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

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| SECURITIES AND EXCHANGE COMMISSION, | § | |
| | § | |
| Plaintiff, | § | |
| | § | Civil Action No. 3:16-CV-1735-D |
| vs. | § | |
| | § | |
| CHRISTOPHER A. FAULKNER, et al., | § | |
| | § | |
| Defendants. | § | |

**RECEIVER'S MOTION TO APPROVE PROPOSED PLAN OF DISTRIBUTION AND TO ESTABLISH PROCEDURES TO DETERMINE AND DISALLOW FINAL CLAIMS**

THE TAYLOR LAW OFFICES, PC

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

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

GOFORTH LAW, PLLC

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

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

COUNSEL FOR RECEIVER

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Thomas L. Taylor III ("Receiver"), appointed as temporary receiver pursuant to Orders[1] of this Court in the above-styled action (the "Enforcement Action"), respectfully files this Motion[2] ("Motion") to approve the Receiver's proposed plan for the ultimate distribution of Receivership Assets[3]; and (2) establish procedures to determine and disallow final claims against the Receivership.

Due, *inter alia*, to the pervasive comingling of investor proceeds and assets traceable to investor proceeds -- raised through BOG, BRC, BECC, Crude Energy, Crude Royalties, and Patriot (the "Offering Entities") -- the Receiver proposes that Receivership Assets ultimately be distributed to those investors who have suffered a "net out-of-pocket loss"[4] resulting from their investments in or through the Offering Entities (the "Investor Claimants").[5] Receivership Assets would be distributed to the Investor Claimants on a *pro rata* basis based upon the net out-of-pocket loss of each as a percentage of the total net out-of-pocket losses of all Investor Claimants

[1] Dkt. 108, as amended by Dkt. 142, as amended by Dkt. 320 (collectively referred to as the "Receivership Order"). Unless otherwise specified, citations to the Receivership Order refer to pages and paragraphs in Dkt. 320.

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

[3] Receivership Assets means "[a]ll assets—in any form or of any kind whatsoever—owned, controlled, managed, or possessed by defendants Christopher A. Faulkner [("Faulkner")], Breitling Oil & Gas Corporation ("BOG"), Breitling Energy Corporation ("BECC"), and Patriot Energy, Inc. ("Patriot"), and non-parties Breitling Royalties Corporation ("BRC"), Breitling Ventures Corporation ("BVC"), Breitling Holdings Corporation ("BHC"), Breitling Operating Corporation ("Breitling Ops"), Inwood Investments, Inc. ("Inwood") and Grand Mesa Investments, Inc. ("Grand Mesa"), directly or indirectly." Receivership Order, at 1.

This term also would include any assets of any person or entity placed into receivership by this Court in the future. The Receiver has filed, concurrently with this Motion, a motion requesting that the Court place Defendant Crude Energy, LLC ("Crude Energy") and non-party Crude Royalties, LLC ("Crude Royalties") into receivership. Neither these entities, nor Defendant Parker Hallam, opposes that relief.

[4] Calculated as (A) the total amount invested in or through the Offering Entities; less (B) any amounts, or the value of any assets, received with respect to the investment (*e.g.*, payments or assets transferred from an Offering Entity, payments from a third-party oil and gas operating company, the sale of any oil and gas interest received from an Offering Entity, or the sale of shares of BECC stock) ("net out-of-pocket loss").

[5] In this regard, all defrauded investors would be treated equally, regardless of the manner through which they were induced to invest in the Breitling fraudulent scheme (*e.g.*, participation in a private placement offering, the purchase of BECC shares of stock).

(the "Plan"). *See*, *e.g.*, *SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 328 (5th Cir. 2001); *United States v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996); *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 91 (2d Cir. 2002).[6]

This Motion has been served on all counsel of record and *pro se* parties in the Enforcement Action, and posted on the Receivership's website (http://breitlingreceivership.com/). The Receiver requests that the Court delay determination of this Motion to 21 days after the Receiver files a certificate of service with respect to the notices described below, consistent with Local Rule 7.1(e) of the United States District Court for the Northern District of Texas ("Local Rules"). The Receiver will effect service as follows within 100 days of the date of this Motion:

(a) serve a copy of the notice attached hereto as **Exhibit 1** ("Notice of Plan") by U.S. First Class Mail, postage prepaid, on all potential claimants with postal addresses identified in the Receivership books and records, consistent with FED. R. CIV. P. 5(b)(2)(C)[7], or by electronic mail to all such claimants for which the Receiver identifies an email address but is unable to identify a postal address; and

(b) publish a notice of this Motion consistent with the Notice of Plan for one day in The Dallas Morning News and the national edition of the Wall Street Journal.

## I. ARGUMENT AND AUTHORITY

Upon the legal and factual bases set forth below, the Receiver requests that the Court approve the Receiver's proposed Plan for the ultimate distribution of Receivership Assets to all Investor Claimants on a *pro rata* basis, and establish procedures through which the Receiver may determine or disallow a final claim amount for each Investor Claimant against the Receivership.

[6] As detailed below, at §I.C.3, the Receiver's plan of distribution will also provide a mechanism for the partial or complete disallowance of certain Investor Claimants who are former employees or affiliates of Breitling-related entities from inclusion in any distribution based on evidence that their conduct facilitated the Breitling scheme, or that they had objective notice of the fraudulent nature of the scheme.

[7] As previously reported to the Court (*see* Dkt. 326 at 3-4) the Receiver has engaged Danielle Supkis-Cheek of Pannell Kerr Forster of Texas P.C. ("PKF Texas") to marshal all relevant data regarding potential investors in the Breitling fraudulent scheme.

**A. The Receiver Will of Necessity Seek the Invalidation of Certain Conveyances of Receivership Assets to Defrauded Investors**

As an initial matter, the Receiver informs the Court that in order to ensure a distribution of Receivership Assets that is equitable to all Investor Claimants, he must seek the invalidation of certain conveyances of oil and gas-related royalty interests and overriding royalty interests ("royalty interests") made by Offering Entities to some defrauded investors ("Conveyance Investors").[8] These royalty interests were purchased with contaminated funds from comingled accounts, and the conveyance instruments purportedly transferring these royalty interests to Conveyance Investors were materially defective, in that they over-conveyed the royalty interests in amounts greater than what was owned by the transferor Offering Entity. Invalidating these defective conveyances and returning clear title to the transferor Offering Entity will enable the Receiver to liquidate these assets under Court supervision for the benefit of all Investor Claimants under the Plan.

