with Tainted Funds and Cannot Be Traced***

The uncontroverted evidence indicates that periodic payments of principal and interest were made by Network, L.P. to Wallace Bajjali in connection with Objectors' promissory notes from Network, L.P. (Wallace Test. 130:12-20, 131:12-21); (Ellisor Test. 165:7-21, 171:6-14).

[9] It is worth noting that no additional senior secured promissory notes were issued by the Borrower -- Radio Houston.

[10] The Receiver would highlight for the Court that Business Radio Network, L.P., also a Receivership Entity, advanced $125,000 to retire the IIR indebtedness on January 5, 2009, and would also be entitled to the same priority interest, as would any investor who contributed the transferred funds as part of direct equity purchase of an interest in the Radio Station Assets. (Objectors' Ex. 10). Thus, the Objectors and two Receivership Entities would have equal interests in the proceeds of Radio Station Assets.

In addition, Network, L.P.'s own records demonstrate that such payments were made. (Objectors Ex. 11) (5/23/08 – Memo: Repayment P&I on 12% Secured Note – $499,967.00).[11] The uncontroverted receipt of funds from Network, L.P. establishes the presence of tainted funds in the accounts of WB Fund II. The presence of any tainted funds is sufficient to taint the entire account under the law of Ponzi scheme receiverships.

Courts across the country recognize that, due to the fungability of money, *any* commingling is enough to warrant treating all funds as commingled. *SEC v. Byers*, 637 F. Supp. 2d 166, 177 (S.D.N.Y. 2009); *accord U.S. v. Ward*, 197 F.3d 1076, 1083 (11th Cir. 1999) (because money is fungible once tainted proceeds were commingled with other funds all money is tainted and once tainted, proceeds cannot become untainted); *U.S. v. Tencer*, 107 F.3d 1120, 1131 (5th Cir. 1997); *U.S. v. Moore*, 27 F.3d 969, 976-77 (4th Cir. 1994) (When money is commingled it cannot be distinguished); *U.S. v. Garcia*, 37 F.3d 1359, 1365 (9th Cir. 1994) ("it is unnecessary to attempt to segregate in some manner the tainted funds from the commingled account…The presence of some tainted funds . . . is sufficient to taint [all]"); *SEC v. Lauer*, No. 03-80612-CIV, 2009 WL 812719, at *4-5 (S.D. Fla. Mar. 26, 2009); *SEC v. Better Life Club of Am., Inc.*, 995 F.Supp. 167, 181 (D.D.C. 1998) ("When assets are commingled such that the assets cannot be separated out, a constructive trust may extend over the entire asset pool.").

In *SEC v. Byers*, the court held that only some evidence that commingling occurred is sufficient to support a pro rata distribution of all assets, and thereby rejected any priority claims. *Id*. at 178. In *Byers*, a group of investors objected to a pro rata distribution plan claiming they were the only investors entitled to a distribution from a specific account into which they could

[11] Despite including numerous WB Fund II bank records in connection with Objectors Ex. 9, the May account statement for Fidelity account No. 636-299189 (the "12% account") is not included in those materials. Accordingly, Network, L.P.'s records coupled with David Wallace's testimony establish by a preponderance of the evidence that, at least, $499,967.00 from Network, L.P., was received in the WBII accounts.

trace their investments. *Id.* at 178. The court held that mere "coincidence cannot be a basis to treat [certain] investors more favorably" than other similarly situated investors. *Id*.

