NO. 12-20633

United States Court of Appeals
for the
Fifth Circuit

SECURITIES AND EXCHANGE COMMISSION,

PLAINTIFF

VS.

ALBERT FASE KALETA,

DEFENDANT

RONALD ELLISOR; LAVONNE ELLISOR; RICHARD KADLICK; SAILAJA URI KONDURI; ROBERT FICKS; ET AL.,

APPELLANTS

VS.

THOMAS L. TAYLOR, III, THE RECEIVER FOR KALETA CAPITAL MANAGEMENT, INC.; BUSINESSRADIO NETWORK, L.P., DOING BUSINESS AS BIZRADIO; DANIEL FRISHBERG FINANCIAL SERVICES, INC., DOING BUSINESS AS DFFS CAPITAL MANAGEMENT INC., AND ALL OF THE ENTITIES THEY OWN OR CONTROL,

APPELLEES

On Appeal from the United States District Court for the Southern District of Texas in No. 4:09-cv-3674 (Hon. Nancy Atlas, Judge)

APPELLANT'S BRIEF

January 2, 2013

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CASE NO. 12-20633

ELLISOR, KADLICK, KONDURI, FICKS, ET AL. VS. TAYLOR

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualifications or recusal.

1. Ronald Ellisor of Houston, Texas
2. Lavonne Ellisor of Houston, Texas
3. Richard Kadlick of Houston, Texas
4. Sailaja Uri Konduri of Houston, Texas
5. Robert Ficks of Sugar Land, Texas
6. Larry Mullins of Angleton, Texas
7. Kohur Subramanian of Sugar Land, Texas
8. Anuradha Subramanian of Sugar Land, Texas
9. Timothy Koehl of Houston, Texas
10. Martin Grosbol of Kingwood, Texas
11. Doug Shaffer of Bacliffe, Texas
12. Kay Shaffer of Bacliffe, Texas
13. Phillip Jones of The Woodlands, Texas
14. Alisa K. Jones of The Woodlands, Texas
15. Kevin Deering of Corinth, Texas
16. Ed Gray of Montgomery, Texas

17. Helena Gray of Montgomery, Texas
18. Johnny Gauntt of Pasadena, Texas
19. Betty Gauntt of Pasadena, Texas
20. Tony Huerta of Houston, Texas
21. Marcus Erickson of Missouri City, Texas
22. George Tompkins of Houston, Texas
23. Marene Tompkins of Houston, Texas
24. Tompkins, Inc., a Texas Corporation
25. Public Express, Inc., a Texas Corporation
26. Tompkins 2007 Family Partnership, Ltd., a Texas Limited Partnership
27. James Stewart of San Antonio, Texas
28. Patricia Stewart of San Antonio, Texas
29. Paul Williams of Houston, Texas
30. Simona Williams of Houston, Texas
31. Steve Cook of Houston, Texas
32. Raymond Warner of Spring, Texas
33. John Willis, as Executor of the Estate of Geraldine J. Willis, under administration in Hampden County, Massachusetts
34. Ronald Martens of Deer Park, Texas
35. Ellis Couch of Tulsa, Oklahoma
36. Joseph Miller of San Antonio, Texas
37. Sarah Miller of San Antonio, Texas
38. Nada Por Nada, Ltd, a Texas Limited Partnership

39. Thomas L. Taylor, III, the receiver for Kaleta Capital Management, Inc.; BusinessRadio Network, LP d/b/a BizRadio; Daniel Frishberg Financial Services, Inc. d/b/a DFFS Capital Management, Inc. and all of the entities they own or control
40. Youssef Boutrous of Houston, Texas
41. Paul and Diane Collings of Houston, Texas
42. TR Dunn Family Trust
43. John Dosier of The Woodlands, Texas
44. Dan Gunderson of Houston, Texas
45. Glenn and Ann Latta of Livingston, Texas
46. Barbara Ploetz of Middleton, Wisconsin
47. Florence Reiley of Bellaire, Michigan
48. Eric Rothenberg of Houston, Texas
49. Bruce Ruisard of The Woodlands, Texas
50. Blake Taylor of Sugar Land, Texas
51. Don and Ethelyn Taylor of Sugar Land, Texas
52. David Wallace of Sugar Land, Texas
53. Costa Bajjali of Missouri City, Texas
54. Wallace Bajjali Development Partners, LP, a Texas Limited Partnership
55. West Houston WB Realty Fund, LP, a Texas Limited Partnership
56. Laffer Frishberg Wallace Economic Opportunity Fund, LP, a Texas Limited Partnership
57. Wallace Bajjali Investment Fund II, LP, a Texas Limited Partnership
58. Spring Cypress Investments, LP, a Texas Limited Partnership

59. Porter Hedges, LLP, attorneys for the Wallace Bajjali Parties

STATEMENT REGARDING ORAL ARGUMENT

Appellants respectfully request that this Court grant oral argument. Appellants submit that argument will assist the Court in resolving the application of law to the novel issue presented in this appeal, *i.e.*, whether the District Court's equitable power over the administration of an SEC receivership extends so far as to foreclose legal redress by non-parties against non-parties through an anti-litigation injunction.