Although the Breitling investment scheme was, in substance, an ongoing, continuous scheme, members of the public invested in the Breitling-related offerings in varying formats. Thus, for the most part, investors in working interest investments did not receive conveyances of specific assets but rather were assigned a participation in an investment program, with administration of the working interests left to the Offering Entities -- both for collection and distribution of revenue. *See*, *e.g.*, R_APP 332-36, 342-391, 392-431, 443-45, 460-499. Investments in royalty interests generally were "managed" (collection and distribution of revenue) by the Offering Entity, although in many instances investors received purported conveyances of specific (albeit inaccurate) percentages in specified assets. *See*, *e.g.*, R_APP 004-029, 030-106. Particularly in the months

[8] Many of these defective conveyances were executed by Crude Royalties. The Receiver could not seek the invalidation of these Crude Royalties conveyances unless the Court places Crude Royalties into receivership, as requested by separate motion.

prior to the collapse of the Breitling scheme, there was some effort by the Offering Entities to convey royalty interests to investors, and to contact oil and gas operators in order to place these investors in "direct pay," rather than processing their royalty payments through an Offering Entity. R_APP 202-206.

In almost all cases, however, material discrepancies exist in the conveyance instruments executed by Offering Entities in favor of Conveyance Investors and, in many instances, recorded in official real property records in various counties of several States. Specifically, the Offering Entities "over-conveyed" royalty interests, creating an anomalous situation in which investors collectively received -- of record -- more than 100% of the interest which the Offering Entity purported to own. *See*, *e.g.*, R_APP 199, 208, 212-251. In all of these instances, title to the royalty interests conveyed by Offering Entities is clouded, to say the least. As a result of these title defects, (i) many oil and gas operators have suspended royalty payments to Conveyance Investors and Offering Entities under the Texas Natural Resources Code, Section 91.402(b) (*id.*); and (ii) these royalty interests are unmarketable for resale. Notably, with respect to some of these royalty interests, the Offering Entities remain "in pay" with oil and gas operators, notwithstanding the execution and recording of the defective conveyances to Conveyance Investors. For example, the Receivership recently received a royalty check from an oil and gas operator with respect to a royalty interest which is the subject of a defective conveyance to Conveyance Investors, but who were never put "in pay" with the operator. These circumstances are further complicated by the fact that there is, in many cases, no definitive evidence of the nature and scope of the assets initially acquired by the Offering Entities.

In addition to these conveyance-related issues of suspended payments and clouded title, it is clear that funds invested by potential claimants (whether with respect to working interests or

royalty interests) were commingled between and among various accounts of the Offering Entity, various Offering Entities, and even as between working interests and royalty interests. *See* R_APP 162-69, 260-64, 268-69, 282-84, 286-87, 288-294. The overwhelming evidence reveals that BOG, BRC, BECC, Crude Energy, Crude Royalties and Patriot were, in substance, operated as a single fraudulent enterprise. Notwithstanding representations to investors, their invested funds were not maintained in strictly segregated accounts. Rather, the evidence shows that funds were commingled between and among the several working interest offerings; funds were commingled between and among the various royalty investments; and funds were commingled between and among accounts (including operating accounts of the Offering Entities) irrespective of whether the invested funds were directed to working interests or royalty interests. *Id*.

Between January 2011 and February 2016, over $74 million was transferred between and among BECC/BOG, BRC, Crude, and Patriot. R_APP 264. It is noteworthy that these transfers between and among entities took place over the life of the enterprise. There is no evidence that the Receivership entities restricted their investment activity to working interests or royalty interests during any period of time. Stated another way, funds were received by the Offering Entities for both royalty interests and working interests during the same periods of time. Thus, the commingling of investments in working interests and royalty interests almost certainly took place throughout the life of the fraudulent enterprise. Moreover, many royalty interests acquired by BRC (with comingled funds) were later transferred to Crude Royalties, which in turn executed defective conveyances to Conveyance Investors. *See*, *e.g.*, R_APP 187-197, 206, 222.

It is clear that the Offering Entities acquired royalty interests with contaminated funds in commingled accounts and then over-conveyed these interests to Conveyance Investors, yielding the result that more than 100% of the assets owned by them were purportedly transferred. Some

Conveyance Investors have suggested to the Receiver that these title defects be cured by Stipulation, executed by the Receiver and all affected Conveyance Investors, to artificial and arbitrary percentages in interest among the Conveyance Investors. This solution is not feasible. It would be inequitable to concede ownership of these interests to investors who -- by happenstance -- ended up with a recorded deed. To do so would be to assign to these investors assets which may have been -- and probably were -- purchased in part with monies invested by other potential claimants. Moreover, there is insufficient evidence to establish with certainty the starting place for many of these conveyances (*i.e.*, the precise nature and extent of the asset which was conveyed away by the Offering Entities). Under the circumstances, the Receiver could not as an equitable -- or even factual -- matter, stipulate as to a specific interest conveyed to any Conveyance Investor.

Accordingly, the most equitable solution in the Receiver's judgment 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 (payments on which will no longer be held in suspense due to clouded title, but paid in the interim into Receivership accounts) subject to confirmation by the Court. As one Court has noted: "it is best to consider the question of who owns which assets after they have been marshaled by the Receiver[,] not while the process is ongoing." *SEC v. Behrens*, No. 8:08-CV-13, 2008 WL 2485599, at *3 (D. Neb. Jun. 17, 2008) (quoting *SEC v. Novus Tech, LLC*, No. 2:07-CV-0235, 2008 WL 115114, at *4 (D. Utah Jan. 10, 2008)). Once the Receiver has liquidated these assets, all defrauded Investor Claimants will be able to share equally in the sales proceeds pursuant to the Plan of distribution proposed herein. In order to accomplish this equitable result, these Receivership Assets must be returned to the Offering Entities.

Additional legal principles support the invalidation of the defective conveyances. Without limitation, these conveyance contracts never came into existence because (1) there was no mutual assent (meeting of the minds) with respect to the terms of the offering documents underlying the conveyances;[9] (2) the Offering Entity principals lacked authority to execute these documents because they were acting adversely to the interests of the Offering Entities;[10] (3) the subscription agreements through which the Conveyance Investors invested were *ultra vires* because relevant laws prohibited the Offering Entities use of investor proceeds as part of an illegal fraudulent scheme;[11] and (4) as a matter of public policy, purported investment contracts underlying fraudulent schemes are treated as sham instruments, regardless of the culpability (or innocence) of the party seeking enforcement of a contractual provision -- if the subject matter of the contract (the fraudulent offering) is illegal, a valid, enforceable contract does not exist.[12]

Alternatives to the invalidation of the conveyances and *pro rata* treatment of the Conveyance Investors vis-à-vis the other Investor Claimants are inequitable, time-consuming and costly to the Receivership (and therefore the Investor Claimants). Under circumstances where the Conveyance Investors retain their (albeit defective) royalty interests, the Receiver must calculate their net out-of-pocket losses by analyzing their claims against the value of the royalty interests they received as a result of their investment. In order to do so, every royalty interest transferred to

[9] *Lyn-Lea Travel Corp. v. Am. Airlines, Inc.*, 283 F.3d 282, 289 (5th Cir. 2002) (citing Restatement (Second) of Contracts § 164 (1979)).

