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## I. NATURE AND STAGE OF THE PROCEEDING

Plaintiff Thomas L. Taylor III (“Receiver”) was appointed by this Court as receiver for Kaleta Capital Management, Inc. (“KCM”), BusinessRadio Network, L.P. d/b/a BizRadio (“BizRadio”), Daniel Frishberg Financial Services, Inc., d/b/a DFFS Capital Management, Inc. (“DFFS”) and all entities they own or control (collectively the “Receivership Entities”). See *SEC v. Albert Fase Kaleta, et al.*, Civil Action No. 4:09-cv-03674 (S.D. Tex.) (the “Enforcement Action”), Docs. # 7, 34.<sup>1</sup> The Receiver commenced this action seeking damages from Defendants Daniel and Elisea Frishberg and others for, *inter alia*, negligence, breach of fiduciary duty and fraudulent transfer in regard to their respective conduct as an owner, officer or control person of Receivership Entities DFFS and BizRadio.<sup>2</sup> The Receiver now moves for partial summary judgment against Daniel Frishberg (“Frishberg”) under FED. R. CIV. P. 56 holding that Frishberg was negligent and breached his fiduciary duties of loyalty and care through his conduct as an officer of DFFS and BizRadio.<sup>3</sup>

## II. ISSUE TO BE RULED UPON BY THE COURT AND STANDARD OF REVIEW

1. Whether the Receiver is entitled to summary judgment against Frishberg for negligence and the breach of his fiduciary duties of loyalty and due care to DFFS and BizRadio based on his actions as Chief Executive Officer. Summary judgment is proper if the movant shows through the pleadings, the discovery and disclosure

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<sup>1</sup> Citation to the Enforcement Action Docket will be styled as “EA Doc. # \_\_\_.”

<sup>2</sup> This Court has approved settlements with the other defendants against whom this action was originally filed. See Docs. # 21 (Albert F. Kaleta) and 24 (Barrington Financial Advisors, Inc. and William C. Heath). Daniel and Elisea Frishberg are the only remaining defendants.

<sup>3</sup> The Receiver reserves for trial a determination of the damages for which Frishberg is liable.

materials on file, and any affidavits that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.” FED. R. CIV. P. 56(a); *O’Dea v. Wells Fargo Home Mortg.*, 2013 U.S. Dist. LEXIS 15713, at \*9-11 (S.D. Tex. Feb. 5, 2013) (Atlas, J.) (citations omitted). A genuine issue of material fact exists when the evidence is such that a reasonable jury could return a verdict for the non-movant. *Tamez v. Manthey*, 589 F.3d 764, 769 (5th Cir. 2009) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)).

### III. SUMMARY OF ARGUMENT

Frishberg was the Chief Executive Officer of Receivership Entities DFFS, an investment advisory firm registered with the Securities and Exchange Commission (the “Commission”) and BizRadio, a media company operating radio stations and producing financial investing-focused programming. BizRadio -- unbeknownst to investors -- was, according to Frishberg, a “loss leader” operated to entice new clients to DFFS. Under Frishberg’s management these two businesses were ruined, leaving in their wake millions of dollars in liability, the ultimate result of which was their placement by this Court into receivership. The Receivership Estate is now liable to claimants of DFFS and BizRadio for the consequences of Frishberg’s wrongful conduct. As the result of Frishberg’s conduct, he has been enjoined from violating the Investment Advisers Act of 1940 [15 U.S.C. §§ 80b-1, *et seq.*] (the “Advisers Act”) Section 206 [15 U.S.C. § 80b-6] and has been barred from association with any investment advisor or broker-dealer.

Frishberg utilized KCM, an entity owned by DFFS account executive Albert Kaleta and which fraudulently offered promissory notes (“KCM Notes”) to DFFS clients,

to finance the operations of DFFS and BizRadio. KCM noteholders were not informed that their investments would be used to prop up failing affiliates of KCM. DFFS required loans upwards of \$300,000 to pay its quarterly expenses despite annual revenues in excess of \$2 million. *See* Exhibits F, G. BizRadio failed to turn a profit in any month of its existence. When DFFS lost access to a commercial bank credit line, Frishberg replaced it with funds raised by KCM which, by design, came from DFFS clients who were referred to Kaleta and KCM. These clients were simultaneously offered investments in BizRadio directly, and other entities which invested proceeds into BizRadio. Frishberg failed reasonably to supervise Kaleta and the KCM Note offerings, while at the same time benefitting financially through his compensation from DFFS and BizRadio, which needed capital from KCM to operate. Frishberg also conflated his personal finances and the finances of KCM, DFFS and BizRadio through the use of a KCM American Express account (the “KCM Amex”).

When the Commission commenced the Enforcement Action against Kaleta, and Frishberg’s companies collapsed, he sold the assets of DFFS (its cash flow from management fees) to Barrington Financial Advisors, Inc. (“Barrington”), which further benefitted him financially while leaving DFFS with no means to repay its creditors -- namely KCM noteholders. Frishberg was negligent in his management of DFFS and BizRadio and his supervision of DFFS account executives, and he breached the fiduciary duties of loyalty and care which he owed to the entities as CEO. Frishberg is liable to the Receivership Estate for the harm sustained by DFFS and BizRadio due to his wrongful conduct.



#### **IV. STATEMENT OF UNDISPUTED MATERIAL FACTS**

##### **A. The Receivership Estate and the Receiver's Appointment**

On December 2, 2009 this Court appointed Thomas L. Taylor III as Receiver over KCM's Records and Assets, and subsequently on June 17, 2010 placed DFFS and BizRadio into the Receivership Estate. *See* EA Docs. # 7, 34. The Order Appointing Receiver empowers the Receiver to institute proceedings the Receiver deems necessary and advisable to carry out his mandate under the Order. EA Doc. # 7 ¶5(i).