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I. JURISDICTIONAL STATEMENT

The underlying enforcement action arises under the Securities Act, the Exchange Act, and the Advisors Act. The lower court had jurisdiction pursuant to 15 U.S.C. § 78aa and 28 U.S.C. § 1331. In the course of administering the receivership imposed on motion of the SEC, the District Court entered an order approving a settlement between the Receivership Estate and the Wallace Bajjali Parties on February 7, 2012, to which the Objecting Investors filed a timely Motion for Reconsideration under Federal Rule of Civil Procedure 59(e) on March 6. The motion remained pending until August 1, 2012, when it was denied. On August 31, the Objecting Investors timely appealed the lower court's order to this Court.

This Court has jurisdiction over the injunctive aspect of this appeal pursuant to 28 U.S.C. § 1292(a)(1), as the appeal of an interlocutory order of a District Court of the United States "granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions." At the crux of this appeal is a "Bar Order", being an anti-litigation injunction. The Objecting Investors seek review of the Bar Order by this Honorable Court pursuant to its jurisdiction over injunctive writs. Review is proper under subsection 1292(a)(1). *Carson v. Am. Brands, Inc.*,

450 U.S. 79 (1981) (holding that the denial of a joint motion of the parties to enter a consent decree containing injunctive relief is an appealable order).

Beyond the Bar Order, the Objecting Investors also seek review of the District Court's confirmation of the settlement agreement as inequitable. As to the settlement agreement, the lower court's decision as to the affected parties falls in that small class of orders which finally determine claims of rights separable from, and collateral to, rights asserted in the underlying action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546 (1949). The Supreme Court has recognized that the final order rule of 28 U.S.C. § 1291 deserves a practical rather than a technical construction. *Id.* The Court has stated the rule as follows:

> To come within the "small class" of decisions excepted from the final-judgment rule by *Cohen*, the order must: 1) conclusively determine the disputed question, 2) resolve an important issue completely separate from the merits of the action, and 3) be effectively unreviewable on appeal from a final judgment.

Coopers & Lybrand v. Livesay, 437 U.S. 463, 468 (1978). Here, the Receiver's settlement with the Wallace Bajjali Parties extinguishes the Objecting Investors' rights to seek redress for their investment losses from the Wallace Bajjali Parties, which is a separate matter from the underlying

SEC enforcement action. Also, this order would not be otherwise reviewable. On the basis of the above, the collateral order exception to the final judgment rule applies to the Objecting Investors' appeal of the Receiver's entire settlement agreement with the Wallace Bajjali Parties.

II. ISSUES PRESENTED FOR REVIEW

This case first presents a question on the limits of the District Court's equitable powers over the administration of a receivership instituted in connection with an enforcement action brought by the Securities and Exchange Commission. Particularly, the case examines the court's power to enjoin litigation by third parties against persons and entities beyond the Receivership, to restrain the rights of affected parties to pursue recovery against the third parties.

Secondly, the case questions the propriety of the District Court's approval of a settlement between a Receiver and a third party liable to the Receivership Estate where: (1) the consideration paid by the settling parties is grossly inadequate, considering their liability and ability to pay; (2) the record has no credible evidence to support a finding of insolvency of the settling parties; and (3) the evidence negates concerns that the settling parties lack income to satisfy a prospective judgment against them.

III. STATEMENT OF THE CASE

The Objecting Investors, Appellants before this Court, are a subset of investors defrauded by Daniel Frishberg, Albert Kaleta, David Wallace, and Costa Bajjali in connection with BizRadio and Kaleta Capital Management. These investors were induced to make investments in debt and equity transactions in BizRadio, unrelated small businesses, and real estate development ventures, all of which were orchestrated by Daniel Frishberg, Albert Kaleta, David Wallace, and Costa Bajjali acting in concert. Without the investors' knowledge or consent, investment funds were redirected, misapplied, and transferred to funds which Frishberg, Kaleta, Wallace, and Bajjali knew to be losing investments and transactions designed for their own benefit.

The Securities and Exchange Commission commenced an enforcement action against Albert Kaleta in the United States District Court for the Southern District of Texas. A Receivership Estate was created to marshal, administer, and distribute the assets of Kaleta Capital Management, Inc. ("KCM"), Daniel Frishberg Financial Services, Inc. ("DFFS"), and Business Radio Network, L.P. ("BizRadio"), with Thomas L. Taylor appointed as Receiver.

The Receiver sought approval of a settlement with David Wallace, Costa Bajjali, and their related entities: Wallace Bajjali Development

Partners, L.P., the West Houston WB Realty Fund, L.P., the Laffer Frishberg Wallace Economic Opportunity Fund, L.P., the Wallace Bajjali Investment Fund II, L.P., and Spring Cypress Investments, L.P. (all these individuals and entities collectively referred to as "the Wallace Bajjali parties" herein), under which these persons were released from liability to any defrauded investor in exchange for promissory notes and personal guaranties made by David Wallace and Costa Bajjali. In connection with the settlement, the Wallace Bajjali Parties bargained for a Bar Order, precluding litigation against them for claims arising from the BizRadio frauds. The Receiver recommended the Bar Order as part of the settlement, and the District Court approved the Wallace Bajjali settlement and entered the Bar Order. The Objecting Investors seek review by this Court of the Wallace Bajjali settlement, particularly the Bar Order.