[10] An agent may only act for the benefit of the principal. Restatement (Second) of Agency § 396(b); *Apollo Techs. Corp. v. Centrosphere Indus. Corp.*, 805 F. Supp. 1157, 1195 (D.N.J. 1992).

[11] An act by an entity that is "beyond the scope of power allowed or granted by a corporate charter or by law" is *ultra vires*. BLACK'S LAW DICTIONARY (10th ed. 2014). A purported contract that is made *ultra vires* "is not voidable only, but wholly void, and of no legal effect." *California Nat'l Bank v. Kennedy*, 167 U.S. 362, 367 (1897) (citation omitted).

[12] *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011) (rejecting "form over substance rule in fraudulent transfer actions" that "ignore[s] the realities of how [fraudulent] schemes operate"); *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) ("the interest of the public, rather than the equitable standing of individual parties, is of determining importance").

the Commence Investors would require, at minimum, one appraisal. The Receiver's capacity to appraise the value of royalty interests in the hands of third parties is limited at best. Importantly, if the Receiver bears the burden of these administrative costs, it will be inequitable vis-à-vis the Investor Claimants who received no conveyances -- their distributions would be reduced by the payment of these costs. These circumstances would also implicate extensive litigation by the Conveyance Investors, who would have a vested interest in a low appraised value of their royalty interests -- the lower the value of the asset they received, the higher their potential net out-of-pocket loss (and claim against the Receivership) would be.

Invalidating the conveyances to the Conveyance Investors is consistent with the principles underlying a *pro rata* distribution, avoids the tracing of investor proceeds through the tangled web of Faulkner's fraudulent scheme, is the least costly and most efficient course of action for the Receivership and permits the most equitable result for all Investor Claimants.[13]

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

The Receiver proposes ultimately to distribute all Receivership Assets (net of administrative costs subject to day-to-day operations and fees subject to approval through the Receiver's Quarterly Fee Applications) on a *pro rata* basis to Investor Claimants -- those who suffered a net out-of-pocket loss resulting from an investment in or through the Offering Entities. As detailed below, at §I.C.3, the Receiver will seek to disqualify certain Investor Claimants based on evidence that their conduct facilitated the Breitling fraudulent scheme, or that they had objective notice of the fraudulent nature of the scheme.

[13] With respect to the Conveyance Investors, once the conveyances are invalidated, the Receiver would subtract any payment received by the Conveyance Investors vis-à-vis the conveyed assets (*e.g.*, royalty payments from oil and gas operators) from their gross investment amounts in calculating their net out-of-pocket losses. *See infra* at §I.B.3.

To date, the Receiver has not discovered any creditors with claims purportedly secured by Receivership Assets. To the extent that the Receiver later discovers, or a party later asserts, a secured interest in a Receivership Asset, the Receiver will seek resolution with Court approval as to any such secured claim -- to the extent it is valid and enforceable -- from proceeds of the sale of the Receivership Asset(s) securing the debt.

The Receiver further requests that the Court exercise its "broad powers and wide discretion to determine the appropriate relief in an equity receivership," *SEC v. Safety Fin. Serv., Inc.*, 674 F.2d 368, 372–73 (5th Cir. 1982) (quoting *SEC v. Lincoln Thrift Association*, 577 F.2d 600, 606 (9th Cir. 1978)), and subordinate any claims of trade creditors or other similarly-situated, non-investor, unsecured creditors to the claims of the Investor Claimants. "The equitable doctrine of constructive trusts gives 'the party injured by the unlawful diversion a priority of right over the other creditors of the possessor.'" *Quilling v. Trade Partners, Inc.*, No. 1:03-CV-236, 2006 WL 3694629, at *1 (W.D. Mich. Dec. 14, 2006) (*citing* III CLARK ON RECEIVERS § 662.1 at 1174 (Anderson 3d ed.1959) (quoting authorities)); *CFTC v. PrivateFX Global One*, 778 F.Supp. 2d 775, 786-87 (S.D. Tex. 2011) (*citing Trade Partners*). Like in *Trade Partners*, Receivership Assets "available for distribution are the result of investments by the investors … [and a] constructive trust arose on behalf of each investor **at the time** the investor contributed funds to [a Receivership entity]." *Id*. (*citing United States v. Fontana*, 528 F.Supp. 137 (S.D.N.Y. 1981)) (emphasis in original). In the unlikely event that distributions of Receivership Assets fully satisfy the Investor Claimants' claims, the Receiver may seek leave from the Court to distribute any remaining funds to trade creditors and other unsecured creditors on a *pro rata* basis.

*1. A* pro rata *distribution is the most equitable method of distribution*

"A district court has wide latitude when it exercises its inherent equitable power in approving a distribution plan of receivership funds." *SEC v. AmeriFirst Funding, Inc.*, No. 3:07-cv-1188-D, 2008 WL 919546, at *3 (N.D. Tex. Mar. 13, 2008) (Fitzwater, J.) (citing *Forex Asset Mgmt.*, 242 F.3d at 331); *see also Safety Fin. Serv., Inc.*, at 372–73; *Credit Bancorp*, 290 F.3d at 91; *SEC v. Basic Energy & Affiliated Res., Inc.*, 273 F.3d 657, 668 (6th Cir. 2001); *SEC v. Elliott*, 953 F.2d 1560, 1566-67 (11th Cir. 1992); *SEC v. Hardy*, 803 F.2d 1034, 1037-39 (9th Cir. 1986). The Receivership Order contemplates a plan of distribution of Receivership Assets to claimants. (Dkt. 320 at ¶52; authorizing, empowering, and directing the Receiver "to develop a plan for the fair, reasonable, and efficient recovery and liquidation of all remaining, recovered, and recoverable Receivership Assets.") "District courts considering how to treat the investors who have bought into [fraudulent] schemes must determine the most equitable remedy, and they are 'vested with broad discretionary power' to do so." *PrivateFX*, 778 F. Supp. 2d at 779 (quoting *Forex Asset Mgmt.*, 242 F.3d at 331).[14]