Just as in *Byers*, the Objectors claim that because they are able to trace their investments to the payment of Radio Houston's indebtedness, they should have a priority interest in the proceeds from the sale of the Radio Station Assets. Yet, David Wallace testified that it was merely fortuitous that Objectors had invested through Wallace Bajjali. (Wallace Test. 118:12-15). The *Byers* court refused to allow tracing or to establish a priority interest where the traced funds have been comingled with tainted assets. Here, the evidence uncontrovertibly establishes that tainted funds flowed from Network, L.P. to WB Fund II and therefore tainted the WB Fund II accounts. Just as in *Byers* this Court should refuse to permit tracing from funds commingled with tainted funds from the Ponzi scheme.[12]

4. ***Pro Rata Distribution Is Equitable and Appropriate***

Federal courts have long held that similarly situated investors in a Ponzi-type scheme generally occupy the same legal position as other investors, thereby leading to the prevailing view that equity should not permit one group a preference over another. *SEC v. Credit Bancorp, Ltd.*, No. 99 CIV. 11395 RWS, 2000 WL 1752979, at *27 (S.D.N.Y. Nov. 29, 2000) (emphasis added) (finding that "[t]he fundamental principle governing the adoption of a distribution plan is that it should be equitable and fair, with *similarly-situated investors treated alike*"); *U.S. v. Durham*, 86 F.3d 70, 73 (5th Cir. 1999); *SEC v. Elliot*, 953 F.2d 1560, 1569 (11th Cir. 1992). As

[12] Objectors make the unsupported claim that the Receiver must show either that payments were fraudulent transfers or that the payments were made after the initiation of the Receivership. Objectors are incorrect. First, the evidence established that Network, L.P. had little, if any, revenue and was constantly raising money from unwitting investors to perpetuate its business of driving additional investment advisory clients into the clutches of Frishberg's and Kaleta's scheme. Objectors have not challenged that Network, L.P., KCM, and other related entities were part of a massive fraudulent Ponzi scheme. Transfers from a Ponzi scheme are presumptively tainted, as they are deemed to be the assets of other unwitting investors. *Quilling v. Schonsky*, 247 Fed. Appx. 583, 586, 2007 WL 2710703, at *2 (5th Cir. 2007) (holding transfers made from a Ponzi scheme are presumptively made with intent to defraud, because a Ponzi scheme is, as a matter of law, insolvent from inception.) (internal citations omitted) (citing *Warfield v. Byron,* 436 F.3d 551, 559 (5th Cir. 2006))).

the Supreme Court explained in the litigation that gave the Ponzi scheme its name, "equality is equity" among "equally innocent victims." *Cunningham v. Brown*, 265 U.S. 1, 13 (1924); *accord SEC v. Forex Asset Mgmt., LLC*, 242 F.3d 325, 331-32 (5th Cir. 2001); *Durham*, 86 F.3d at 73. Objectors are equally innocent victims defrauded in the same scheme, by the same fraudsters as scores of others and are therefore not entitled to any priority.

Because courts agree that investors in a Ponzi scheme generally occupy the same position, courts accept that some investors will receive less than they would under tracing distribution. *SEC v. Orgel*, 407 Fed. Appx. 504, 506 (2d Cir. 2010) (affirming pro rata distribution plan). Courts will not elevate positions of investors based merely on the "actions of the defrauders." *Durham,* 86 F.3d at 72. The Fifth Circuit has held that the fact an investor can trace funds does not make a pro rata distribution inequitable. *Id.*; *see also Orgel,* 407 Fed. Appx. at 505-06 (finding that pro rata distributions are "especially appropriate" for fraud victims of Ponzi scheme).

Objectors simply cannot distinguish the Fifth Circuit cases supporting pro rata distribution plans. In *Durham,* it was "uncontested by court or party that all but $8,803.99 of the money in the [relevant] accounts could be traced to seven claimants." *Durham*, 86 F.3d at 72. However, the district court elected to distribute all the money in the account on a pro rata basis, declining to trace the assets even though it would have been permissible. *Id.* The Fifth Circuit affirmed the District Court's holding, finding that anything but a pro rata distribution would have been "inequitable" where it allowed certain investors to receive a larger return. *Id.* at 72. The pro rata distribution plan was approved and affirmed even though "[n]o one [could] dispute that tracing would have been permissible." *Id.* at 73.

