**IN THE UNITED STATES DISTRICT COURT**
**FOR THE NORTHERN DISTRICT OF TEXAS**
**DALLAS DIVISION**

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| **SECURITIES AND EXCHANGE COMMISSION**, Plaintiff, | § | |
| v. | § | Case No.: 3:16-cv-01735-D |
| **CHRISTOPHER A. FAULKNER, et al.**, Defendants, | § | |
| and | § | |
| **TAMRA M. FREEDMAN, et al.**, Relief Defendants. | § | |

**RECEIVER'S SUPPLEMENTAL SUBMISSION IN SUPPORT OF HIS MOTION TO APPROVE PROPOSED PLAN OF DISTRIBUTION AND TO ESTABLISH PROCEDURES TO DETERMINE AND DISALLOW FINAL CLAIMS**

Pursuant to this Court's April 2, 2020 Order (ECF No. 536), Court-appointed[1] Receiver[2] Thomas L. Taylor III respectfully files this supplemental submission[3] in support of his previously filed Plan Motion[4], and would show the Court as follows:

[1] *See* ECF No. 108, as amended by ECF No. 142, as amended by ECF No. 320, as amended by ECF No. 418, as amended by ECF No. 496 (collectively referred to as the "Receivership Order"). Citations to the Receivership Order refer to pages and paragraphs in ECF No. 496.

[2] Capitalized terms not defined herein have the same meaning given to them in the Receiver's Motion to Approve Proposed Plan of Distribution and to Establish Procedures to Determine and Disallow Final Claims (ECF No. 406) ("Plan Motion").

[3] The Receiver has filed an appendix concurrently herewith, the contents of which are incorporated by reference herein (cited to as "R_SUPP_APP _").

[4] The Receiver also previously filed an Appendix in support of his Plan Motion (ECF No. 407), and an omnibus response to various objections to the Plan Motion, as his reply in support of the Plan Motion (ECF No. 460) ("Reply"). The Receiver incorporates by reference herein the Plan Motion, Appendix, and Reply.

## SUMMARY

The Receiver seeks the Court's authorization for the ultimate distribution of net[5] Receivership Assets to Investor Claimants -- all persons or entities that have sustained a "net out-of-pocket loss"[6] as a result of any investment in or through an Offering Entity (BOG, BRC, BECC, Crude Energy, Crude Royalties, or Patriot). Plan Mot. at 9.[7] These distributions would be made on a *pro rata* basis -- the proportion of the net out-of-pocket loss of each Investor Claimant as a percentage of the total net out-of-pocket losses of all Investor Claimants. *Id*.

Investor Claimants would be treated as a single class -- regardless of the form or timing of their particular investment, or the Offering Entity in or through which that investment was made -- due, *inter alia*, to the pervasive commingling of investor proceeds and assets traceable to investor proceeds by and through the Offering Entities. *Id*. at 20. With respect to Conveyance Investors in royalty interests and overriding royalty interests ("RI" or "royalty interests"), the Receiver will seek the invalidation of the conveyances of royalty interests from Offering Entities to Conveyance Investors. This is necessary to effect an equitable distribution to all Investor Claimants because (1) these royalty interests were purchased with contaminated funds from accounts containing commingled proceeds from royalty interest investors, working interest ("WI" or "working interests") investors and other sources, and (2) the Offering Entities over-sold royalty interest offerings and then over-conveyed royalty interests to Conveyance Investors in amounts greater than what was owned by the transferor Offering Entity. *See id*. at 12 – 13; Reply at 8 – 9, 17 – 19.

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[5] Distributions would be made net of administrative costs subject to day-to-day operations and fees subject to approval through the Receiver's Quarterly Fee Applications. *See* Receivership Order, at ¶¶ 7(D), 56 – 62.

[6] *See* Plan Mot. at 9, fn.4.

[7] Citations to page numbers in prior filings refer to page numbers in the CM/ECF Headers of that docket entry.