The Court's exercise of discretion in adopting a plan of distribution is guided by equitable principles, *Durham*, 86 F.3d at 73 ("Sitting in equity, the district court is a 'court of conscience.'") (citing *Wilson v. Wall*, 73 U.S. 83, 90 (1867)), and courts may authorize any distribution of

[14] *See*, *e.g.*, *Durham*, 86 F.3d at 73 ("Because the court used its discretion in a logical way to divide the money, the court committed no error requiring our intervention. … We will not rob the lower court of the discretion essential to its function."); *Credit Bancorp,* 290 F.3d at 91 (finding that the district court's approval of a plan of distribution was "within the Court's equitable discretion"); *SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997) ("The crafting of a remedy for violations of the [Securities Exchange Act of 1934] lies within the district court's broad equitable discretion."); *SEC v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996) (stating that the district court has "broad equitable power to fashion appropriate remedies" in securities fraud cases); *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991) (stating that the trial court is vested with "broad discretionary power . . . to craft an equitable decree"); *SEC v. Infinity Group Co.*, 226 Fed. App'x 217, 218 (3d Cir. 2007) ("District Courts have wide equitable discretion in fashioning distribution plans in receivership proceedings . . . ."); *Elliott*, 953 F.2d at 1566-67 ("The district court has broad powers and wide discretion to determine relief in an equity receivership."); *Hardy*, 803 F.2d at 1037-39 ("'[I]t is a recognized principle of law that the district court has broad power and wide discretion to determine the appropriate relief in an equity receivership.'") (citations omitted).

receivership assets that is "fair and equitable." *Forex Asset Mgmt.*, 242 F.3d at 328; *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 332-33 (7th Cir. 2010) ("fair and reasonable"); *Wang*, 944 F.2d at 85; *SEC v. Byers*, 637 F. Supp. 2d 166, 174 (S.D.N.Y. 2009) (quoting *Wang*, 944 F.2d at 81). So long as a court divides the assets "in a logical way," the court's distribution will not be disturbed on appeal. *Durham*, 86 F.3d at 73. Appellate review of distribution orders is "narrow," *Forex Asset Mgmt.*, 242 F.3d at 331 (quotation omitted), as appellate courts must not "chain the hands of the court in Equity" nor "rob the lower court of the discretion essential to its function." *Durham*, 86 F.3d at 73.

In equity receiverships, federal courts overwhelmingly order *pro rata* distribution, relying on the equitable maxim that "equality is equity." *See Wealth Mgmt.*, 628 F.3d at 333; *Infinity Grp.*, 226 F. App'x at 218; *SEC v. Capital Consultants, LLC*, 397 F.3d 733, 737, 746-47 (9th Cir. 2005); *Credit Bancorp*, 290 F.3d at 87-89; *Forex Asset Mgmt.*, 242 F.3d at 331-32; *Elliott*, 953 F.2d at 1569-70; *Byers*, 637 F. Supp. 2d at 176; *United States v. 13328 and 13324 State Highway 75 North*, 89 F.3d 551, 553-54 (9th Cir. 1996) (approving like distributions to similarly situated parties).

A *pro rata* distribution acknowledges that in reality, the perpetrators of the underlying fraud in the Enforcement Action failed to observe corporate formalities and customary legal distinctions among the various Receivership and Offering Entities. *See generally SEC v. Faulkner*, No. 16-CV-1735-D, 2017 WL 4238705 (N.D. Tex. Sept. 25, 2017) ("*Faulkner I*"); *SEC v. Faulkner*, No. 16-CV-1735-D, 2018 WL 4362729 (N.D. Tex. Sept. 12, 2018) ("*Faulkner II*").

Assets originally intended to be separate were actually commingled and used for unauthorized -- and illegal -- purposes. *See*, *e.g.*, *Faulkner I* at *3-4; *Faulkner II* at *3, 4-5.[15]

The purposeful avoidance of the corporate form by Faulkner and his confederates erased the traditional legal boundaries among the various Receivership and Offering Entities, such that they effectively became alter egos of one another. Accordingly, the most equitable and most reasonable approach to distributing the recoverable assets of the Receivership Estate is to return to each investor a prorated share of his or her gross investment in any Offering Entity, less any cash distributions received during the life of the investment, or the value of any assets received as a result of the investment.

Additionally, "[c]ourts have favored *pro rata* distribution of assets where . . . the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders." *Credit Bancorp*, 290 F.3d at 88-89.[16] As demonstrated in prior

[15] *See also*, *e.g.*, Dkts. 102, 103, 105, 281, 282. Additionally, Defendant Faulkner entered a guilty plea in a parallel criminal action, *USA v. Faulkner*, No. 3:18-cr-00500-B (N.D. Tex. 2018), to counts of Securities Fraud and Aiding and Abetting, Engaging in Illegal Monetary Transactions and Aiding and Abetting, and Tax Evasion. In entering his plea, he admitted to "obtain[ing] approximately $23 million in commingled royalty [interest] and working [interest] investor funds for his own personal benefit." The Receiver asks the Court to take judicial notice of Faulkner's guilty plea and amended factual resume (R_APP 170-186) pursuant to FED. R. EVID. 201, the contents of which are admissible hearsay pursuant to FED. R. EVID. 803(22).

[16] *See also PrivateFX*, 778 F.Supp. 2d at 778; *SEC v. Enter. Tr. Co.*, 559 F.3d 649, 652-53 (7th Cir. 2009) (affirming receiver's plan of distribution); *Liberte Capital Group, LLC v. Capwill*, 148 Fed. App'x 426, 436 (6th Cir. 2005) (affirming *pro rata* disbursement plan and noting that in two previous cases "the courts rejected a tracing method, even though tracing was clearly possible"); *Basic Energy & Affiliated Resources*, 273 F.3d at 668 (approving district court's plan to treat investors "in the same manner" as others because "[a]s the Supreme Court noted in the original Ponzi case, such cases 'call strongly for the principle that equality is equity'") (citing *Cunningham v. Brown*, 265 U.S. 1, 13, 44 S. Ct. 424, 427, 68 L. Ed. 873 (1924)); *CFTC v. Topworth Int'l Ltd.*, 205 F.3d 1107, 1110 (9th Cir. 1999) (approving receiver's plan that proposed combining multiple entities into one fund "[b]ecause each entity appeared to be the alter ego of the other"); *13328 and 13324 State Highway 75 North*, 89 F.3d at 553 (in upholding *pro rata* distribution to victims, stating "[t]his Court believes that where, as here, the struggle over the res derived from fraudulent conduct is between innocent parties, tracing should not and will not apply."); *United States v. Vanguard Investment Co.*, 6 F.3d 222, 227 (4th Cir. 1993) (approving *pro rata* distribution although some investors could trace their funds as all investors shared same equitable position); *Elliott*, 953 F.2d at 1570 (affirming district court's decision to disallow tracing in Ponzischeme, holding that all former securities owners "occupied the same legal position" and thus some should not be preferred over others); *In re Trending Cycles for Commodities, Inc.*, 27 B.R. 709, 710-11 (Bankr. S.D. Fla. 1983) (in a "pool operation, [in which] there is no record of any specifically identifiable property held for any specific customer," court approves distribution plan "based upon an amount equal to the total out-of-