In *Durham* the Fifth Circuit acknowledged the investors *could* have traced the funds, but ultimately held that to permit tracing would not provide the most equitable remedy.[13] *Id.* The same result is true in this circumstance. The Objectors were victimized in the same manner, by the same people, and in the same scheme as scores of other investors. (Wallace Test. 105:14-19); (Ellisor Test. 164:2-8). Equity will not permit coincidence—or the mere fortuitous fact that Objectors were defrauded into investing through Wallace Bajjali—to result in a more substantial recovery when all investor–victims were victimized by the same fraud perpetrated by the same fraudsters. *Forex Asset Mgmt.*, 242 F.3d at 327-29. The Fifth Circuit has repeatedly sided with receivers and refused to apply tracing to the detriment of a larger group of aggrieved investors victimized by a Ponzi scheme. *Id*. at 332. [14]

In addition, at least one district court within the Fifth Circuit has found that pro rata distribution is appropriate even if funds among separate entities were not commingled but part of a "unified scheme to defraud." *See SEC v. Amerifirst Funding, Inc.*, No. No. 3:07–CV–1188–D, 2008 WL 919546, at *4 (N.D. Tex. Mar. 13, 2008) (*citing Forex* and *Durham* and finding that

[13] If any "general rule" exists, it is that the district court is vested with broad discretionary powers to impose an equitable remedy. *See, e.g., Durham,* 86 F.3d at 72; *Forex Asset Mgmt,* 242 F.3d at 331. In utilizing those broad equitable powers, courts have supported the implementation of pro rata distribution plans in situations where the funds were far more distinct than the instant matter where money directly used in the fraud was transferred to and from the accounts at issue. *See, e.g., Forex Asset Mgmt,* 242 F.3d at 330-32 (finding that tracing not proper even when the only funds in the account were the proceeds from the investment); *Amerifirst Funding, Inc.,* 2008 U.S. Dist. LEXIS 2004, at *12-13 (despite less evidence of commingling among separate entities, pro rata distribution warranted).

[14] It should also be noted that numerous cases are in accord with the Fifth Circuit's decisions in *Durham* and *Forex*. *SEC v. Elliot*, 953 F.2d 1560, 1568-69 (11th Cir. 1992) (upholding *pro rata* distribution despite tracing of securities transferred to defrauder); *U.S.* v. *Vanguard Inv. Co.*, 6 F.3d at 224 (4th Cir. 1993) (affirming *pro rata* distribution despite investor tracing transfer of a parcel of real property to defrauder's estate); *Real Property,* 89 F.3d at 553 (affirming *pro rata* distribution even though majority of funds were traceable to specific claimants); *Credit Bancorp*, 2000 WL 1752979, at *16-18 (affirming *pro rata* distribution and distinguishing *SEC v. P.B. Ventures*, No. 90-CV-5322, 1991 WL 269982, at *2-3 (E.D. Pa. Dec. 11, 1991) (affirming *pro rata* distribution and noting that "[a] polling approach as opposed to a tracing approach is the law in this circuit"); *SEC v. Amerifirst Funding, Inc.*, No. 07-CV-1188, 2008 WL 919546, at *2-5 (N.D. Tex. Mar. 13, 2008) (the absence of commingling between various receivership entities does not render a pooled, *pro rata* distribution inequitable); *Homeland*, 2010 WL 2035326, at *2 (affirming *pro rata* distribution).

pro rata distribution plan appropriate even in light of investors claims that pooling investors of each distinct entity would be inequitable "when the separate legal entities were involved in a unified scheme to defraud"). Here there can be no question or legitimate dispute that the Objectors' funds were used in furtherance of the scheme and that the Objectors were victimized by Kaleta and Frishberg in the same manner as scores of other investors.

Finally, Judge Gray Miller has recently approved a pro rata plan of distribution over the objection of a group of investors who argued in favor of tracing. *SEC v. PrivateFX Global One, Ltd., et al*., 778 F. Supp. 2d 775, 783-84 (S.D. Tex. 2011). In *PrivateFX*, a group of investors defrauded in a currency trading scheme could trace their funds directly to a single segregated account and argued that they should be the sole recipients of any distribution from that account. *Id.* at 779-80. Judge Miller relied upon the precedent of *Durham* and *Forex* to approve the pro rata plan of distribution and reject the investors' tracing arguments. *Id.* at 781-84.