Ten timely objections to the Plan Motion were submitted to the Court. ECF Nos. 429, 436, 437, 443, 445, 447, 448, 450, 452, 455. Nine of these Objections fell within three distinct groups[8]: (1) the Royalty Class Objections, in which objections were raised to the Receiver's Plan on the grounds that royalty interest and working interest investors should be treated as two distinct claimant classes in the Receiver's Plan; (2) the Conveyance Objections, in which objections were raised on the grounds that the Receiver is not entitled to invalidate the royalty conveyance instruments executed by Receivership Entities in favor of Conveyance Investors; and (3) the Working Interest Objection, in which objections were raised to the Receiver's Plan on the grounds that working interest holders in completed prospects were a class distinct from those working interest investors who invested in prospects which were not completed.[9]

## SUPPLEMENTAL SUBMISSION

### *A. The Court Should Approve the Ultimate Distribution of Receivership Assets on a* Pro Rata *Basis to All Investor Claimants*

As asserted in the Plan Motion, a *pro rata* distribution of assets is appropriate where the funds of defrauded investor victims were commingled and where victims were similarly situated with respect to their relationship to the fraud. Plan Mot. at 20 (quoting *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88 – 89 (2d Cir. 2002)); *id*. fn.16 (citing cases). Federal courts overwhelmingly order *pro rata* distributions in equity receiverships, relying on the equitable maxim that "equality is equity." Plan Mot. at 19 (citing cases).

[8] The Carole Faulkner Objection was distinct from the others in that it was not filed by a purported Investor Claimant, but a purported trade creditor to Receivership Entities. *See* Reply at 21 – 23.

[9] Several aspects of the relief sought by the Receiver were not opposed by the Objectors. *See* Reply at 5, fn.4. Accordingly, the Receiver submits that these forms of relief are unopposed.

1. **Investor Funds were extensively commingled in multiple ways**

The Objectors' positions on commingling range from questioning whether it occurred, to downplaying its significance, to not addressing commingling at all. Reply at 8. The Receiver provided extensive evidence of commingling by the Enforcement Action Defendants. *See* Plan Mot. at 20 – 21 (citing *Faulkner I* at *3 – 4; *Faulkner II* at *3, 4 – 5; ECF Nos. 102, 103, 105, 281, 282; R_APP 170 – 186; R_APP 162 – 69, 282 – 84, 291 – 92; R_APP 007 – 08, 034 – 35, 091, 183 – 84; R_APP 182 – 85, 268, 274 – 284, 291 – 301; R_APP 187 – 197, 206, 222); Reply at 8 – 9 (citing ECF Nos. 103, 105, 320, 418; R_APP 273, 289, 293).

The Receiver supplements this evidence with the attached Declaration of Rodney Sowards (R_SUPP_APP 001 – 011) ("Sowards Decl."). Mr. Sowards, Vice President of Veritas Advisory Group, Inc., previously submitted an expert report (ECF No. 105-11)[10] in support of Plaintiff Securities and Exchange Commission's *ex parte* Motion for various forms of injunctive relief (ECF No. 102). Mr. Sowards demonstrates in his new declaration that there were essentially two levels of commingling by Breitling: (1) deposits of investor monies into incorrect bank accounts; and (2) transfers between the Breitling Entities' bank accounts. Sowards. Decl. ¶¶ 6 – 10 (R_SUPP_APP 003 – 004).

With respect to category (1), all WI investor monies should have been deposited into segregated WI-Prospect bank accounts and all RI investor monies should have been deposited into segregated RI-Prospect bank accounts. However, the Breitling entities failed to segregate investor monies in such a manner. Instead, $12.977 million of WI and RI investor monies was directly deposited into general/operating accounts of the Breitling Entities, commingling funds from separate offerings. Moreover, the Breitling Entities improperly deposited $825,000 of WI investor

[10] Excerpts of which were submitted in the Receiver's Appendix in Support of the Plan Motion. R_APP 252 – 324.

monies into RI-Prospect bank accounts and $709,000 of RI investor monies into WI-Prospect bank accounts. *Id*. ¶¶ 7 – 8 (R_SUPP_APP 003).