filings by the SEC and Receiver, and previous holdings by the Court, there is overwhelming evidence that the funds of the defrauded investors were commingled in this case and the victims were similarly situated with respect to their relationship to the Defendants. *Faulkner II* at *3, 4-5; *see also generally* Dkts. 103, 105, 281, 282; R_APP 162-69, 282-84, 291-92.

A *pro rata* distribution is also supported in this case because the investor-victims were similarly situated. *See Credit Bancorp*, 290 F.3d at 88-89. In this regard, from approximately 2011 to 2013, BOG and BRC undertook several offerings to investors, the purpose of which was to fund the acquisition of oil and gas interests. R_APP 004-029, 332-334, 342-391. From about 2014 to 2016, Crude Energy, Crude Royalties and Patriot undertook several offerings to investors, the purpose of which was to fund the acquisition of oil and gas interests. R_APP 030-106, 392-431, 460-499. These Offering Entities made similar misrepresentations in the offering documents for these offerings. Among others, they made similar misrepresentations regarding the segregation of investor funds and the use of proceeds in operations. *See*, *e.g.*, R_APP 007-8, 034-35, 091, 183-84. In fact, investor funds were extensively comingled among Offering Entity accounts, and used to fund Faulkner's lavish lifestyle. R_APP 162-69, 182-185, 268, 274-284, 291-301. Royalty interest assets were transferred from BECC subsidiary BRC to Offering Entity Crude Royalties, R_APP 187-197, 206, 222, which the Receiver seeks to include in the receivership.

Because of the disregard of corporate formalities by Faulkner, the pervasive commingling among the assets of the Receivership and Offering Entities, and the investor-victims being similarly situated, the Receiver respectfully submits that a *pro rata* distribution is the fairest and most reasonable approach in this case.

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pocket deposit made by a customer minus withdrawals with respect to such contracts" under a rescission/restitution theory) (citations omitted).

*2. Application of tracing principals would cause an inequitable result*

Any alternative approach to a *pro rata* distribution would require a tracing analysis to determine which victim's funds, raised through numerous investment offerings, were traceable to each and every expenditure by the Offering Entities. To the extent that any Receivership Asset recovered by the Receiver was traceable to specific victims, that Receivership Asset (or proceeds from the sale thereof) would be distributed preferentially to those victims. The Receiver believes that a plan of distribution based on the tracing of assets would yield an inequitable result for numerous reasons.

A distribution based on tracing would be inequitable because "whether at any given moment a particular [investor's] assets are still traceable is a 'result of the merely fortuitous fact that the defrauders spent the money of the other victims first.'" *SEC v. Credit Bancorp Ltd.*, No. 99-CV-11395, 2000 WL 1752979, at *15 (S.D.N.Y. Nov. 29, 2000), *aff'd*, 290 F.3d 80 (2d Cir. 2002) (quoting *Durham*, 86 F.3d at 72)). To allow one investor "to elevate his position over that of other investors similarly 'victimized' … would create inequitable results, in that certain investors would recoup 100% of their investment while others would receive substantially less []."*Elliott*, 953 F.2d at 1569 (quotation omitted).

A tracing analysis would benefit later victims of the Breitling fraud because expenditures from 2016 would necessarily be easier to trace than expenditures from 2011. The Offering Entities would also be more likely to currently own assets acquired in 2016 than those acquired in 2011. Accordingly, later in time investors are more likely to receive greater distributions. Second, tracing would disproportionately harm investors whose funds were traced to expenditures such as services, rather than the acquisition of assets. In this regard, an investor whose funds were used to purchase a working interest (a real property interest under Texas law) now held with record title by an Offering Entity would receive preferential treatment vis-à-vis an investor whose funds were used

to pay the drilling expenses associated with that working interest. This aspect of a distribution regime based on tracing would be particularly harmful to investors whose funds were traced to Faulkner's misappropriation of assets and spending on extravagant personal services like international vacations and adult entertainment. Third, with respect to victims' funds that are not traceable to a specific Receivership Asset under the Receiver's control, those victims would be treated on a *pro rata* basis, although the pool of funds available to distribute to them would be smaller, after all assets traceable to other victims are removed from that pool. Moreover, tracing would be costly to administer. The Receiver would necessarily be required to engage accounting professionals to perform the analysis, further depleting the funds available to distribute to all investor-victims.

With respect to the Conveyance Investors, permitting them to retain the royalty interests conveyed to them by the Offering Entities would be a form of tracing. The assets conveyed to them would essentially be traced back to their investments. However, even under these circumstances, tracing assets to these conveyances would not be straight-forward. Because of the extensive comingling of investor proceeds, there is a high likelihood that assets conveyed to the Conveyance Investors were purchased with funds from accounts contaminated by proceeds invested by other investors. In other words, some non-Conveyance Investor proceeds may be traced to assets that were conveyed to Conveyance Investors. In such cases, the Receiver would not be able to distribute traced assets to investors whose funds were used by Faulkner to acquire specific assets -- the desired outcome under tracing principles. The Conveyance Investors would retain the asset they received from the Offering Entity, and other investors whose funds were used to purchase that asset would be treated like those whose funds were used by Faulkner on personal expenditures. In light of these inequities, coupled with the systematic and pervasive commingling of assets and the

total disregard of corporate formalities by Faulkner and his confederates, a tracing-based distribution plan should be rejected.

Courts and commentators have roundly criticized the use of tracing methods in the context of equity receiverships as arbitrary and unfair.[17] Such criticism persists even when, like here, it is possible to trace certain assets to particular investors:

> To allow any individual to elevate his position over that of other investors similarly "victimized" by asserting claims for restitution and/or reclamation of specific assets based upon equitable theories of relief such as fraud, misrepresentation, theft, etc. would create inequitable results, in that certain investors would recoup 100% of their investment while others would receive substantially less … . In the context of this receivership the remedy of restitution to various investors seeking to trace and reclaim specific assets as originating with them is disallowed as an inappropriate equitable remedy.