While Objectors scenario is unique, it does not warrant elevating their claims above those of any other investor. If anything was made clear at the October 3, 2011 hearing, it was that the Objectors—like all other victims of this multi-faceted fraud—were taken by Frishberg and Kaleta. They were, as David Wallace testified, merely fortuitous to have invested through Wallace Bajjali. (Wallace Test. 118:12-15). Because they did not have perfected security interests in the Radio Station Assets, there is no basis to elevate their claims above the other victims of this fraud.

B. The Objectors Are Not Contractually Subrogated to the Duly Perfected, Valid, or Enforceable Secured Interests in the Radio Station Assets Granted to IIR and South Texas in the Initial Loan Documents

1. ***The Agencies of WB Fund II and WB Development Cannot Be Conflated***

Objectors' claim that they are the "other senior lenders" referenced in the UCC-1 financing statement filed by WB Fund II is belied by their own documentation, which makes

clear that Objectors do not stand in the shoes of IIR or South Texas and are not perfected by the instrument filed by WB Fund II.

The Objectors' Brief states that "[c]ourts around the country have routinely upheld security interests where agents of the secured party were identified." The Receiver does not dispute that. The Objectors' agent, WB Development, is not identified. (See Objectors' Ex. 4). Objectors assert that WB Fund II was their indirect agent based on the testimony of David Wallace. Such claims are misleading. Mr. Wallace merely testified that the entity that was to be the agent for the investors – but not IIR – was changed to WB Development, as demonstrated in the Investor Loan Documents. (Wallace Test. 22:22). No evidence shows that this change was carried out in relation to WB Fund II's agency for IIR. Further, David Wallace testified that no notice was given of such a change, whether by filing a UCC-1 financing statement or otherwise. (Wallace Test. 27:23). Changing the agent that is named in a UCC-1 financing statement renders such a filing materially misleading.

Essentially, the Objectors attempt to assign their agency agreements with WB Development to WB Fund II in order to achieve a perfected security interest. Doing so goes against Fifth Circuit precedent. In *In the Matter of E. A. Fretz Company, Inc.*, first lien holder, Revlon, attempted to increase the size of its lien by causing two subsidiaries with junior and unperfected liens to assign those interests to it, claiming all interests were perfected by its security agreement. 565 F.2d 366, 368-69 (5th Cir. 1978). The Fifth Circuit was:

> unwilling to impose on any junior secured creditor, with knowledge or without, the additional risk that, at a date subsequent to his perfection, **any affiliate of the senior creditor or any stranger to it - unnamed as secured parties** in a security agreement or a financing statement - could be metamorphosed into senior secured parties **by virtue of an assignment "or otherwise"** . . . .

Id. at 372 (emphasis added). Just as Revlon's unsecured subsidiaries attempted to claim the benefit of Revlon's first lien interest "by virtue of an assignment" to a related entity, the

unsecured Objectors are attempting to claim the benefits of IIR and South Texas's lien interests, claiming an undocumented and unproven agency relationship because their agent was not named in the UCC-1 financing statement. Furthermore, the subsidiaries in *Fretz* had security agreements granting them interests in the same collateral as Revlon, unlike here where the Objectors do not have security agreements granting them interests in the Radio Station Assets.

The Objectors also cite *Heights v. Citizens Nat'l Bank*, 342 A.2d 738, 463 Pa. 48 (Pa. 1975) in order to claim that WB Fund II was their agent. In *Heights*, however, the secured party named on the UCC-1 financing statement repossessed collateral in which it had perfected interests. Here, Objectors do not have a perfected security interest, and are not in privity with perfected parties. Accordingly, *Heights* is not persuasive as to WB Fund II's agency relationship with Objectors.