Additionally, and with respect to category (2) above, over 500 money transactions exceeding $74 million were transferred among the Breitling Entities, with no integrity maintained to segregate either WI or RI investor monies by offering. Sowards. Decl. ¶ 5 (R_SUPP_APP 002). The majority of investor money that *was* deposited in prospect-specific, segregated bank accounts was transferred to general/operating bank accounts. In this regard, over $67 million was transferred from WI-Prospect bank accounts to general/operating bank accounts (or over 95% of the $70 million of commingled WI and RI investor funds deposited into WI-Prospect bank accounts). Additionally, over $53 million was transferred from RI-Prospect bank accounts to general/operating bank accounts (or over 81% of the $66 million of commingled WI and RI investor funds deposited into RI-Prospect bank accounts). *Id*. ¶10 (R_SUPP_APP 004).

The extensive commingling of investor proceeds in various Breitling accounts supports the distribution of Receivership Assets on a *pro rata* basis, rather than through a tracing methodology. *See* Plan Mot. at 22 – 25; Reply at 9 – 12. As Sowards declares, "comingled WI and RI investor funds were indistinguishable and untraceable within the general/operating bank accounts," which accounts "ended up holding the vast majority of both WI and RI investor funds." Sowards Decl. ¶ 10 (R_SUPP_APP 004). Because investor funds were so extensively commingled, tracing investor funds for the purpose of calculating claims is all but impossible.[11] Accordingly, this Court should adopt the Plan proposed by the Receiver to distribute Receivership Assets *pro rata*.

[11] Even if possible, a tracing-based methodology would not be equitable. *See* Plan Mot. at 22 – 25; Reply at 9 – 12.

2. **Investor Claimants in RI and WI offerings are similarly situated**

The extensive commingling demonstrated by the Receiver in the Motion and Reply, as detailed by Mr. Sowards in his declarations, illustrates that all victims of Faulkner's fraudulent scheme were similarly situated.

a. All Investors had the same "mindset"

Royalty Class Objectors assert that they should be treated differently from other investors, and particularly working interest investors, because they had a different "mindset" than other investors when purchasing their royalty-interest securities from an Offering Entity. Reply at 7 – 9. However all investor victims of Faulkner's scheme had the same mindset when making their investments -- each investor thought that they were providing funds to Offering Entities in exchange for an interest in an oil and gas investment, with the expectation that their funds would be segregated and used in line with the representations in the respective offering documents. All investors were induced to do so upon fraudulent misrepresentations in the offering documents, and nearly all investor funds, regardless of the kind of offering or the Offering Entity, were commingled with the funds of other offerings and other entities, of both the WI and RI variety. Sowards. Decl. ¶ 10 (R_SUPP_APP 004).

Even though WI and RI investments are distinct from each other, the proceeds received by Offering Entities were not treated with any distinction. Those Investor Claimants entitled to a distribution of Receivership Assets should not be treated distinctively either, but equitably, as similarly situated victims of the same fraudulent scheme.

b. Tax-related differences between WI and RI investments do not warrant treating these Investor Claimants differently under the Plan

Royalty Class Objectors also object to a distribution to a single class of claimants upon the basis that working interest investors received some form of preferential tax treatment. Reply at 12 – 14. The purported tax implications of WI and RI investments do not warrant treating these investors differently and, in fact, all Investor Claimants will have the ability to make a claim on federal tax forms to some extent regarding their losses for federal tax purposes, so these differences will balance out in the end. Reply at 13.