##### **B. Affiliated Receivership Entities Under Frishberg's Management**

DFFS was a registered investment advisor ("RIA") registered with the Commission. Exhibit B (hereinafter "Frish. Exam."), 8:11-13. Frishberg was the CEO of DFFS, holding ultimate authority over its strategic and operational decisions, Frish. Exam. 24:11-25:18, including its compliance responsibilities as a RIA, Exhibit C (hereinafter "Frish. Depo."), 34:9-13, and the supervision of its account executives, including Kaleta. Frish. Exam. 67:22-68:1. Frishberg was responsible for investment decisions DFFS account executives made on behalf of, and presented to, clients. Frish. Exam. 24:11-25; Frish. Depo. 16:19-22, 17:23-24. BizRadio was a limited partnership and Frishberg was the majority owner and CEO of its corporate general partner. Frish. Exam. 84:23-85:1; 85:24-86:8, 108:6-21. DFFS and BizRadio -- and KCM -- operated from shared high-rise office suites at 3050 Post Oak Boulevard in Houston, Texas. Frish. Depo. 101:11-22. Frishberg hosted a radio program on BizRadio which financially benefitted Frishberg and was a mechanism for recruiting clients for DFFS. Frish. Exam. 87:12-88:6; Exhibit D ("Bizradio...is responsible for generating the [R]IA business.").

### C. Financial Condition of DFFS and BizRadio

Both DFFS and BizRadio were in dire financial condition, needing consistent infusions of capital in order to maintain their operations. DFFS, which generated revenues from fees charged against assets it managed for clients, consistently borrowed hundreds of thousands of dollars per quarter. *See, e.g.*, Exhibit E, at 119-20 (Loan from Greaves), 161 (Loan from BizRadio), 217 (KCM). This was necessary to pay its exorbitant expenses, Frish. Depo. 45:19-23, which consisted of “wildly above-market salaries” to its account executives (including and negotiated by Frishberg, Exam. 191:14-192:6) and “outrageously expensive furnishings” for its offices. Frish. Depo. 52:3-14. DFFS engaged in this pattern for years and from a variety of sources.<sup>4</sup>

BizRadio also consistently required capital infusions to maintain operations. BizRadio never made a profit in any month of its existence. Frish. Exam. 113:25-114:2; 168:4-6. In fact, Frishberg operated BizRadio as a “loss leader” for DFFS, to entice new clients to DFFS. Exhibit D (“BizRadio ... is responsible for generating the [R]IA business”). BizRadio’s payroll was one of its largest expenses, with payroll related costs totaling over \$3.2 million in 2008 and approximately \$1.5 million in 2009. Exhibits J, K. Moreover, Frishberg increased his salary to approximately \$200,000 or more knowing that BizRadio had not ever made a profit. *See id.*; Frish. Exam. 168:19-169:6. Mrs.

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<sup>4</sup> Beginning at least in 2006 and continuing through August 2008, DFFS borrowed funds from the family of an account executive totaling at least \$687,000 in principal. Exhibit E, 119-20; Frish. Depo. 45:16-23. DFFS also utilized a line of credit with Compass Bank through Kaleta and Richard Jordan, a DFFS account executive and its then Chief Compliance Officer (“CCO”). Kaleta Aff. ¶4. DFFS also borrowed funds from BizRadio. Exhibit E, at 161.

Frishberg also was paid a salary from BizRadio of approximately \$60,000. See Exhibits J, K; Frish. Exam. 169:10-20.

DFFS and BizRadio each were able to maintain their operations only because they received millions of dollars in KCM Note Proceeds, which were raised from DFFS clients. BizRadio also raised capital from DFFS clients through equity and debt offerings. Frish. Exam. 84:25-85:13, 114:3-10. Frishberg's use of DFFS client money to prop up these affiliate entities placed all of the Receivership Entities in a precarious financial situation which, coupled with the manner in which KCM raised its proceeds, caused significant damages upon their collapse -- damages which are now the subject of claims against the Receivership Estate.

#### **D. Securities Offered to DFFS Clients**

##### **1. KCM Notes**

Compass Bank withdrew the line of credit it had extended to Kaleta and Jordan (utilized by DFFS) as of the end of the Fourth Quarter 2007, following a review of Daniel Frishberg's credit report during an internal audit. Exhibit N, Affidavit of Albert F. Kaleta ("Kaleta Aff.") ¶4. Frishberg called a meeting with Kaleta and Jordan at this time to discuss options to replace the source of funds formerly supplied by Compass Bank. Kaleta Aff. ¶5. Kaleta said that KCM could raise funds and use them to make loans. *Id.* Frishberg, with ultimate authority as CEO, decided to use KCM to replace the Compass Bank line of credit. Frish. Exam. 177:13-178:5; Kaleta Aff. ¶5.

Kaleta began selling KCM promissory notes to DFFS clients beginning in December 2007. Kaleta Aff. ¶6. No offering documents were used in the offer and sale of

KCM Notes, Frish. Exam. 161:10-13, nor were investors informed that their money would be used to make loans to prop up KCM affiliates DFFS and BizRadio. Exhibit O, Affidavit of Douglas Fingold (“Fingold Aff.”) ¶7. Approximately \$6 million in KCM Note principal was raised from DFFS clients during the time period of December 2007 to July 2009. See Exhibit L.