2. ***The Objector Loan Documents Do Not Contain Subrogation Clauses***

The Objectors cannot stand in the shoes of IIR or South Texas as parties holding duly perfected, secured interests in the proceeds of the sale of the Station under the doctrine of contractual subrogation. Their contracts, the Objector Loan Documents, do not contain subrogation clauses to that effect, or at all. (Ellisor Test. 179:9-13). In addition to lacking the necessary contractual clauses subrogating the Objectors to anyone, the Objector Loan Documents do not refer to the Initial Loan Documents, IIR, or South Texas. Moreover, they do not provide for subrogation of the rights and interests conferred in the Initial Loan Documents. (STB Exs. 25-83).

"Contractual subrogation clauses express the parties' intent that reimbursement should be controlled by agreed contract terms rather than external rules imposed by the courts." *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 648 (Tex. 2007). While Objectors cite the *Fortis* opinion to

support the proposition "that subrogation clause[s] in policy 'must be enforced [as written]' " (*Objectors' Outline* at p. 6.), that case has little in common with the present circumstances. The court in *Fortis* upheld contractual language in an insurance contract executed by and between the party seeking subrogation (the insurer) and the party from which relief was sought (the insured). Here, the parties seeking subrogation (the Objectors) are attempting to enforce the contractual language of the Initial Loan Documents—to which they and their agent, WB Development, are strangers—against a party with which they are not in privity of contract (Radio Houston, the owner of the Radio Station Assets, and the sole member of BusinessRadio Houston Licensee, LLC, holder of the FCC license[15]). Other Supreme Court of Texas cases on contractual subrogation cited by the Objectors follow this pattern.[16]

3. ***The Express Language of the Objector Loan Documents Evidences an Intent to Make Loans to a Different Borrower and Secure Those Loans with Different Collateral***

The express language of the Objector Loan Documents evidences an intent to loan money to borrower "Biz Radio Network LP,"[17] and secure such loans with the "Borrower's" (i) "Equipment"; (ii) "Furniture and Fixtures"; and (iii) all "Proceeds" therefrom. Of particular note is that "Biz Radio Network LP" does not own the Radio Station Assets at issue, and additionally

[15] See South Texas Exh. 14.

[16] *See Tex. Health Ins. Risk Pool v. Sigmundik*, 315 S.W.3d 12 (Tex. 2010) (subrogation clause in contract **between insurer and insured** could not be circumvented by "made whole" doctrine); *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co*., 236 S.W.3d 765 (*pro rata* clause in insurance contract with insured **did not grant co-insurer the right to subrogate** and recover *pro rata* share of made insurance payments **from another co-insurer with which it was not in privity**).

[17] While "Biz Radio Network LP" is not a registered entity in the state of Texas [or Delaware], *see South Texas Hearing Exhibit* 19, Receiver proceeds in this Brief, solely *arguendo* in order to avoid further confusion, as if the Objector Loan Documents (and other materially identical documents held by non-objecting investors) named "BusinessRadio Network, LP" as "Borrower."

there are no UCC-1 financing statements on file with the proper government offices to perfect any interest in assets of "Biz Radio Network LP."[18] (STB Ex. 17-19).

The collateral described in the IIR UCC-1 filing (Objectors' Ex. 4) stands in drastic contrast to the collateral in the Objectors' security agreements. The Initial Loan Documents and Objector Loan Documents evidence the intent of the parties with respect to each of them, and an examination of those documents reveals the vastly differing intentions of what the parties bargained for:

- The Initial Loan Documents evidence the intent to make loans to "BusinessRadio Houston LLC" and secure those loans with the "equipment," "furniture," "fixtures," "membership interests" in BusinessRadio Houston Licensee LLC, "accounts," "contracts," "leases," "other contracts," and all general "intangibles" of "BusinessRadio Houston LLC" and any "proceeds" from their sale; (Objectors' Exs. 1, 2, and 6).
- The Objector Loan Documents evidence the intent to make loans to "Biz Radio Network LP" and secure those loans with the "equipment," "furniture" and "fixtures" of "Biz Radio Network LP" and any "proceeds" from their sale.[19] (STB Exs. 25-83).