IV. STATEMENT OF FACTS

A. THE FRISHBERG/KALETA FRAUDS

Daniel Frishberg ("Frishberg") and Albert Kaleta ("Kaleta") owned and operated Daniel Frishberg Financial Services ("DFFS") and Kaleta Capital Management ("KCM"). (*See* R. at 2723.) DFFS was a legitimate business that earned money by managing investments for individual clients. KCM was a pure Ponzi scheme in which investors purchased Notes bearing

10% interest, and KCM made interest payments by selling new Notes to other unsuspecting investors. (*See* R. at 36-37.) Kaleta consented to entry of an injunctive order against him, which was later modified to include $3 million in sanctions. (R. at 88-93, 1308.) The SEC later brought an enforcement action against Frishberg in Civil Action No. 4:11-cv-01097.

DFFS and KCM obtained clients through a radio show hosted by Dan Frishberg, on a radio station in Houston called BizRadio. The Objecting Investors, as many other Receivership stakeholders, engaged DFFS as their investment advisors. (*See* R. at 1803.) Ultimately, Frishberg, Kaleta, and Wallace, in concert, purchased the BizRadio station, with the expectation that they could generate more clients by controlling the station. (*See* R. at 1806-06.) BizRadio consistently lost money, and Frishberg and Kaleta had to solicit new investment capital to keep BizRadio afloat. (*Id; id.* at 2503.) Near the end of the scheme, Frishberg described BizRadio to several of its investors as a "loss leader for DFFS." That was obviously shocking news to individuals who had been conned into investing in BizRadio without any ownership interest in DFFS.

B. THE ROLE OF THE WALLACE BAJJALI PARTIES

Frishberg and Kaleta decided that they should offer investment opportunities in commercial real estate in order to present a more diversified

and appealing service to existing DFFS investors and prospective new investors. They engaged their associates, David Wallace and Costa Bajjali, local real estate developers, to assist in the scheme. (*See* R. at 2347-51, 2509.) Wallace, as the former Mayor of Sugar Land, and his partner in the LFW Economic Opportunity Fund, Arthur Laffer, lent their credibility to Frishberg and Kaleta. (*See* R. at 2436-38, 2523-24.) BizRadio and DFFS and KCM began funneling investors to Wallace Bajjali, purportedly so they could invest in real estate deals.

When BizRadio began experiencing financial problems, Frishberg enlisted Wallace and Bajjali to help generate a stream of investment into the radio station. Frishberg would sign up clients, and then invest their money in Wallace's frivolous real estate investments. A key aspect of the fraud is that the individual investors, including Appellants, thought that they were investing in real estate transactions, but Wallace was re-investing investors' money back into BizRadio so that his pipeline of new cash would keep flowing. At all costs, Frishberg, Kaleta, and Wallace had to keep the radio station online so that they could bring new investors to the table that would provide cash to pay returns to the earlier investors. It was a classic Ponzi scheme.

Wallace Bajjali had investors enter into agency agreements with Wallace Bajjali Development Partners, LP ("WBDP"). Then, investors would loan money to WBDP pursuant to secured promissory notes. WBDP would then redirect investors' money to BizRadio through a second secured Note, naming WBDP as payee "as agent for" the relevant investor. The parties refer to these notes as the "BizRadio Notes." (R. at 2424-26.) None of these notes were repaid, and Wallace and Bajjali failed to document them properly, which resulted in a decision by the District Court that investors in the BizRadio Notes did not have valid security interests in the station's assets. (R. at 2770-2801.) Messrs. Wallace and Bajjali, and their related entities, have liability to Appellants for their breach of fiduciary duties, fraud, and negligence.[1]

C. THE RECEIVER'S SETTLEMENT

Thomas Taylor, as Receiver for DFFS, KCM, and BizRadio, negotiated a settlement with David Wallace and Costa Bajjali on behalf of themselves and the entity Wallace Bajjali parties. (R. at 1939-56.) The settlement releases the Wallace Bajjali Parties from liability for all claims that could be brought against them by the Receivership, for payment of some

[1] The SEC also brought an enforcement proceeding against Wallace and Bajjali in Civil Action No. 4:11-cv-01932. (*See* R. at 3494.) That case resulted in entry of Agreed Final Judgments against Wallace and Bajjali individually, permanently enjoining each from future securities violations and imposing on each a civil penalty of $60,000. (*Id.*)

$1,500,000. (R. at 1958-2096.) That settlement amount might be reasonable if it were a settlement merely of the Receiver's Note claims related to loans made by BizRadio to the Wallace Bajjali Parties. However, the settlement resolves all fraud, conspiracy, negligent misrepresentation, and other claims by the Receivership against the Wallace Bajjali Parties. (R. at 1963-64, 1982.) Further, the terms of the settlement provide that Appellants be barred from asserting claims related to the BizRadio Notes against the Wallace Bajjali Parties. Those claims alone total more than $4.5 million, plus interest, attorneys' fees and/or exemplary damages.