## 2. **BizRadio and Affiliated Investments**

Frishberg also approved the offer and sale of investments in BizRadio debt and equity to DFFS clients. Frish. Depo. 117:20-118:17. It was not disclosed to BizRadio investors that BizRadio was financially dependent on the receipt of KCM Note proceeds. At Frishberg’s direction, DFFS also introduced clients to real estate investment funds operated by David Wallace and Costa Bajjali (“WB Funds”). Frish. Exam. 61:18-21. These investments indirectly benefitted BizRadio in that the WB Funds loaned to and made investments in BizRadio, *see e.g.*, Exhibit H, at 22 (“Equity Investment by LFW Fund” and “Repayment P&I on 12% Secured Note ... Wallace Bajjali Inv Fund”); Exhibit I, at 6 (“W/T-LFW Fund - Equity Investment”), and received loans from KCM. *See* EA Doc. # 113 at 3, ¶4. Frishberg was a member of the investment committees which approved the investments in BizRadio. Frish. Exam. 79:7-16. Investors in the WB Funds were not told about those funds’ investments into BizRadio. Fingold Aff. ¶8.

### **E. Use of KCM Note Proceeds by DFSS and BizRadio**

Frishberg “always” knew about Kaleta’s company KCM, Frish. Exam. 155:15-17, and that it was a lending company.<sup>5</sup> Frishberg began executing loans by DFSS from KCM in December 2007. Exhibit M, at 2. Between that time and approximately June 2009, DFSS borrowed at least \$1.7 million from KCM. Exhibit M. When DFSS was placed into receivership by this Court, its outstanding liability to KCM totaled \$1.2 million. EA Doc. # 34 at 2.

Under Frishberg’s leadership and with his knowledge, BizRadio received millions of KCM Note proceeds as well. KCM loaned funds to BizRadio as early as March 2008. Exhibit H, at 15. BizRadio began 2009 with \$1.84 million in liability to KCM and ended 2009 with \$5.04 million owed. Exhibit I, at 150-51. Kaleta used KCM Note proceeds on behalf of BizRadio at the request of Frishberg, including for the purchase of a Dallas radio station, Kaleta Aff. ¶9, and lease payments to radio stations in Dallas and Denver. Kaleta Aff. ¶9. KCM also funded payments to Arthur Laffer, a sponsor of the Laffer Frishberg Wallace Economic Opportunity Fund, LP (“LFW Fund”) for consulting and to appear on BizRadio programming. Kaleta Aff. ¶9.

Frishberg also knew that KCM was borrowing money from DFSS clients at the same time it was loaning money to BizRadio. Frish. Exam. 157:17-158:4. BizRadio, like

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<sup>5</sup> Frishberg (1) described KCM as a “mezzanine lender” and as a “credit line” [Frish. Exam. 157:3-15; Frish. Depo. 141:7-20; Exhibit D (“it took a transition to get past losing the credit line of KCM.”)]; (2) knew that KCM replaced a line of credit from Compass Bank which DFSS had utilized [Frish. Exam, 177:13-24; Frish. Depo. 150:21-23; Kaleta Aff. ¶5]; (3) executed promissory notes from DFSS to KCM from December 2007 through June 2009 [Exhibit M; Kaleta Aff. ¶7]; (4) knew that KCM made payments on behalf of BizRadio [Frish. Exam. 156:4-17; Kaleta Aff. ¶9]; and (5) borrowed from KCM approximately \$100,000 for the purchase of a personal residence in approximately November 2008 [Frish. Depo. 158:9-159:3; Kaleta Aff. ¶8].

DFFS, used the KCM Amex to pay for expenses. Frish. Depo. 81:19-23. As detailed above, the KCM Amex account was not only used by BizRadio for business expenses, but by DFFS for business expenses and for the payment of personal expenses by the Frishbergs. Frish. Depo. 80:14-84:1. KCM noteholders had not been informed their money would be loaned to BizRadio. Fingold Aff. ¶7.

Frishberg also regularly used the KCM Amex account; indeed Frishberg had his own card under the account. Frish. Depo. 82:9-13. Frishberg used the KCM Amex account to pay for the expenses of DFFS and BizRadio. Frish. Depo. 81:3-83:23. Frishberg, however, did not only use KCM to prop up his companies -- he received money personally as well. Frishberg used the KCM Amex account for his personal expenses, conflating the finances of DFFS, BizRadio, KCM, and his family. Frish. Depo. 81:8-83:7. Additionally, in 2008 Frishberg borrowed approximately \$100,000 from KCM for the purchase of a personal residence. Frish. Depo. 158:9-159:3; Kaleta Aff. ¶8.

#### **F. DFFS Compliance Responsibilities**

Despite Frishberg's knowledge of the KCM Note offering, the source of proceeds therefrom and the use of those proceeds by affiliates, he never reviewed or audited the program, which he admits a reasonable supervisor would have done. Frish. Depo. 38:18 – 39:9. Furthermore, in approximately December 2008, Chief Compliance Officer Richard Jordan (“Jordan”) told Frishberg that Jordan believed Kaleta lacked precision in his representations to DFFS clients. Frish. Exam 216:14-217:13. Jordan also told Frishberg that DFFS was borrowing its clients' money through KCM. Frish. Exam 179:13-17. Despite being so informed, Frishberg promoted Kaleta to CCO upon Jordan's retirement

at the end of 2008, not considering anyone else for the role. Frish. Exam 214:21-23; 215:1-4; 218:23-219:2. Kaleta had no previous experience as a compliance professional. Frish. Exam 203:2-7. As Frishberg knew, Kaleta's responsibility as CCO included ensuring DFFS's compliance with the securities laws and regulations regarding conflicts of interest. Frish. Exam. 204:11-17. Frishberg promoted Kaleta knowing that -- unbeknownst to KCM noteholders -- KCM Note proceeds were being used for the benefit of DFFS and BizRadio. Frish. Exam. 157:19-158:4; Kaleta Aff. ¶¶7, 9. In the time following Kaleta's promotion, approximately \$3.3 million in KCM Notes were sold to DFFS clients, Exhibit L, at 113-226, and approximately \$561,000 in loans were made by KCM to DFFS. Exhibit M, at 32-67.