*Elliott*, 953 F.2d at 1569 (citing and affirming district court decision approving a *pro rata* distribution).

Thus, in cases involving similar operative facts -- namely, extensive commingling and a lack of adherence to corporate formalities -- a *pro rata* distribution is favored as both fair and reasonable in the exercise of the district court's broad equitable discretion to implement a plan of distribution. *See*, *e.g.*, *Liberte Capital Group, LLC*, 148 Fed. App'x at 436 (affirming *pro rata* distribution plan and noting that in two previous cases "the courts rejected a tracing method, even though tracing was clearly possible"); *13328 and 13324 State Highway*, 89 F.3d at 553 (upholding *pro rata* distribution to victims and stating that "[i]nstead of engaging in a tracing fiction, the equities demand that all [defrauded customers] share equally in the fund of pooled assets").

[17] *See, e.g., 13328 and 13324 State Highway*, 89 F.3d at 553 (rejecting the application of tracing fictions where funds of fraud victims were commingled, finding that to allow one claimant to better its position over other victims would frustrate equity); *PrivateFX*, 778 F.Supp. 2d at 781-84; *Trade Partners*, 2008 WL 4366039, at *3 ("In receivership proceedings, tracing principles have been soundly rejected as a basis upon which to accord greater compensation to one class of victim over another"); *see also* 2 DAN B. DOBBS, LAW OF REMEDIES (2d ed. 1993) §§ 6.1(3), 6.1(4).

Once again, a *pro rata* distribution avoids the arbitrary application of tracing rules and prevents some victims from recovering more than others simply because of the "merely fortuitous fact that the defrauders spent the money of the other victims" or the fact that there are insufficient records to trace some victims' funds to after-acquired property. *Durham*, 86 F.3d at 72; *see also Credit Bancorp*, 290 F.3d at 89; *Elliott*, 953 F.2d at 1570 ("[T]he equities weigh against allowing some to benefit from the fortuity that [the defendant] had not sold all of the securities."); *SEC v. George*, 426 F.3d 786, 799 (6th Cir. 2005) (stating that the "mere coincidence" that defendants paid certain victims to delay discovery of scheme does not entitle such victims to "preferential treatment").[18]

*3. Distribution should be based on the Investor Claimants' net losses*

Courts routinely order that a *pro rata* distribution be based on the claimants' net losses.[19] A claimant's net loss equals the amount paid into the scheme by the claimant minus the total amount paid to the claimant. *See Capital Consultants*, 397 F.3d at 737; *Capitalstreet*, 2010 WL

[18] *See also Cunningham*, 265 U.S. at 13; *Ruddle v. Moore*, 411 F.2d 718, 719 (D.C. Cir. 1969) (tracing fiction "has nothing to be said for it as a principle governing conflicting claims to restitution by equally wronged parties"); *In re Lemons & Assoc., Inc.*, 67 B.R. 198, 213-14 (Bankr. D. Nev. 1986) ("[A] creditor cannot sufficiently identify or trace the trust res through a commingled fund where the fund is too small to satisfy the claims of similarly situated parties. To do so would allow that claimant to benefit at the expense of those who have equally strong equitable claims to the same fund."); *People v. California Safe Deposit & Trust Co.*, 167 P. 388, 389-90 (Cal. 1917) (refusing to indulge in tracing fiction to allow bank's fraud victim to take full fraud amount from assets of bank in receivership because to do so would harm depositors who were "as much entitled as . . . petitioner to the favorable consideration of a court of equity"); 5 SCOTT ON TRUSTS § 519 (4th ed. 1989 & Supp. 1995) (condemning use of tracing fiction to favor one victim over another).

[19] *See*, *e.g.*, *Capital Consultants,* 397 F.3d at 737; *Topworth Int'l,* 205 F.3d at 1115-16; *In re Dennis Greenman Sec. Litig.*, 829 F.2d 1539, 1541 (11th Cir. 1987); *AmeriFirst Funding*, 2008 WL 919546, at *6-7; *PrivateFX*, 778 F. Supp. 2d at 778; *Gordon v. Dadante*, No. 1:05- CV-2726, 2010 WL 4137289, at *1 (N.D. Ohio Oct. 14, 2010); *CFTC v. Capitalstreet Fin., LLC*, No. 3:09-CV387-RJC-DCK, 2010 WL 2572349, at *1 (W.D.N.C. June 18, 2010); *Byers*, 637 F. Supp. 2d at 171-72; *CFTC v. Barki, LLC*, No. 3:09-CV-106-MU, 2009 WL 3839389, at *1-2 (W.D.N.C. Nov. 12, 2009); *SEC v. Prater*, No. 3:03-CV-01524, 2005 WL 2585269, at *1-2 (D. Conn. Aug. 24, 2005). Although some cases use the terms "net equity" or "net investment" rather than "net loss," the terms are substantively identical. *See*, *e.g.*, *In re Bernard Madoff Inv. Sec. LLC*, 654 F.3d 229, 233 (2d Cir. 2011) ("net equity"); *Capitalstreet*, 2010 WL 2572349, at *1 ("net investment").

2572349, at *3. This approach is sometimes referred to as a "money in, money out" (or "MIMO") formula. *See*, *e.g.*, *Capital Consultants*, 397 F.3d at 737.

*Pro rata* distribution based on net loss is equitable because it ensures that all investors who suffered an out-of-pocket loss receive compensation from the Receivership, and that the compensation received is proportional to the size of investors' loss. *See Barki*, 2009 WL 3839389, at *1-2 (favoring net loss method because it compensates a large percentage of defrauded investors); *Byers*, 637 F. Supp. 2d at 182 (same). "[T]reating the pre-receivership [] payments as a return of investment is the best way of putting those investors … on equal footing with those who" did not receive such payments. *AmeriFirst Funding*, 2008 WL 919546, at *5 (citing *Basic Energy & Affiliated Res.*, 273 F.3d at 660).

This treatment of payments out of the fraudulent scheme (a reduction of one's losses) is consistent with the law of fraudulent transfer, which requires "net winner" investors -- *i.e.*, those who received more in payments as a result of their investment than they invested into the scheme -- to return amounts they received in excess of their investments in the scheme, regardless of the investor's alleged good faith or ignorance of the scheme. *See*, *e.g.*, *Quilling v. Schonsky*, 247 F. App'x 583, 586 (5th Cir. 2007) (citing *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006)); *see also SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295, 301 (5th Cir. 2007). An investor cannot provide "reasonably equivalent value" for their investment into a fraudulent scheme above the amount they invested. *Janvey v. Brown*, 767 F.3d 430, 441-43 (5th Cir. 2014).