As the Receiver stated in his Reply, he can take any tax-related benefits into account in calculating the Investor Claimants' "net out-of-pocket losses". *Id*. Mr. Sowards agrees that this approach is appropriate. He states that any tax deductions claimed by WI Investor Claimants can be "accounted for and netted against the claimed losses suffered by" them. Sowards. Decl. ¶ 16 (R_SUPP_APP 006). "Negating the differing tax treatment between investors in [WI] and [RI] of the Breitling Entities in the [Claims Confirmation Process], results in a commonly defined single class of investors based on investment dollars." *Id*.

Moreover, unique tax-related benefits are/were available to RI Investor Claimants. Royalty interest owners are permitted to make a deduction against the income they have received for the depletion of the oil and gas underlying their royalty interest -- akin to depreciation. *See* 26 U.S.C. § 611 (allowance of deduction for depletion "[i]n the case of mines, oil and gas wells, other natural deposits, and timber"), 26 CFR § 1.611-1 (same); *see also*, *e.g.*, R_APP 076, 096; IRS Publication 535 (2019), Business Expenses, at Ch. 9 (R_SUPP_APP 027 – 033). In calculating claims against the Receivership, the Receiver will be able to take the tax-related benefits of the various kinds of investments into account. These tax-related differences between WI and RI do not warrant treating WI and RI Investor Claimants differently, particularly in light of the extensive commingling of all

investor proceeds by Faulkner and his confederates. The Court should approve the Receiver's Plan and treat all investors equally in determining their *pro rata* share of the distribution.

*B. Invalidating the Conveyances of Royalty Interests to Certain Investors is Necessary to Liquidate those Assets and is the Most Equitable Solution for All Investor Claimants*

As previously detailed to the Court, in order to ensure an equitable distribution of Receivership Assets to all Investor Claimants, the Receiver must seek the invalidation of royalty interest conveyances made by Offering Entities to the Conveyance Investors. Plan Mot. at 11 – 16; Reply at 15 – 19. Detailed below are supplemental pieces of evidence the Receiver herein provides in support of the invalidation of Conveyance Investor conveyances.

1. **Royalty interests were purchased with funds derivative of separate RI offerings and WI investor funds**

Due to the extensive commingling of investor proceeds, the conveyances of royalty interests to the Conveyance Investors must be invalidated because non-royalty interest investor funds were used to purchase RI properties. *See* Plan Mot. at 12 – 13; Reply at 8 – 9. In this regard, Sowards identifies in his new declaration several examples of non-RI proceeds used to purchase royalty interests. First, RI property acquisitions costing $778,000 were paid from three BOG/BECC non-royalty general/operating bank accounts. Only $128,000 of RI investor deposits were made into these accounts (albeit improperly), with WI investor deposits of $7.8 million. Accordingly, at least $650,000 of the $778,000 acquisition costs came from WI investor deposits, commingled funds transferred from other bank accounts, or other income. Sowards. Decl. ¶ 12 (R_SUPP_APP 005).

Second, RI property acquisition costs of $12.8 million were paid from two BRC general/operating bank accounts. Only $1.9 million of RI investor deposits were made into these accounts (albeit improperly), with WI investor deposits of $7,000. Accordingly, WI investor deposits, commingled funds transferred from other bank accounts, or other income must have been used to pay for RI property acquisition costs. Sowards. Decl. ¶ 13 (R_SUPP_APP 005).

In a third example, BRC purchased a royalty interest property and wired $500,000 to the seller from a BOG/BECC (non-royalty) general/operating bank account. As of the date of the wire, the only deposits made into this bank account were from either Pumpkin Ridge WI investor deposits ($1,653,000) or unknown sources ($105,000). Therefore, BRC's payment was made using at least $395,000 of Pumpkin Ridge WI investor funds (the $500,000 transfer amount less the $105,000 from unknown sources). Sowards. Decl. ¶ 14 (R_SUPP_APP 005).