**G. Insurance and Other Claims Against DFFS Arising from Investments Introduced by DFFS to Its Clients**

Investments in KCM Notes and BizRadio notes and equity have exposed the Receivership Estate to considerable liability to DFFS clients. Claims against the Receivership Estate in regard to KCM Notes are approximately \$4.6 million. Exhibit A, Affidavit of Thomas L. Taylor III ("Receiver Aff."), ¶6. Claims against the Receivership Estate in regard to BizRadio equity and debt investments are at least \$9.5 million. *Id.* Because DFFS introduced these investments to its clients under Frishberg's authority, and did so without adequately disclosing the financial condition and existing conflicts of interests, several claims were made against Frishberg, DFFS and others under DFFS's Errors and Omissions insurance policy (the "Policy"), as detailed in the Receiver's Motion to Approve Settlement Regarding Certain Insurance Proceeds. EA Doc. # 234

(the “Insurance Motion”). The claims made against the Frishbergs and DFFS through the Policy on behalf of approximately fifteen DFFS clients total approximately \$16,250,000. *Id.* at 5. Many more similarly situated DFFS clients did not make timely claims against the Policy. But they now hold similar claims against the Receivership Estate. On May 31, 2013, this Court granted the Insurance Motion, which brings \$800,000 into the Estate. *See* EA Doc. # 243. Unfortunately the Policy’s proceeds fall far short of the amount needed for the Estate to satisfy all similarly situated claimants.

#### **H. SEC Enforcement Actions against Frishberg**

As a result of Frishberg’s failure to ensure proper disclosures regarding BizRadio securities offered to DFFS clients, and to supervise Kaleta, the Commission filed *SEC v. Frishberg*, No. 4:11-cv-01097 (S.D. Tex.), alleging violations of §206 of the Advisors Act [15 U.S.C. §80b-6]. Frishberg was enjoined from violating §206 of the Advisors Act in the future and ordered to pay \$65,000 in civil penalties. *See* Exhibit V. Additionally, the Commission commenced an administrative proceeding, *In the Matter of Daniel Sholom Frishberg*, File No. 3-14393, pursuant to §203(f) of the Advisors Act. The Commission barred Frishberg from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent. *See* Exhibit W.

#### **I. Transfer of Assets Under Management to Barrington Financial Advisors**

Fidelity Brokerage Services LLC withdrew as the custodian for DFFS accounts when DFFS was named as a relief defendant in the Enforcement Action, resulting in the inability of DFFS to execute transactions on behalf of its clients. Exhibit S. Frishberg then initiated negotiations with Barrington and its principal, William C. Heath (“Heath”)



to transfer DFFS clients and their assets under management to Barrington, who had a custody arrangement with Charles Schwab Institutional. Frish. Exam. 11:3-23. Barrington did not buy DFFS, however; it bought only DFFS revenue streams from client management fees. *See* Exhibit R.<sup>6</sup> Under this arrangement, Frishberg continued to manage DFFS client assets (likely in violation of the Commission’s bar order) for compensation derived from the management fees paid by former DFFS clients. *See* Exhibit R; Frish. Exam. 13:14-14:1.<sup>7</sup> Mrs. Frishberg also gained employment at Barrington and received a salary, as did several other former DFFS employees allied with the Frishbergs. Frish. Exam. 18:17-19:15; Exhibit P, Deposition of William C. Heath (“Heath Depo.”), 50:13-51:17, 58:23-61:11; Exhibit T. The Frishbergs, directly or through DFFS, have received at least \$318,000 from Barrington in this transaction. *See* Exhibits T, Y; Heath Depo. 63:23-64:2.<sup>8</sup>

## V. ARGUMENT

### A. Applicable Legal Standards

The Receiver stands in the shoes of the entities in Receivership, and therefore may bring the claims of the Receivership Entities against Frishberg. Liability to an entity

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<sup>6</sup> Barrington did not acquire DFFS’s liabilities to KCM. Once DFFS clients moved to Barrington, DFFS no longer could generate revenue and or satisfy its debt to KCM.

<sup>7</sup> Frishberg communicated to DFFS clients that DFFS “will be merging [its] accounts and clients” with Barrington, which “will take over the job of Registered Investment Advisor.” Exhibit Q. Frishberg further represented to DFFS clients that he would continue to “serve as portfolio manager and consultant on all issues.” *Id.* Frishberg’s letter to clients stated that “DFFS will continue to provide research and asset management to Barrington” on all accounts. *Id.*

<sup>8</sup> *Compare* Exhibit Y, showing payments to DFFS/Frishberg (as stated in Heath Depo. 63:23-64:2), to Exhibit T, showing these payments to “Port/Media Consulting.” Therefore all payments to “Port/Media Consulting” in Exhibit T must be added back to the numbers in the “Balance” row. Adding back “Apt. Rent for DSF” (Daniel Sholom Frishberg) equals approximately \$318,000. Payments to “Port/Media Consulting” and “Apt. Rent for DSF” alone total approximately \$150,000.