### C. The Court Should Approve Procedures through which the Receiver will Determine Final Claims through Summary Proceedings

"[A] district court may employ summary rather than plenary proceedings to adjudicate the rights to property allegedly within the receivership estate. Such summary proceedings related to receiverships do not offend the parties' due process rights 'so long as there is adequate notice and

opportunity to be heard.'" *SEC v. Amerifirst Funding, Inc.*, No. 3:07-cv-1188-D, 2008 WL 282275, at *15 (N.D. Tex. Feb. 1, 2008), *aff'd in part, vacated in part, on other grounds, remanded sub nom. Whitcraft v. Brown*, 570 F.3d 268 (5th Cir. 2009) (quoting *SEC v. Am. Capital Investments, Inc.*, 98 F.3d 1133, 1146 (9th Cir. 1996), *abrogated by Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 118 S. Ct. 1003, 140 L. Ed. 2d 210 (1998)) (citing *SEC v. Wencke*, 783 F.2d 829, 838 (9th Cir. 1986); *SEC v. Universal Fin.*, 760 F.2d 1034, 1037 (9th Cir. 1985)) (footnote omitted).[20] The use of such summary proceedings "promotes judicial efficiency and reduces litigation costs to the receivership, thereby preserving receivership assets for the benefit of [claimants]." *Bernstein*, 786 F. Supp. at 177 (internal citations omitted).

The Receiver proposes that the Court implement summary proceedings with respect to validating and disqualifying purported claimants against the Receivership.[21] By clearly delineating the procedure, expectations, and assumptions underlying this process, the Receiver hopes to provide notice and relevant information in an effort to ensure transparency and solicit questions, comments, and active participation from interested parties.

In employing summary procedures, courts have instructed that "the rights of creditors of a receivership must be balanced against the need for expeditious administration of the receivership."

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[20] *See also Elliott*, 953 F.2d at 1567 ("[A] district court does not generally abuse its discretion if its summary procedures permit parties to present evidence when the facts are in dispute and to make arguments regarding those facts."); *McFarland v. Winnebago South, Inc.*, 863 F. Supp. 1025, 1034 (W.D. Mo. 1994) ("[T]he receivership court has the power to use summary procedures in allowing, disallowing, and subordinating claims of creditors, so long as creditors have fair notice and a reasonable opportunity to respond."); *FDIC v. Bernstein*, 786 F. Supp. 170, 177 (E.D.N.Y. Jan. 10, 1992) ("A district court has extremely broad discretion in supervising an equity receivership and in determining the appropriate procedures to be used in its administration."); 13 Moore's Federal Practice (3d ed.) § 66.06[4][b] ("The powers of the courts include the allowance, disallowance, and subordination of the claims of creditors.").

[21] For the purposes of the Plan, any "claim" includes, but is not limited to, a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured, or a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured. This definition parallels that found in Section 101(5) of the Bankruptcy Code [11 U.S.C. § 101(5)].

*Hardy*, 803 F.2d at 1039. Accordingly, during the claims process, the Receiver and/or the Court may properly deny investor or creditor claims that are not adequately substantiated by the claimant with accurate documentation. *United States v. Fairway Capital Corp.*, 433 F. Supp. 2d 226, 246–47 (D.R.I. 2006), *aff'd*, 483 F.3d 34 (1st Cir. 2007).

1. *Notice to Investors of this Motion to Approve the Receiver's proposed Plan of Distribution and Claim Bar Date*

As stated above, the present Motion has been served on all counsel of record and *pro se* parties in the Enforcement Action, and posted on the Receivership's website (http://breitlingreceivership.com/). Additionally, the Receiver has retained PKF Texas to undertake an analysis of the internal records of the Offering Entities, and records obtained from oil and gas operators and other third-parties, in order to identify all of the potentially defrauded investors in the Offering Entities. Each of these potential Investor Claimants will be given notice and opportunity to be heard with respect to the present Motion.

Within 100 days of the date of this Motion, the Receiver will serve a copy of the Notice of Plan (**Exhibit 1**) by U.S. First Class Mail, postage prepaid, on all potential Investor Claimants with postal addresses identified in the Receivership books and records, consistent with FED. R. CIV. P. 5(b)(2)(C). If the Receiver identifies an email address, but is unable to identify a postal address, for any potential Investor Claimant, the Notice of Plan will be served by electronic mail. In order to reach as broad an audience of potential Investor Claimants as possible, the Receiver also will publish a notice of this Motion consistent with the Notice of Plan for one day in The Dallas Morning News and the national edition of the Wall Street Journal.

Upon the completion of the service described above, the Receiver will file with this Court a Certificate of Service. Pursuant to Local Rule 7.1(e), the Court may consider the relief sought herein within 21 days thereof.

The Receiver further requests the Court set a date by which all claims must be made against the Receivership, or be waived (a "Claim Bar Date"). The Receiver proposes the Claim Bar Date be set for the 180th day after entry of the Court's Order approving a plan of distribution. Such a claims bar procedure has been sustained as reasonable in the context of SEC equity receiverships. *See*, *e.g.*, *Hardy*, 803 F.2d at 1038 (finding two-and-one-half month period during which investors could file claim forms was a reasonable length of time to respond to the Receiver's notices). The Receiver respectfully requests that the Court also retain exclusive jurisdiction to determine any disputes with respect to the implementation of the Receiver's Plan.

2. *The Claims Confirmation Process through which the Receiver will establish Final Claim amounts*

Following the Claim Bar Date, the Receiver will commence the below claims confirmation process with respect to all claims identified or received ("Claims Confirmation Process"). The Receiver will consult internal records of the Offering Entities obtained upon his appointment, and records subsequently obtained pursuant to his subpoena powers, along with those records previously submitted by potential claimants, to determine a "notional claim amount" for each potential claimant, equal to the potential claimant's net out-of-pocket loss -- each individual's gross investment in an Offering Entity less any cash distributions or other assets transferred to the investor (and not redeposited/reinvested in another Breitling-related investment) with respect to their investment.

Thereafter, the Receiver will transmit a letter to every Investor Claimant, "net winner" investor, and creditor via regular mail (and/or electronically with written consent).[22] This letter will set forth the amount the investors' or creditors' notional claim against the Receivership estate

[22] A receiver need not separately serve process on the various claimants in a receivership so long as the claimants are given notice and an opportunity to be heard. *Fairway Capital Corp.*, 433 F. Supp. 2d at 237.