V. SUMMARY OF THE ARGUMENT

The Objecting Investors bring this appeal, challenging the District Court's confirmation of the Receiver's settlement with the Wallace Bajjali Parties as an abuse of discretion, because it was done without legal authority, without competent supporting evidence, and was manifestly unjust. The Anti-Injunction Act and applicable case law militate against issuance of an injunction such as the Bar Order at issue here. Also, the settlement was based on false information regarding the Wallace Bajjali Parties' ability to pay a judgment rendered against them, and is inequitable for the consideration paid by the Wallace Bajjali Parties as compared to the

extent of their liability for the frauds perpetrated against the Objecting Investors and others.

VI. ARGUMENT

A. STANDARD OF REVIEW

This Court reviews a district court's decision to grant an injunction for abuse of discretion. *See Merrill Lynch v. Stidham*, 658 F.2d 1098 (5th Cir. 1981). The district court abuses its discretion if it: (1) relies on clearly erroneous factual findings when deciding to grant or deny a permanent injunction; (2) relies on erroneous conclusions of law when deciding to grant or deny the permanent injunction; or (3) misapplies the factual or legal conclusions when fashioning its injunctive relief. *Peaches Entm't Corp. v. Entm't Repertoire Associates, Inc.*, 62 F.3d 690, 693 (5th Cir. 1995). Moreover, *de novo* review applies to the interpretation of law. *See Weight Watchers Int'l, Inc. v. Luigino's, Inc.*, 423 F.3d 137, 141 (2nd Cir. 2005).

B. THE DISTRICT COURT LACKS AUTHORITY TO ENTER THE BAR ORDER, PRECLUDING THE PROSECUTION OF LEGAL CLAIMS BY THIRD PARTIES AGAINST THIRD PARTIES.

1. PRECLUDING APPELLANTS FROM SEEKING REDRESS FOR THEIR INJURIES DEPRIVES THEM OF A SIGNIFICANT PROPERTY RIGHT.

There are many reasons why a Receiver may want to settle a dispute for a fraction of the damages caused to the Receivership Estate. However, the Objecting Investors have the right to sue the Wallace Bajjali Parties to seek redress for the millions of dollars out of which they were bilked. It is one thing for the Receiver to settle his claims for a fraction of their worth, but it is quite another for the Receiver to foreclose others from suing to recoup their personal and individual losses.

The Wallace Bajjali Parties borrowed money from Receivership entities, and the Receiver wishes to settle those claims. Appellants have no individual rights to assert the Receiver's claims because they belonged to BizRadio and KCM even before the Receivership was created. However, Appellants have personal claims against the Wallace Bajjali Parties that arise out of the establishment of their agency relationship. Wallace Bajjali acted as the agents for Appellants in setting up certain secured debt facilities and in the process misrepresented the transactions and mishandled the documentation of the deals. Claims seeking redress for the losses that ensued cannot be brought by the Receiver, and no Receivership entity is directly liable for the claims. The claims are personal to Appellants, who are not Receivership entities, and are against the Wallace Bajjali Parties, whose only connection to the Receivership is that they have agreed to repay the

Receivership funds they borrowed. In that context, there is no legal basis to foreclose the exercise of Appellants' rights to sue the Wallace Bajjali Parties to recover their losses from the agency relationship.

2. THE BAR ORDER VIOLATES THE ANTI-INJUNCTION ACT AND APPLICABLE CASE LAW.

This is a case of a Receiver asking a court to overstep its authority in order to accomplish a settlement. The District Court lacks authority to preclude the Objecting Investors from seeking recovery against third parties who are not Receivership Entities. There is no published opinion in which a Federal Court of Appeals or the Supreme Court approved an anti-litigation injunction preventing third parties from filing suit against entities that were not part of a receivership. When, as here, the parties and assets sought after are not part of the Receivership, there is no basis for an injunction such as the Bar Order at issue in this appeal preventing litigation against those outsiders. All of the cases cited in the Receiver's Motion for Order Approving Proposed Settlement and for Ancillary Orders involve injunctions preventing third parties from suing receivership entities. (*See* R. at 1950-51.) Here, the Receiver sought and obtained an injunction preventing suit against non-receivership entities.