“may be enforced by any person who is seeking to assert the claim of the [entity],” including by a receiver. *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 834 (Tex. Civ. App.—San Antonio 1966, writ *ref'd n.r.e.*).

### 1. Negligence

The elements of a claim for negligence are the existence of a legal duty, a breach of that duty by the defendant, and damages proximately caused by the defendant’s breach. *Sport Supply Grp., Inc. v. Columbia Cas. Co.*, 335 F.3d 453, 466 (5th Cir. 2003) (citations omitted); *HIS Cedars Treatment Ctr. of DeSoto, Tex., Inc. v. Mason*, 143 S.W.3d 794, 798 (Tex. 2004). Proximate cause means the breach was a cause in fact of the damages and the damages were foreseeable. *Western Invs., Inc. v. Urena*, 162 S.W.3d 547, 551 (Tex. 2005); *Mott v. Red's Safe & Lock Servs.*, 249 S.W.3d 90, 96 (Tex. App.—Houston [1st Dist.] 2007). To be a cause in fact, the negligent conduct must be a substantial factor in bringing about the injury. *Id.*; *Prudential Ins. Co. v. Jefferson Assoc.*, 896 S.W.2d 156, 161 (Tex. 1995). To be foreseeable, the defendant need not reasonably anticipate the very consequences which occurred, only consequences of a general nature of those which occurred. *Hopson v. Gulf Oil Corp.*, 150 Tex. 1 (Tex. 1951); *see also Bishop v. South Texas Electric Cooperative, Inc.*, 577 S.W.2d 331, 335 (Tex. Civ. App. Corpus Christi 1979).

A corporation’s officers and directors owe a duty to the corporation to exercise due care in the management of the corporation’s affairs and are “clearly liable to the corporation for any loss it may suffer as a result of [t]his neglect.” *Sutton v. Reagan & Gee*, 405 S.W.2d at 834; *Meyers v. Moody*, 693 F.2d 1196, 1209 (5th Cir. 1982). “Due

care' is that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances." *Meyers v. Moody*, 693 F.2d at 1209.

A corporate officer or director, acting as an employer, also has a duty to use ordinary care in supervising an employee's activities. *Farley v. M. M. Cattle Co.*, 529 S.W.2d 751, 754 (Tex. 1975) (citations omitted). The registered principal of a RIA has the duty to supervise any partner, officer, director, or person who provides investment advice on behalf of the investment adviser. 15 U.S.C. § 80b-2(25). This duty is further demonstrated through the liability imposed in the Advisers Act for the "[failure] reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to [] supervision." 15 U.S.C. § 80b-3(e)(6).

Pursuant to FINRA Rule 3240, a registered person must provide prior written notice to his member firm about any borrowing or loaning of funds with a customer, which are only permitted in circumstances not present at DFFS, and the member must pre-approve such arrangements. *See* Exhibit X. Pursuant to FINRA Rule 3270, a registered person must provide prior written notice to his member firm about his ownership and compensation from outside business activity. *See id.* Pursuant to NASD Rule 3040, a person associated with a member cannot participate in a private securities transaction without providing written notice to the member with which he is associated describing in detail the proposed transaction. If the member approves the person's participation, the member must supervise the person's participation as if the transaction

were executed on behalf of the member. See *id.* It is undisputed that Frishberg, as an officer of DFFS and BizRadio, owed to these entities all duties recognized by law.

## 2. Breach of Fiduciary Duty

The elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary relationship between the parties; (2) a breach by the defendant of a fiduciary duty to the plaintiff; and (3) the defendant's breach resulted in (a) damages to the plaintiff or (b) a benefit to the fiduciary as a result of the fiduciary's breach. *Meaux Surface Protection, Inc. v. Fogleman*, 607 F.3d 161, 169 (5th Cir. 2010) (citation omitted); *Dernick Res. v. Wilstein*, 312 S.W.3d 864, 877 (Tex. App.—Houston [1st Dist.] 2009).

In Texas, corporate officers and directors owe fiduciary duties to the corporations they serve, *Lifshutz v. Lifshutz*, 199 S.W.3d 9, 18 (Tex.App.—San Antonio 2006, *no pet.*); *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963), and general partners of a limited partnership stand in the same fiduciary capacity to the limited partners as a trustee does to trust beneficiaries. *Crenshaw v. Swenson*, 611 S.W.2d 886, 890 (Tex. Civ. App.—Austin 1980). Under Texas law, the fiduciary duties of corporate officers and directors include the duties of obedience, loyalty and due care. *Gearhart Indus. v. Smith Int'l*, 741 F.2d 707, 719 (5th Cir. 1984). A general partner in a limited partnership owes the duties of good faith, fair dealing, loyalty and fidelity over the limited partnership's affairs and its corpus. *Herschbach v. City of Corpus Christi*, 883 S.W.2d 720 (Tex.App.—Corpus Christi 1994, *writ denied*) (duties of trustee owed to beneficiaries).

The duty of loyalty “dictates that [one] act in good faith and must not allow [] personal interests to prevail over the interests of the corporation.” *Gearhart Indus.*, 741 F.2d at 719 (citing *Int’l Bankers*, 368 S.W.2d at 578). The actions of an “interested”<sup>9</sup> officer or director are judged by their fairness to the corporation. *Id.* at 720. “Texas law also imposes a duty of good faith owed to the corporation, that a Texas director act with an intent to confer benefit on the corporation.” *Id.* at 720 (citing *Int’l Bankers*, 368 S.W.2d at 578).