[18] It should be noted that naming "Biz Radio Network LP" as debtor on a UCC-1 financing statement filed to perfect a secured interest in the collateral defined in the Objector Loan Documents would be insufficient to perfect under the Texas UCC, TEX. BUS COM. CODE ANN. § 9.503(a)(1).

[19] Of particular note in analyzing the differences in the collateral defined in the Objector and Initial Loan Documents is the absence from the Objectors' collateral of "Membership Interests" in any "Biz Radio Network LP" subsidiary. In fact, the FCC has held that, because the radio spectrum is owned by the United States government, the use of which is only licensed by the FCC, "no right of reversion can attach to a broadcast station license, and the license, as distinguished from a station's physical assets, is not subject to a mortgage, security interest, or lien." *In re Applications of Kirk Merkely, Receiver*, 94 F.C.C.2d 829 (1983), *recon. denied*, 56 R.R.2d 413 (1984), *aff'd sub nom.*; *See also Merkely v. FCC*, 776 F.2d 365 (D.C. Cir. 1985). In order to secure loans with the Station license, the only collateral which could be offered as security is a controlling interest in the licensee entity, in this case BusinessRadio Houston Licensee LLC. That those interests are defined collateral securing the Initial Loan

C. The Objectors Are Not Equitably Subrogated to the Duly Perfected, Valid, or Enforceable Secured Interests in the Station Granted to IIR and South Texas in the Initial Loan Documents

The Objectors are not equitably subrogated to the duly perfected, valid, or enforceable secured interests in the Radio Station Assets granted to IIR and South Texas in the Initial Loan Documents. The doctrine of equitable subrogation in Texas is imposed when a party has "involuntarily paid a debt primarily owed by another in a situation that favors equitable relief." *Frymire Eng'g Co. v. Jomar Int'l, Ltd.*, 259 S.W.3d 140, 142 (Tex. 2008). Thus Objectors must prove three elements in order to prevail on their claim of equitable subrogation: (1) that any money transferred from a WB Fund II account to IIR or South Texas was the same money deposited by an Objector;[20] (2) that any such transfers of money from a WB Fund II account to IIR or South Texas were transferred involuntarily; and (3) that subrogating any Objector to the rights granted to IIR and South Texas in the Initial Loan Documents is an equitable result in the context of the Receivership as a whole.

1. ***The Objectors' Payments Under the Objector Loan Documents Were Not "Involuntary"***

If the Court were to find that Objectors' tracing is proper -- the Receiver contends it is not – any payments to IIR and South Texas found by the Court to be traceable to an Objector must also be involuntary in order to invoke the doctrine of equitable subrogation. "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 (quoting *Mid-Continent Ins. Co. v. Liberty*

Documents, but absent from the Objector Loan Documents, sheds light on the intent of the parties to the Objector Loan Documents.

[20] Tracing on funds is discussed in detail in Section II(a)(1) supra.

Mut. Ins. Co., 236 S.W.3d 765, 774 (Tex. 2007)). Any payment of Objector funds made to IIR and South Texas from a WB Fund II account must satisfy all three elements.

As detailed above, the Objector Loan Documents do not contain subrogation clauses or any other language conferring on the Objectors subrogation to the rights granted to IIR and South Texas in the Initial Loan Documents. (Ellisor Test. 179:9-13). The Objector Loan Documents merely attach a secured interest (which was never perfected (Wallace Test. 104:4-5, 105:6-8)) in three categories of "Biz Radio Network LP" assets; no express "assignment or agreement for subrogation" exists. (See Objector Loan Documents, STB Exs. 25-83). Furthermore, the evidence does not show that any implied "assignment or agreement for subrogation" exists. (Ellisor Test. 179:9-13).