The Anti-Injunction Act precludes injunctions against parties who wish to proceed with state court litigation. *See* 28 U.S.C. § 2283; *Atl. Coast*

Line R.R. Co. v. Bhd. of Locomotive Eng'rs, 398 U.S. 281 (U.S. 1970). Courts may issue injunctions barring suits pursuant to an exception to that act if the injunction is necessary to protect their jurisdiction. *Atl. Coast Line R.R. Co.*, 398 U.S. at 295 ("to prevent a state court from so interfering with a federal court's consideration or disposition of a case as to seriously impair the federal court's flexibility and authority to decide that case"). The Objecting Investors acknowledge that a district court is empowered to bar suits against Receivership entities to protect its jurisdiction. *See SEC v. Byers*, 609 F.3d 87 (2nd Cir. 2010); *SEC v. Lincoln Thrift Ass'n*, 557 F.2d 1274 (9th Cir. 1977). However, that power should be used on a limited basis, as the Court in *Byers* stated: "We hold that while it should be sparsely exercised, district courts possess the authority and discretion to enter anti-litigation orders." *SEC v. Byers*, 609 F.3d 87, 89 (2nd Cir. 2010) (emphasis added); *see also id.* at 91 ("it is a power to be exercised cautiously"); *id.* at 92 ("such injunctions should be used sparingly"). There is no such basis to support the Order here. Appellants wish to pursue litigation against the Wallace Bajjali Parties, potentially in state court.[2] That litigation will in no way impact or restrict the District Court's jurisdiction over the Receivership.

[2] A lawsuit was filed on January 6, 2012, by Appellants against the Wallace Bajjali Parties, and was non-suited pursuant to a tolling agreement. Appellants intend to litigate their disputes with the Wallace Bajjali Parties, including claims associated with the "BizRadio Notes" if this Court mandates that the District Court's Bar Order be vacated.

3. THE RECEIVER LIKEWISE CITES NO VALID LEGAL PRECEDENT TO SUPPORT ENTRY OF THE BAR ORDER.

Wencke II, cited as favorable authority by the Receiver, establishes a two-tier standard for the issuance of an anti-litigation injunction, even as to Receivership entities: 1) The court must have jurisdiction to issue the injunction, and 2) The court must consider whether exceptions to such an injunction are appropriate. *SEC v. Wencke*, 622 F.2d 1363, 1372 (9th Cir. 1980). The latter determination is a balance of considerations such as the potential disruption to administration of the receivership estate introduced by the other litigation, whether the moving party will suffer substantial injury if not permitted to proceed, and the merit of the movant's claims. *Id.* at 1374; *see also Liberte Capital Group, LLC v. Capwell*, 462 F.3d 543 (6th Cir. 2006) (recognizing potential exceptions from anti-litigation injunction). The Objecting Investors point out that these factors apply to analyze whether an exception to the anti-litigation injunction would be appropriate to allow the moving party to pursue claims **against receivership entities**.

Here, the Wallace Bajjali Parties are not within the Receivership. Still, evaluation of the *Wencke II* factors all militate against entry of the Bar Order sought by the Receiver. These claims would not disrupt administration of the Receivership Estate, as the Investors plan to pursue

these claims outside of the Receivership against the Wallace Bajjali Parties and related parties who made misrepresentations and caused harm to the Investors through breach of duties owed as fiduciaries, as a matter of contract, and as implied in law for ordinary care and prudence. The Objecting Investors' assertion of their claims against the Wallace Bajjali parties does not interfere with the Receiver's collection efforts.

The Investors will suffer substantial injury if their right to pursue satisfaction from the Wallace Bajjali Parties is foreclosed, particularly for those who were to have secured notes if not for the acts of the Wallace Bajjali Parties. Upon an evidentiary hearing, the Investors can demonstrate the merits of their claims. In light of the above, the Bar Order is not appropriate, even by the standards advanced by the Receiver.

Below, the Receiver relied on two cases from this Court: *SEC v. Forex Asset Management*, 242 F.3d 325 (5th Cir. 2001) and *SEC v. Safety Finance Service, Inc.*, 674 F.2d 368 (5th Cir. 1982). The citation to *Forex* is only for quoted material taken from *Safety Finance*. *Safety Finance* does not involve an anti-litigation injunction at all. *See generally* 674 F.2d 368. There, the Receiver challenged the trial court's order recognizing the validity of a particular creditor's lien rights in the proceeds from liquidated property of the receivership estate. The Fifth Circuit affirmed the trial court,

thereby recognizing the rights of the creditor over the receivership as to proceeds of that lien. In the same way, the Investors' causes of action against the Wallace Bajjali Parties should be preserved for their benefit.

Several other cases incorporated into the analysis in the Court's Order of February 7 likewise address factually distinct situations from the case at bar. As with the cases the Receiver cited in his Motion to Approve Settlement, *SEC v. Lincoln Thrift Association* involved claims brought against receivership entities. *See Lincoln Thrift Ass'n*, 557 F.2d 1274, 1275-76 (9th Cir. 1977) (movants sought to bring breach of lease claim against receiver to recover possession of shopping center). Apart from *Stanford Int'l Bank* and *Gordon v. Dadante*, discussed below, the other cases involve no anti-injunction at all. *See SEC v. Arkansas Loan and Thrift Corp.*, 427 F.2d 1171 (8th Cir. 1970) (approving loan company's settlement with fidelity bond issuer); *SEC v. Forex Asset Mgmt.*, 242 F.3d 325 (investors unsuccessfully urge priority status on unsecured loan deposited in separate account); *United States v. Durham*, 86 F.3d 70 (5th Cir. 1996) (refusing to trace money to give preferential treatment to certain investors); *US Commodity Futures Trading Com'n v. PrivateFX Global One*, 778 F.Supp.2d 775 (S.D. Tex. 2011) (refusing to apply tracing).