Under Texas law, corporate officers and directors have “a duty to exercise due care in the management of the corporation’s affairs.” *Gearhart Indus.*, 741 F.2d at 720 (citing *McCullum v. Dollar*, 213 S.W. 259 (Tex.Comm’n App. 1919, holding approved)). “Unquestionably, under Texas law, a director as a fiduciary must exercise his unbiased or honest business judgment in pursuit of corporate interests.” *Id.* (citing *In re Westec Corp.*, 434 F.2d 195, 202 (5th Cir.1970) and *Int’l Bankers*, 368 S.W.2d at 577). “‘Due care’ is that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances.” *Id.* The business judgment rule in Texas prevents Texas courts from imposing liability upon a *non-interested* director or officer unless the challenged action is ultra vires or is tainted by fraud, *Gearhart Indus.*, at 721, however the business

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<sup>9</sup> An officer or director is “interested” if he “(1) makes a personal profit from a transaction by dealing with the corporation or usurps a corporate opportunity; (2) buys or sells assets of the corporation; (3) transacts business in his director’s capacity with a second corporation of which he is also a director or significantly financially associated; or (4) transacts business in his director’s capacity with a family member.” *Gearhart Ind.* at 719-20 (internal citations to Texas state decisions omitted).

judgment rule is not an available defense to interested directors and officers, whose actions are judged by their fairness to the corporation. *Id.* at 720.<sup>10</sup>

Additionally, the fiduciary duties of investment advisers as adopted in the Advisers Act are based upon canons incorporated by the Commission in its Report to Congress,<sup>11</sup> as articulated by the Supreme Court of the United States in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).<sup>12</sup> It is undisputed that Frishberg, as an officer of DFFS and BizRadio, owed to these entities all fiduciary duties recognized by law.

## **B. Frishberg Breached Legal Duties He Owed to DFFS**

### **1. Frishberg's Negligence in His Management of DFFS**

In several respects, Frishberg acted negligently in managing the affairs of DFFS. Under Frishberg's supervision and control, DFFS clients were introduced to and sold several investments in which Frishberg had a conflict of interest. Kaleta sold the KCM Notes to DFFS clients without disclosing that proceeds from the notes would be used to prop up DFFS and BizRadio, and that DFFS and BizRadio were in such poor financial

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<sup>10</sup> Furthermore, "the business judgment rule extends only as far as the reasons which justify its existence. Thus, it does not apply in cases, *e.g.*, in which the corporate decision lacks a business purpose, is tainted by a conflict of interest, is so egregious as to amount to a no-win decision, or results from an obvious and prolonged failure to exercise oversight or supervision. Other examples may occur." *FDIC v. Brown*, 812 F. Supp. 722, 726 (S.D. Tex. 1992) (quoting *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982)).

<sup>11</sup> See *Capital Gains*, 375 U.S. at 187 n.15 (1963).

<sup>12</sup> The canons "announced the following guiding principles: ... that the adviser should devote his time "exclusively to the performance" of his advisory function; that he should not "share in profits" of his clients; and that he should not "directly or indirectly engage in any activity which may jeopardize [his] ability to render unbiased investment advice." These canons were adopted "to the end that the quality of services to be rendered by investment counselors may measure up to the high standards which the public has a right to expect and to demand." *Id.* at 189 (citations omitted).

condition (under Frishberg's management) that the prospects of repayment were low.<sup>13</sup> Frishberg benefitted from the sale of KCM Notes personally in that proceeds were transferred to DFFS and BizRadio (at Frishberg's request and often by his signature) in order for those entities to satisfy payroll obligations, including compensation to Frishberg (and his wife) of several hundred thousand dollars annually. *See, e.g.,* Exhibit U. Additionally, Frishberg used the KCM Amex to pay for DFFS and BizRadio expenses, and for personal expenses. Frishberg also borrowed over \$100,000 from KCM for the purchase of a personal residence.

Despite this glaring conflict of interest, Frishberg failed reasonably to supervise Kaleta and the KCM Note offering. Under the FINRA and NASD Rules, DFFS had discretion over Kaleta's outside business activity and participation in private securities transactions, because Kaleta was a registered licensed adviser with DFFS and subject to Frishberg's supervision. Frishberg either knew or was willfully ignorant of the particulars of the KCM Note offering, and never conducted a review or performed an audit on KCM activity -- even after his CCO told him that DFFS was borrowing client money through KCM. The KCM Notes were not accompanied by offering documents, nor were proper representations made regarding the use of the proceeds. In this manner, Frishberg breached his duty reasonably to supervise Kaleta as an account executive of DFFS.

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<sup>13</sup> Frishberg was, as CEO, ultimately responsible for the poor financial conditions of DFFS and BizRadio. DFFS had large expenses due to Frishberg's negotiation of "wildly above-market" salaries, and was vulnerable to the availability of credit, as demonstrated by the ever-changing sources of credit utilized by DFFS. This vulnerability (and the foreseeability of its consequences) is demonstrated by DFFS turning to KCM when it lost a commercial credit line, and Frishberg's stating in an email draft that "it took a transition to get past losing the credit line of KCM" following the Enforcement Action. Exhibit D.

Frishberg's failure reasonably to supervise Kaleta is made worse by Frishberg's promotion of Kaleta to CCO -- despite Kaleta's lack of compliance-related experience and with full knowledge that Kaleta was selling KCM Notes to DFFS clients while loaning proceeds to affiliates DFFS and BizRadio. Frishberg admits as to the KCM Note offering that "the person in charge of preventing it was the person doing it." Frish. Exam. 205:15-16. Frishberg neglects the fact that he was the "person in charge" of DFFS, and that he placed Kaleta in the position of CCO knowing of the conflict-of-interest between DFFS clients and KCM, which was loaning funds to DFFS and BizRadio.