Moreover, Breitling was making some payments to RI interest holders from the commingled funds of other investors -- not from income derived from RI interests. In this regard, an outside vendor engaged to provide bookkeeping services with respect to payments by Breitling to both WI and RI investors advised Scott Cox, Breitling's Vice President of Land, that Breitling had been making direct payments to cover the overages relating to its over-selling of offerings, in order to provide payments to investors commensurate with their purported interests. Declaration of Scott Cox (R_SUPP_APP 012 – 026) ("Cox Decl."), at ¶¶ 1, 10, 14 (R_SUPP_APP 012, 014, 015). Not only did these payments conceal Breitling's fraud, but it distributed commingled funds of some investors to other investors.

In light of this evidence that Conveyance Investors received purported conveyances of assets purchased with funds from other defrauded investors (including WI investors), and received purported royalty payments from commingled investor funds not derived from income from

royalty interest-assets, the most equitable solution is to invalidate the defective conveyances at issue, restore clear title to the Offering Entities which executed the defective conveyances, and proceed to liquidate these assets subject to confirmation by the Court. The Receiver can then distribute, *pro rata* to all Investor Claimants, the sales proceeds from these assets which were purchased with commingled investor funds.[12] To permit the Conveyance Investors to retain assets purchased with commingled investor funds would be inequitable to all other Investor Claimants.

### 2. Royalty interest offerings were over-sold and over-conveyed to Conveyance Investors

The Receiver asserts that the conveyances of royalty interests to the Conveyance Investors must be invalidated not only because of the extensive commingling of WI and RI proceeds as detailed above, but because the Offering Entities over-sold, and over-conveyed, royalty interests -- conveying amounts greater than what was owned by the transferor Offering Entity. Plan Mot. at 12; Reply at 17 – 18.

The Receiver provided evidence of the over-conveyance of royalty interests by the Enforcement Action Defendants. *See id.* (citing, *e.g.*, R_APP 199, 208, 212 – 251). The Receiver supplements this evidence with the attached Cox Declaration. Mr. Cox was the Vice President of Land for Breitling entities beginning in or about July 2013. At that time no conveyances of royalty interests to investors had been effected, notwithstanding that royalty interest offerings had been ongoing since 2010. Cox Decl. ¶ 3 (R_SUPP_APP 013). Mr. Cox facilitated the conveyance of

[12] Clearing title to these assets in the name of an Offering Entity would also enable the release of royalty payments currently held by operators in suspense (*see* Plan Mot. at 12, 14; Reply at 17 – 19) into Receivership accounts, for *pro rata* distribution to all Investor Claimants.

royalty interests to Conveyance Investors based upon information provided to him by Breitling management. *Id*. ¶ 4 (R_SUPP_APP 013).

In late 2013, Mr. Cox became aware that the sum of the percentage interests conveyed to Conveyance Investors was in excess of the percentage interest owned by Breitling in the underlying properties, and that BRC had "over-conveyed" the interests to investors. Cox Decl. ¶ 9 (R_SUPP_APP 014). In this regard, Mr. Cox received an email from Breitling's CFO indicating that outside auditors had determined three royalty interest offerings had been over-sold (and therefore over-conveyed), and that Breitling had been making direct payments to Conveyance Investors cover the overages and to provide payments to investors commensurate with their purported interests. *Id*. ¶¶ 10, 12 (R_SUPP_APP 014, 015). Mr. Cox learned in May 2014 that two additional royalty interest offerings had been over-sold, which caused over-conveyancing, and he ceased to issue purported conveyances of interests to Conveyance Investors. *Id*. ¶ 12 – 13 (R_SUPP_APP 015); *see also* R_SUPP_APP 021 – 024. Mr. Cox learned in March 2015 that yet another royalty interest offering had been over-conveyed, *id*. ¶ 16 (R_SUPP_APP 016), and also learned that that offering and two others had been either lost upon failure to make payments on the owner financing of the acquisition or not purchased in the first instance. *Id*. ¶¶ 14, 15, 17 (R_SUPP_APP 015, 016).