SEC v. Stanford International Bank, an unpublished opinion of this Court, involved claims that, although they were not asserted directly against receivership entities, impacted the receivership, as the intended defendants had substantial holdings in the receivership. *See Stanford Int'l Bank*, 424 F. App'x 338 (5th Cir. 2011) (unpublished). There, the movants sought to be excepted from the anti-litigation injunction in order to pursue claims against their fund managers. *Id.* at 340. The situation there is distinguishable in two important respects. First, the receiver in *Stanford International Bank* had asserted a claim against the financial advisors much greater than those asserted by the movants seeking relief from the injunction. *Id.* Here, the Receiver has brought no claim against the Wallace Bajjali Parties for fraud, breach of fiduciary duty, or negligence that is similar to Investors' claims and does not intend to do so. Second, there was potentially a limited pool of insurance proceeds in *Stanford International* to satisfy any judgment rendered against the financial advisors. *Id.* at 341. In contrast, there is no insurance applicable here, but the Wallace Bajjali Parties have substantial holdings and expectancy of greater assets outside of the Receivership Estate; moreover, Messrs. Wallace and Bajjali have agreed to release what claims they may have against the Receivership Estate through the funds and limited partnerships they own and control. (*See* R. at 1964-65, § 5.3.1(a).) It is also

important to note that although the movants in *Stanford Int'l Bank* were denied leave to pursue their claims, the effect was not permanent. *Id.* at 342 (stating the that the district court "indicated a willingness to reweigh the factor once the evidence in the ancillary litigation revealed more facts regarding the financial advisors' knowledge and participation in the scheme"). The Bar Order here is of unlimited duration and scope, and is thus overbroad and outside the scope of the District Court's authority.

Gordon v. Dadante addressed a permanent bar order extended by the receiver in connection with a settlement. 336 F. App'x 540 (6th Cir. 2009) (unpublished). In that case, the objectors to the settlement were given opportunity to obtain and present evidence, and indications were that the settlement represented the greatest recovery that could be had from the released defendants. *See generally id.* Also important in the court's analysis were the facts that the consideration paid by the released party was substantial in comparison to the value of the potential claims of the receivership against the released party, *id.* at 543, the individual objectors lacked standing to assert claims against the released party, *id.* at 544, and the individual objectors could not prove the reliance element necessary to establish a claim against the released party, *id.* None of these circumstances apply in the instant case. The consideration paid in exchange for the release

is low in comparison to the value of the Investors' claims; the Investors do not have impediments to asserting their claims against the Wallace Bajjali Parties, and, most importantly, the Investors requested, and were denied, an opportunity to present evidence on the sufficiency of the proposed settlement in light of new revelations of the Wallace Bajjali financial situation. (R. at 3186-87) (ordering that, "the Court will hold a conference (not an evidentiary hearing) on the Motion for Reconsideration"); (R. at 3551-3607) (Objecting Investors not allowed to present evidence or argue motion beyond issues in Wallace Bajjali/Perry settlement).

4. THE COURTS OF APPEAL HAVE OVERTURNED BAR ORDERS IN ANALOGOUS SITUATIONS.

Courts should not bar claims against third parties to allow a settlement of claims to go forward. In the securities context, Courts of Appeals reverse orders that bar claims against third parties in connection with securities "good faith" hearings. For example, the Tenth Circuit reversed a settlement approval that barred contribution claims against third parties. *FDIC v. Geldermann, Inc.*, 975 F.2d 695 (10th Cir. 1992). In that case, the Court found that it was improper for the FDIC to attempt to settle some of the Defendants' rights to contribution against third parties because the claims "were not the FDIC's to settle." *Id.* at 698. Here, the Receiver is effectively settling and releasing claims that are "not his to settle."

The Ninth Circuit has reversed a settlement with similar issues. That Court found that the interests of accomplishing a settlement do not justify foreclosing parties' claims against third parties. *Employers Insurance of Wausau v. Musick, Peeler & Garrett*, 954 F.2d 575 (9th Cir. 1992). The Court stated, "We hold that a settlement agreement cannot be relied upon to bar subsequent actions for contribution by settling defendants against individuals who were not party to the original suit." *Id.* at 579. By analogy, this Court should not allow a settlement of claims for the repayment of loans the Receiver has against the Wallace Bajjali Parties to foreclose tort claims of non-parties against persons and entities who are not in the Receivership.

C. THE RECEIVER'S SETTLEMENT WITH THE WALLACE BAJJALI PARTIES WAS BASED ON FALSE INFORMATION.

Allowing Frishberg's co-conspirators to escape liability for a $1.5 million payment would only be acceptable if the Receiver had no prospect of collecting a judgment against them. Here, that is not the case. Investors are not asking the Receiver to wait for years to find out if Wallace and Bajjali are going to complete a Billion-dollar deal. The transactions referenced in the Motion for Reconsideration are imminent. (*See* R. at 3155-63.)