Objectors argue that their payments were not voluntary because "[i]f 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." *Objectors' Brief* at p. 8-9. Objectors derive this argument from a line of cases involving mortgages on real property. *Rubarts v. First Gibraltar Bank*, 896 F.2d 107, 115 (5th Cir. 1990); *see also Vogel v. Veneman*, 276 F.3d 729, 735 (5th Cir. 2002) (discussing equitable subrogation in the context of second lien on homestead property); *First Nat'l Bank v. Kerrville v. O'Dell*, 856 S.W.2d 410, 415 (Tex. 1993); *Langston v. GMAC Mortg. Co.*, 183 S.W.3d 479, 481-82 (Tex. App.—Eastland 2005, no pet.). In these instances, Texas courts have held that a payment is involuntary, where at the request of the owner, a party lends money to extinguish a debt secured by realty, and in exchange, the lender takes a first lien on that realty. *Rubarts*, 896 F.2d at 115 (*citing Kone v. Harper*, 297 S.W.294, 297 (Tex. Civ. App.—Waco 1927), *aff'd sub nom. Ward-Harrison Co. v. Kone*, 1 S.W.2d 857

(Tex. Comm'n App. 1928, judgm't adopted). Assuming that this rule also applies to personality, it is nevertheless inapplicable to the instant case.[21]

First, although found to be invalid under Texas's homestead laws, the lenders in *Rubarts* and *Vogel* who claimed equitable subrogation had deeds of trust executed by the homeowners. *Vogel v. Veneman*, 276 F.3d at 735; *Rubarts*, 896 F.2d at 107, 115 (noting that the deed of trust executed as part of the loan specifically provided for subrogation). Here, the Objectors do not have a security agreement executed by the owner of the Radio Station Assets. Second, for this rule to apply the loan must be made at the request of the debtor. *Kerrville*, 856 S.W.2d at 415 (finding that equitable subrogation did not apply where the lender paid off the first and second notes but not at the request of the debtor). But unlike the property owner in *Rubarts*, Radio Houston, the owner of the Radio Station Assets, never requested that Objectors lend it money. (Wallace Test. 125:14-18) (Radio Houston received no money from any Wallace Bajjali investor).

Second, in these cases the lenders agreed to lend money for the purpose of extinguishing a debt secured by that property. *See, e.g.*, *Rubarts*, 896 F.2d at 115. In the instant case, however, the Objectors did not lend money to Radio Houston for the purpose of extinguishing a debt secured by property it owned, rather they voluntarily lent money to Network, LP via WB Partners to be use as needed, and some of those proceeds happened to be used to extinguish Radio Houston's debt. In fact, nothing in evidence demonstrates that investors were told that they would "stand in the shoes of a creditor." Rather, it was represented that their investments would be secured by perfected interests in assets of an eventual "borrower." (See, STB Ex. 48). Thus, because Radio Houston did not ask Objectors to extinguish the debt, and because

[21] After an exhaustive search, , the Receiver has found no cases where a court has applied this rule to personality.

Objectors did not lend money for the purpose of extinguishing that debt, they cannot now by virtue of their good fortune claim to be equitably subrogated under the rule laid out in *Rubarts*.

Finally, Texas courts have held that that equitable subrogation cannot apply where a party "would derive an advantage from, or establish his claim through, his own negligence . . . ." *Huey et al v. Brand Banking Com'r et al*, 92 S.W.2d 505, 507 (Tex. Civ. App.—Amarillo 1936), *judgm't aff'd by Borger v. Brand*, 131 Tex. 614 (1938). Here, the sole Objector to testify, Ron Ellisor, admitted that he did not read his investment documents (Ellisor Test. 177:11-15, 178:23-25). Moreover, Mr. Ellisor also testified that his investments were completely voluntary, not made pursuant to any legal obligation, and were not made to protect any existing legal rights. (Ellisor Test. 179:14-180:6). Pursuant to *Frymire*, Objectors' payments were indeed voluntary.