The over-selling and over-conveyancing of RI properties to Conveyance Investors belies the Objectors' position that they received what they paid for as stated in the offering documents. In reality, the conveyances made to Conveyance Investors were based upon inaccurate information provided to Mr. Cox, and did not align with the Conveyance Investors' *pro rata* share of the offerings in which they participated. *See generally* Reply at 15 – 18; Cox Decl. ¶¶ 3 – 9 (R_SUPP_APP 013 – 014). Importantly, not all RI investors received conveyances -- Mr. Cox

"determined not to facilitate additional inaccurate conveyances" "[s]ince it had become clear to [him] that Breitling had previously issues inaccurate conveyances." Cox Decl. ¶ 13 (R_SUPP_APP 015).[13] He did not issue any conveyances with respect to the Abraham/Liberty royalty interest offerings, nor did any other person to his knowledge. *Id*. ¶ 15 (R_SUPP_APP 015).

The over-selling and over-conveyancing of RI offerings and assets, coupled with the evidence above that RI assets were purchased with WI investor proceeds and other funds, supports a determination by the Court that the most equitable solution for all Investor Claimants is to invalidate the defective conveyances at issue, return the RI assets with clean title to the Offering Entities for liquidation, and distribute the sales proceeds (with all other Receivership Assets) *pro rata* to all Investor Claimants.

## CONCLUSION

The supplemental evidence submitted to the Court herein reinforces the Receiver's position that the conveyances of royalty interests by Offering Entities to the Conveyance investors should be invalidated, those interests liquidated by the Receiver, and all net Receivership Assets be distributed on a *pro rata* basis to all Investor Claimants. The Receiver sympathizes with the Objectors and recognizes the harsh reality that each of them has been defrauded in the Breitling scheme. No single distribution plan will satisfy all Investor Claimants. In light of these circumstances, however, all Investor Claimants should be treated equally to ensure the most equitable solution for everyone.

[13] As the Receiver noted in his Reply, the Braun/Meyer Objectors admit that they received "conveyances of some, but not all, of their interests." Reply at 16.

Accordingly, the Receiver respectfully requests that the Court grant his February 25, 2019 Motion (1) to approve the Receiver's proposed plan for the ultimate distribution of Receivership Assets and (2) to establish procedures to determine and disallow final claims against the Receivership Estate (ECF No. 406).

Dated: April 13, 2020

Respectfully submitted,

THE TAYLOR LAW OFFICES, PC

Thomas L. Taylor III
Texas Bar: 19733700
*taylor@tltaylorlaw.com*

245 West 18th Street
Houston, Texas 77008
Tel: 713.626.5300
Fax: 713.402.6154

COURT-APPOINTED RECEIVER

GOFORTH LAW, PLLC

By: /s/ Andrew M. Goforth

Andrew M. Goforth
Texas State Bar: 24076405
*andrew@goforth.law*

7614 Fairdale Lane
Houston, Texas 77063
Tel: (713) 464-2263
Fax: (713) 583-1762

COUNSEL FOR RECEIVER

**CERTIFICATE OF SERVICE**

I certify that on April 13, 2020 I filed the foregoing document through the Court's CM/ECF filing system, which satisfies service requirements under FED. R. CIV. P. 5(b)(2)(E). I also emailed copies of the foregoing document to Objectors as follows:

Paula Morris, *pmorris@morrisiplaw.com*
Paul Wohrman, *pwohrman@yahoo.com*
Robert Kohls, *rjkohls@flash.net*
Marcus P Gober, *PAULGOBER@msn.com*
Michael A. Descamps, *schneda2@gmail.com*
Dan E. Oelkers, *djoelkers@cox.net*
Daniel Schwimmer, *danielschwimmer@gmail.com*

/s/ Andrew M. Goforth
Andrew M. Goforth