Frishberg's failure reasonably to supervise Kaleta and the investments being offered to DFFS clients proximately caused damages to DFFS. The Commission's examination and eventual filing of the Enforcement Action based on the KCM Note offering exposed a fraudulent scheme within DFFS, and along with DFFS being named as a relief defendant, caused its custodian, Fidelity, to terminate its relationship with DFFS. Furthermore, BizRadio's liability to KCM and its investors are now claims against the Receivership Estate. These consequences, or injury of this general nature, could reasonably have been anticipated by Frishberg. Kaleta was offering promissory notes and loaning the proceeds to affiliated businesses, and DFFS was offering investments which also ultimately benefitted Frishberg through DFFS and BizRadio. It was reasonably foreseeable that such activity would instigate an examination by the Commission, particularly in light of Frishberg's failure to perform any audits or other oversight of KCM.



## 2. Frishberg Breached the Fiduciary Duties He Owed to DFFS

### a. Frishberg Breached his Duty of Loyalty to DFFS

In several respects, Frishberg “allow[ed] his personal interests to prevail over the interests” of DFFS in breach of his duty of loyalty. *Gearhart Indus.*, 741 F.2d at 419. Due to Frishberg’s interests in the following transactions, greater scrutiny must be given to the fairness of these transactions and decisions to DFFS.

Frishberg was an “interested” officer under Texas law in regard to the KCM Note offering by Kaleta, a DFFS account executive. The proceeds of the KCM Note offering, the vast majority of which were raised from DFFS clients, were loaned by KCM to DFFS and BizRadio, businesses in which Frishberg was an officer and “significantly financially associated.” *Gearhart Indus.*, at 719-20. Significantly, the loans from KCM to DFFS and BizRadio necessarily allowed these entities to meet payroll obligations, and therefore, Frishberg would not have received compensation from these entities but for the loans from KCM. Frishberg was always paid on time. Frish. Depo. 47:8-14. Frishberg failed to ensure that DFFS clients were adequately informed of the sources of the KCM Note proceeds and the conflicts of interest between KCM, DFFS and BizRadio. Frishberg was also “interested” in regard to his promotion of Kaleta to CCO, because of the money flowing from KCM to DFFS and BizRadio. Rather than hire an experienced compliance professional, Frishberg promoted the person offering notes in conflict of interest with his clients, which notes were financing his affiliate businesses.

Additionally, Frishberg was “interested” under Texas law in regard to the investments introduced by DFFS to its clients in BizRadio and the WB Funds. Frishberg

received compensation from BizRadio, and the WB Funds loaned money to or invested in BizRadio, sustaining its operations. BizRadio also made loans to DFFS. Furthermore, DFFS clients paid management fees to DFFS based on their assets under management, which assets included BizRadio promissory notes and WB Fund interests for those clients who purchased them. Frishberg personally profited both from managing these assets for clients and from the transactions between these entities and BizRadio. Importantly, Frishberg has been enjoined from violating the Advisers Act and barred from the industry due to his failure to adequately inform investors about these conflicts of interest and to supervise the KCM Note offering.

Frishberg was also “interested” under Texas law in regard to the transfer of DFFS client accounts to Barrington, because Frishberg sold an asset of DFFS and, as part of that sale, retained a significant financial interest in Barrington for himself and his wife, *Gearhart Indus.*, at 719-20, each of whom were compensated by Barrington following the sale. This transaction was not fair to DFFS, as it left the DFFS entity as an empty shell with millions of dollars in liability (much of it to DFFS clients who purchased KCM Notes) and no manner in which to satisfy it. These liabilities are now borne by the Receivership Estate. The consequences of the sale of DFFS’s revenue stream was certainly foreseeable -- by removing any prospect of revenue the firm would be unable to satisfy its liabilities. That Frishberg did not sell the DFFS business in its entirety suggests that this was indeed the goal of the transaction. Furthermore, Frishberg was paid handsomely for the move to Barrington. Frishberg and his wife received approximately \$318,000 from Barrington following the transaction. *See supra*, Note 8.

**b. Frishberg Breached his Duty of Due Care to DFFS**

As shown by the above undisputed material facts, Frishberg did not manage the affairs of DFFS with due care -- “that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances,” *Gearhart Indus.*, 741 F.2d at 720 -- and thus breached this fiduciary duty which he owed to DFFS as an officer. Because the business judgment rule does not apply when an officer is interested in the transaction or “in [cases] which the corporate decision lacks a business purpose ... or results from an obvious and prolonged failure to exercise oversight or supervision,” *FDIC v. Brown*, 812 F. Supp. 722, 726 (S.D. Tex. 1992), Frishberg cannot claim his failure reasonably to supervise Kaleta and the KCM Note offering are protected. Nor is the offering of BizRadio investments to DFFS clients without adequate disclosures regarding conflicts of interest, or the transfers of DFFS assets to Barrington for Frishberg’s benefit, protected. Frishberg’s conduct so described caused foreseeable damages to DFFS, for which Frishberg is liable.