2. ***Equitable remedies are only appropriate when they cause an equitable result***

Legal subrogation is a creature of equity not depending upon contract, but upon the equities of the parties. Compania Anonima Venezolana v. A.J. Perez Export Co., 303 F.2d 692, 697 (5th Cir. 1962). It is not an absolute right, but one which depends upon the equities and attending facts and circumstances of each case. Id. Equitable subrogation will not be enforced to the prejudice of other rights of equal or higher rank, or to displace an intervening right or title, or to overthrow the equity of another. Id. (citing 50 Am. Jur. Subrogation §13 at 691-92). The whole aim of subrogation is equity and justice, and the relief shall not be decreed where it will injure an innocent third person. Id. (citing 50 Am. Jur. Subrogation §17 at 693).

The Objectors equities pale in comparison to the equities of the Receivership Estate. Each victimized investors was defrauded by the same people in the same manner as the Objectors. Moreover, KCM investors also loaned money to retire the indebtedness of Radio Houston to IIR. Finally, Objectors' evidence demonstrates that other non-objecting investors were duped into making identical investments. There is no basis to elevate Objectors over other

similarly situated investors. To elevate a small group of investors such that they receive the lions share of the Receivership Estate's assets would be an injustice that would undoubtedly cause the injury of numerous innocent third persons – each of whom was victimized by the same fraud as the Objectors. Equity mandates that all similarly situated investors should be treated alike. Durham, 86 F.3d at 70; SEC v. Forex Asset Mgmt., 242 F.3d at 325.

D. The "Crider Subrogation Agreement" does not create a right to contractual subrogation

Objectors rely on the "Crider Subrogation Agreement" (Objectors Ex. 5), to ratify their secured interests in the proceeds of the sale of the Station, but their reliance is misplaced. The credibility of the Crider Subrogation Agreement is suspect at best, and its weight as evidence is minimal.

In the first instance, the timing of the document is, in the best light, dubious. It is dated January 31, 2010, two months **after** Network, L.P. is named as a Relief Defendant by the SEC and the institution of the Receivership. Indeed, the Receiver's investigation of the Receivership Entities during that same time period resulted in the Court ordering Network, L.P. to be subsumed into the Receivership Estate. Secondly, the Crider Subrogation Agreement suffers from similar material defects as those found in the Objector Loan Documents. WB Development, not WB Fund II, is named in this document as "Administrative Agent for Industrial Info Resources, Inc., and other senior lenders." (*Id.* at p. 1). There is nothing in evidence before the Court in which IIR assents to WB Development acting as its agent. Furthermore, as Mr. Wallace testified at the Hearing held October 3, 2011, no filings or notice evidencing any change in agency regarding the secured indebtedness of Radio Houston to IIR and South Texas were ever filed with the respective offices in Texas or Delaware or otherwise provided. (Wallace Test. 27:23). An entity (here, WB Development) cannot unilaterally change

or ratify its agency of another that is not in privity with it (IIR). Also Wallace's testimony doesn't reference changing agent for IIR, only changing agent for investors. To the extent the Crider Subordination Agreement ratifies anything, it ratifies the Objectors' unperfected interests in certain collateral of "Biz Radio Network LP."

III. CONCLUSION

WHEREFORE, the Receiver respectfully requests that the Court overrule Objectors' claims for a priority interest and/or lien on the proceeds from the sale of the Radio Station Assets.

Dated: October 14, 2011.

Respectfully submitted,

SNR DENTON US LLP

By: */s/Gene R. Besen*
Gene R. Besen
State Bar No. 24045491
2000 McKinney Avenue, Suite 1900
Dallas, Texas 75201
(214) 259-0900
(214) 259-0910 - Fax
gene.besen@snrdenton.com

ATTORNEYS FOR THOMAS L. TAYLOR III, RECEIVER

CERTIFICATE OF SERVICE

On October 14, 2011 I electronically submitted the foregoing document with the clerk of the court of the U.S. District Court, Southern District of Texas, using the electronic case filing system of the court. I hereby certify that I have served all counsel and/or pro se parties of record electronically or by another manner authorized by Federal Rule of Civil Procedure 5(b)(2).

/s/ *Gene R. Besen*

Gene R. Besen