1. THERE IS NO CREDIBLE EVIDENCE OF THE WALLACE BAJJALI PARTIES' INSOLVENCY.

When the Receiver first sought approval of the settlement, he stated that the most significant reason to approve the settlement was the lack of collectability of any judgment. (*See* R. at 1948) ("most significantly—the ability to collect any potential judgment obtained in amounts in excess of the amount which will be achieved in the present settlement proposal.") The Receiver's original Motion further emphasized his reliance on this point:

> The Receiver is satisfied, based on the financial documentation provided, that the settlement represents the maximum which could be paid by the Wallace Bajjali Parties. It is the Receiver's judgment that protracted litigation against the Wallace Bajjali Parties, brought by him or by any other plaintiff, would render any monetary judgment against the Wallace Bajjali Parties materially uncollectable beyond the value of the present settlement.

(R. at 1949-50.) In his original Motion, the Receiver stated that he was "satisfied that those settlement obligations undertaken by the Wallace Bajjali Parties is the maximum which they likely could bear while maintaining the economic viability necessary to discharge those obligations." (R. at 1953.) He also incorrectly stated that "any judgment obtained against the Wallace Bajjali Parties would not likely be collectable in greater amounts than those obtained by the Receivership through this settlement." (*Id.*)

Once the Receiver learned that Wallace and Bajjali are about to begin generating $90 million in high-margin income over the next few years through a development contract they have been awarded to rebuild Joplin,

Missouri, he retreated from the above strong assertions. Statements such as "it was never assumed by the Receiver that the Wallace Bajjali Parties would cease to do business or that they would not have business opportunities in the future" (R. at 3092) directly contradict the "most significant basis" for the settlement.

In his Response to the Motion for Reconsideration, the Receiver defended the settlement on the basis of the facts known to him at the time. Although Investors believed the settlement was too low from the beginning, Investors concede that the Receiver was not fully informed by the Wallace Bajjali Parties at the time of the original settlement deal, and that, therefore, the settlement should have been rejected at the time of the Motion for Reconsideration because of the late disclosure by the Wallace Bajjali Parties of their billion-dollar development deals.

Investors are not asking this Court or the Receiver to make decisions based on some nebulous idea that the Wallace Bajjali Parties will someday make money. The Wallace Bajjali Parties themselves have asked Investors to nonsuit a lawsuit, and they have recommended to their fiduciaries (all partners in their real estate deals) to vote to approve this transaction based on a "high degree of confidence" that the IPO will go forward. Recent information is that the Wallace Bajjali Parties were awarded the $1.2 Billion

Joplin Contract earlier this year. As recently as December 28, 2012, the Joplin City Council approved a 3000-acre tax increment financing district to provide financing for the Wallace Bajjali development project. David Wallace has stated that $1 Billion of private capital has been committed for the project. That is what he represented to his investors at the meeting where he asked investors to vote in favor of the plan. (R. at 3045-46.)

Investors requested that the Court hold an evidentiary hearing, at which they could produce evidence to support the significant assets held by the Wallace Bajjali Parties. Particularly, Investors should have been given the opportunity to cross-examine Messrs. Wallace and Bajjali to illustrate their ability to respond to a judgment significantly higher than the settlement amount, in contrast to the representations of the Receiver. The District Court declined to hold such a hearing, and thus abused its discretion in determining that the Wallace Bajjali Parties were insolvent without a full evidentiary hearing. (R. at 3186-87, 3551-3607).

2. THE EVIDENCE SHOWS THAT THE WALLACE BAJJALI PARTIES WILL GENERATE SUFFICIENT INCOME TO SATISFY A JUDGMENT AGAINST THEM.

Investors concede that whether or not the Wallace Bajjali Parties will be able to complete their Initial Public Offering is unknown at this time.

However, the IPO is a symbol of the value of the contracts the Wallace Bajjali Parties are currently holding, and the contract they were awarded by the Joplin City Council at the end of last year. (*See* R. at 3155-63.) Messrs. Wallace and Bajjali, through an entity, have been given a development contract expected to generate over $70 million in fees in Joplin, Missouri, and they are currently engaged in a project in Amarillo, Texas, expected to generate $12 million in fees. (*See* R. at 3046.) Both of these projects have already generated revenues for the Wallace Bajjali Parties. (R. at 3301-03.) The revenues are "development fees," and are not payments for construction work, so they are very profitable, high-margin projects for Wallace Bajjali. (*Id.; see* R. at 3117-19.) So much so that the Wallace Bajjali Parties have asked their investors to vote in favor of taking the business public, which is expected to result in a valuation of $120 million. (*See* R. at 3045.)

This is not a case where an insolvent party is paying the "most it can afford" to settle with a Receiver. The settling parties here control a significant volume of real estate and have entered into contracts to generate tens of millions in development fees. To allow them to discharge significant liability to the Receivership and Appellants for what amounts to a fraction of their income, let alone the value of their assets, would be manifestly unjust.