**C. Frishberg Breached Legal Duties He Owed to BizRadio**

**1. Frishberg’s Negligence in the Management of BizRadio**

Frishberg failed to exercise due care in managing the affairs of BizRadio. Despite his knowledge that BizRadio had failed to make a profit in any month of its existence, Frishberg increased his compensation, which in 2009 equaled \$232,692 (his wife made \$69,807 in 2009). Exhibit K. Because BizRadio was always operating at a loss, it constantly needed infusions of capital to maintain operations. These infusions of capital included loans of KCM Note proceeds, millions of which remain outstanding. Under

Frishberg, BizRadio continually and consistently raised funds from a common group of investors -- DFFS clients -- which were directly or indirectly funneled to BizRadio. These include the KCM Notes, BizRadio equity and promissory notes, and interests in the WB Funds, which in turn invested in BizRadio. These infusions of investor money conflated the business expenses of BizRadio with other affiliated entities, including DFFS and KCM -- and with the personal expenses of he and his wife -- through the use of the KCM Amex. Frishberg's negligence is particularly egregious due to BizRadio's extremely high debts to KCM and its financial dependence on funds raised from clients of Frishberg's RIA DFFS.

Frishberg's conduct caused foreseeable damages to BizRadio, for which Frishberg is liable. BizRadio was exposed to substantial debts to KCM and DFFS clients, which it had little prospect to repay, and its financials were intertwined with those entities and the WB Funds, increasing the risk of liability. These debts and investments went to the payment of BizRadio's expenses, including large salaries received by the Frishbergs, despite BizRadio's never having made a profit.

## **2. Frishberg Breached the Fiduciary Duties He Owed to BizRadio**

### **a. Frishberg Breached his Duty of Loyalty to BizRadio**

As the CEO of BizRadio and controlling owner of the BizRadio general partner, Frishberg owed to BizRadio and to its limited partners the fiduciary duty of loyalty -- limited partners which now hold claims against the Receivership Estate for their investments in BizRadio and KCM, which loaned millions to BizRadio. The undisputed factual evidence demonstrates that Frishberg's actions in management of BizRadio were

not “in good faith” and that Frishberg “allow[ed] his personal interests to prevail over the interests” of BizRadio. *Gearhart Indus.*, 741 F.2d at 419.

Under Frishberg’s management, BizRadio engaged in multiple transactions for which Frishberg was “interested” under Texas law. BizRadio borrowed funds from or received investments from entities of which Frishberg was also an officer, had supervisory control or had a significant financial interest, specifically KCM, DFFS and LFW Fund, and through the WB Funds, where Frishberg was a member of the investment committees which approved transactions with BizRadio. Frishberg knew that KCM made loans to BizRadio when it was borrowing money from clients DFFS, which Frishberg controlled. Frishberg also knew that the WB Funds were investing funds into BizRadio and that DFFS clients were being introduced to the WB Funds as investments. Frishberg had financial interests in (1) DFFS as an officer and owner, (2) BizRadio as an officer and owner, and through the marketing exposure of DFFS (for which BizRadio was a “loss leader”) from BizRadio and Frishberg’s radio show, and (3) the WB Funds, as an owner of LFW Fund, through the fees collected by DFFS based on client assets invested in the WB Funds, and through Frishberg’s BizRadio compensation, which was necessarily funded by investments in BizRadio by DFFS clients and the WB Funds and through KCM loans to BizRadio.

Due to Frishberg’s interests in these transactions and decisions made under him as the CEO of BizRadio, greater scrutiny must be given to the fairness of these transactions and decisions to BizRadio. These transactions were not fair to BizRadio given Frishberg’s interest, and in fact caused substantial harm to BizRadio, which was in such

dire financial straits that it was placed into receivership and is subject to claims against the Estate. By causing BizRadio to engage in these transactions or failing to stop BizRadio's engaging in actions in which Frishberg was interested, BizRadio was exposed to substantial liability. Frishberg is liable to the Receivership Estate, which now bears the liability of the harm which Frishberg caused.

**b. Frishberg Breached his Duty of Due Care to BizRadio**

As shown by the above undisputed material facts, Frishberg did not manage the affairs of BizRadio with due care -- "that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances," *Gearhart Indus.*, 741 F.2d at 720 -- and thus breached this fiduciary duty which he owed to BizRadio as an officer. The business judgment rule does not apply when an officer is interested in the transaction or "in [cases] which the corporate decision lacks a business purpose ... or results from an obvious and prolonged failure to exercise oversight or supervision." *FDIC v. Brown*, 812 F. Supp. at 726. Frishberg cannot claim BizRadio's massive borrowing from related and conflicting sources, nor loans from BizRadio to DFFS, nor his financial profit through the conflicting loans received by BizRadio are so protected. Frishberg's conduct so described caused foreseeable damages to BizRadio, for which Frishberg is liable.

**VI. RELIEF REQUESTED**

Receiver requests the Court issue summary judgment against Frishberg, finding that Frishberg (1) was negligent in his management of DFFS's affairs, (2) breached the fiduciary duties of due care and loyalty he owed to DFFS, (3) his negligence and

breaches of fiduciary duty proximately caused harm to DFBS and / or provided a benefit to Frishberg (4) was negligent in his management of BizRadio's affairs, (5) breached the fiduciary duties of due care and loyalty he owed to BizRadio, and (6) his negligence and breaches of fiduciary duty proximately caused harm to BizRadio and / or provided a benefit to Frishberg. The Receiver further requests all other relief to which he may be entitled.

Dated: October 15, 2013

Respectfully submitted,

THE TAYLOR LAW OFFICES, P.C.

By:   
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COUNSEL FOR RECEIVER

**CERTIFICATE OF SERVICE**

On October 15, 2013, I electronically submitted the foregoing document with the clerk of court for the U.S. District Court, Southern District of Texas, using the CM/ECF electronic filing system. I hereby certify that I have served all counsel of record electronically or by other means authorized by the Federal Rules of Civil Procedure.

/s/ Andrew M. Goforth  
Andrew M. Goforth