D. THE RECEIVER'S SETTLEMENT WITH THE WALLACE BAJJALI PARTIES IS UNJUST.

1. THE WALLACE BAJJALI PARTIES ARE POTENTIALLY LIABLE TO THE RECEIVERSHIP FOR ALL LOSSES INCURRED.

Wallace and Bajjali were active and knowing participants in the Ponzi scheme that gave rise to the Receivership. They knew that new investors' funds were being used to pay prior investors, and that the money Wallace Bajjali was funneling to BizRadio was without full consent of the investors. The Receiver's papers filed in connection with the settlement recognize that the Receivership has claims against the Wallace Bajjali Parties beyond the loans that are being settled, but yet the Receiver has taken no action to seek damages from the Wallace Bajjali Parties. Considering that more than $30 million was lost by investors in connection with the scheme, the settlement amount is too small to be reasonable.

2. THE TOTAL EXTENT OF THE BIZRADIO NOTES LOSSES EXCEEDS $6.5 MILLION.

The BizRadio Notes purchased by Appellants total over $4.5 million. Appellants estimate that there are individual investors who are not party to this appeal who lost another $2 million or more in the same BizRadio Notes. If the settlement between the Receiver and the Wallace Bajjali Parties is

upheld, neither Appellants nor other investors will have a right of redress for having been bilked out of more than $6.5 million.

3. APPELLANTS ARE LIKELY TO PREVAIL ON THEIR CLAIMS AGAINST THE WALLACE BAJJALI PARTIES.

Investors have not had the opportunity to conduct discovery on their claims against the Wallace Bajjali entities. They should have the right to do that before their claims are foreclosed. The District Court did hear evidence of the existence of notes at issue, which were not issued in the name of BizRadio, but rather were issued by Wallace Bajjali Development Partners, LP. In a prior hearing, the District Court found that Wallace Bajjali, as agent for the Appellants, failed to document the transactions correctly, and thus Appellants were not entitled to the security interests for which they bargained. (R. at 2770-2801.)

The Notes, on their face, establish agency and fiduciary relationships between the Wallace Bajjali Parties and Investors for purposes of completing those loan transactions and for purposes of securing the loans with collateral. A significant portion of Investors' claims is proving that the Wallace Bajjali Parties were negligent and/or breached fiduciary duties in completing the transactions, and the District Court has already ruled after an evidentiary hearing that Wallace, *et al*., failed to complete the transactions

properly. That finding significantly increases the Investors' chances of success. Investors also have common-law and statutory fraud claims related to the Notes. Precluding the Investors from pursuing these claims before they are even able to conduct discovery on them, would be manifestly unjust. Particularly where, as here, there is no significant return coming to these Investors from the Receiver's settlement.

The Receivership Estate successfully challenged the claims to security interests by particular Investors. In so doing, the Receiver argued that those security interests were ineffective because of defects in the documentation of the associated notes and financing statements, all of which was prepared by the Wallace Bajjali Parties or their agents. It is unfair to subject the Investors to a permanent Bar Order that prevents them from seeking redress against the Wallace Bajjali Parties when the Receiver has argued and the District Court ruled that the negligence of the Wallace Bajjali Parties precluded Investors from receiving the benefits for which they bargained.

In light of the amount of money lost by Appellants and other investors, and the rulings of the District Court related to Wallace and Bajjali's failure to properly document the BizRadio Notes, and the modest amount of the settlement amount, the Receiver's settlement with the Wallace

Bajjali Parties is not reasonable and is not in the best interests of Appellants or the Receivership Estate.

VII. CONCLUSION

The District Court exceeded its legal authority by issuing the Bar Order preventing non-Receivership entities from suing other non-Receivership entities. At minimum, the portion of the District Court's Order approving the settlement that bars Appellants from asserting claims against the Wallace Bajjali Parties related to the BizRadio Notes should be reversed.

Additionally, Appellants believe that the District Court abused its discretion by confirming the Receiver's settlement with the Wallace Bajjali Parties because the consideration paid to the Receivership is insufficient in light of the damages caused by Wallace Bajjali and the financial position of the settling parties. Accordingly, the Objecting Investors respectfully request that this Honorable Court reverse the order confirming the Receiver's proposed settlement with the Wallace Bajjali Parties, or, in the alternative, reverse and remand the matter for a full evidentiary hearing before the District Court to evaluate the reasonableness of the settlement.

Respectfully submitted,

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CERTIFICATE OF SERVICE

As required by Texas Rule of Appellate Procedure 6.3 and 9.5(b), (d), (e), I certify that I have served this document on all other parties, which are listed below, on January 2, 2013 as follows:

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the paper size, line spacing, and margin requirements of Federal Rule of Appellate Procedure 32 (a)(4), the

typeface requirements of Rule 32(a)(5)(A), and the page limitation of Rule 32(a)(7)(A). This brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font, double-spaced with one-inch margins.

Dated this 2nd day of January 2013.

s/ C. Thomas Schmidt

C. Thomas Schmidt

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USDC No. 4:09-CV-3674

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Sincerely,

LYLE W. CAYCE, Clerk

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