(net out-of-pocket loss) or liability to the Receivership estate (net out-of-pocket gain) as determined by the Receiver pursuant to the Plan. The notices will also contain detailed contact information for the Receiver so that the Receiver and his advisors may answer any questions or concerns voiced by the investors with respect to the claims process. The individual notices will also contain detailed information about how to dispute the amount of the claim, and the deadline by which the investor must do so.

In this regard, should any investor or creditor believe the stated amount of his, her or its notional claim (or liability) is inaccurate or inequitable they will have thirty (30) days from receipt of the Receiver's letter to respond to the Receiver. The investor or creditor will be required to respond in writing and submit the proposed amount of their revised claim against the Receivership estate with documentation sufficient to establish the basis for any revision to the amount of their notional claim. Any notional claim amount not properly disputed within thirty (30) days will become a "Final Claim Amount." In the event that the Receiver and investor cannot then agree on the amount of the claim, such investor would be able to then submit the matter to the Court for determination through summary proceedings.

At the conclusion of this Claims Confirmation Process, the Receiver will file with the Court and mail (or email, with written consent) to each then-confirmed Investor Claimant, "net winner" investor, and creditor an additional notice setting forth the exact amounts of their Final Claim Amount (or liability) and the percentage of that claim with respect to all Final Claim Amounts (*i.e.*, the *pro rata* share of all distributed Receivership Assets that will be received by that Investor Claimant on that Final Claim Amount). The Receiver will separately move the Court to approve any and all interim and final distributions of Receivership Assets to Investor Claimants as the circumstances permit.

3. *Disqualification of certain Investor Claimants based on evidence that their conduct facilitated the Breitling fraudulent scheme, or that they had objective notice of the fraudulent nature of the scheme*

Through the summary procedures detailed above, the Receiver may also seek to disqualify certain Investor Claimants who are former employees and affiliates of Breitling-related entities, based on evidence that their conduct facilitated the Breitling fraudulent scheme, or that they had objective notice of the fraudulent nature of the scheme.

Excluding disqualified defendants and their related parties -- as well as individuals such as Offering Entity employees who actively participated in the development, implementation, and/or marketing of the fraudulent scheme -- from participation in distributions has been held as reasonable, as it permits limited assets to be distributed to those who are most innocent. *See Basic Energy & Affiliated Resources, Inc.*, 273 F.3d at 660-61. In *Basic Energy*, the Sixth Circuit approved a plan of distribution that categorized investors into one of four classes based on their level of participation in the underlying fraudulent scheme and adjusted their net investor claims accordingly for purposes of calculating their ratable shares. The Sixth Circuit approved the receiver's decision to reduce the claims of these classes by varying degrees. *Id*.

Disqualifying certain claimants or reducing certain claim amounts has been approved by other courts as well, so long as the claimants are provided notice and an opportunity to be heard. *See*, *e.g.*, *SEC v. Enter. Tr. Co.*, No. 08-CV-1260, 2008 WL 4534154, at *3-6 (N.D. Ill. Oct. 7, 2008), *aff'd*, 559 F.3d 649 (7th Cir. 2009) ("[d]isqualifying those who took the business over the edge is the most common feature, and the least contested aspect, of distribution plans … [i]t is difficult to find cases in which business officers like [the principals] took a share of a Receiver's distribution, and it will not occur in this case. They are not innocent victims of Enterprise's actions."); *SEC v. Merrill Scott & Assocs., Ltd.*, No. 2:02-cv-39, 2006 WL 3813320, at *6-7 (D. Utah Dec. 21, 2006) (excluding investor because his "unusually close relationship with Merrill

Scott and his activities in referring potential clients [made] him an 'insider' who should be equitably excluded from any distribution."); *Credit Bancorp*, 290 F.3d at 88 (a *pro rata* distribution should only be made to those individuals who are "similarly situated with respect to their relationship to the defrauders."). Furthermore, a court sitting in equity has wide discretion to refuse distributions to such individuals under the doctrine of "unclean hands." *Precision Instrument Mfg. Co. v. Auto. Maint. Mach. Co.*, 324 U.S. 806, 814–15, 65 S. Ct. 993, 997, 89 L. Ed. 1381 (1945) ("Any willful act concerning the cause of action which rightfully can be said to transgress equitable standards of conduct is sufficient cause for the invocation of the maxim.").[23]

*4. Procedures for Seeking reconveyance of assets conveyed to investors*

As detailed above, the Receiver intends to move the Court to invalidate specific conveyances of Receivership Assets from Offering Entities to Conveyance Investors through summary proceedings. "[A] district court may employ summary rather than plenary proceedings to adjudicate the rights to property allegedly within the receivership estate. Such summary proceedings related to receiverships do not offend the parties' due process rights 'so long as there is adequate notice and opportunity to be heard.'" *AmeriFirst Funding*, 2008 WL 282275, at *15 (quoting *Am. Capital Invs.*, 98 F.3d at 1146) (citing *Wencke*, 783 F.2d at 838; *Universal Fin.*, 760 F.2d at 1037) (footnote omitted).

Accordingly, when the Receiver moves this Court with respect to the conveyances at issue, he will give notice to all Conveyance Investors implicated thereby. Such notice shall be by U.S. First Class Mail, postage prepaid, to such person's last know postage address, consistent with FED.

[23] *See also Dunlop-McCullen v. Local 1-S*, 149 F.3d 85, 90 (2d Cir. 1998) ("[W]hile equity does not demand that its suitors shall have led blameless lives, as to other matters, it does require that they shall have acted fairly and without fraud or deceit as to the controversy in issue.").

R. CIV. P. 5(b)(2)(C). These Conveyance Investors will then have the opportunity to appear and oppose the Receiver's requested relief within the time limits set forth in the Local Rules.

## II. CONCLUSION

The Receiver requests that the Court approve the Plan for the ultimate distribution of Receivership Assets as proposed herein -- on a *pro rata* basis to all Investor Claimants who suffered a net out-of-pocket loss. Due to the pervasive comingling of investor proceeds and the continuous nature of Faulkner's fraudulent scheme -- effected through multiple entities and multiple securities offerings -- a *pro rata* distribution through which all defrauded investors would be treated equally, regardless of the manner through which they were induced by Faulkner and his confederates to invest funds into the underlying fraudulent scheme, is the most equitable way to distribute Receivership Assets.

Dated: February 25, 2019

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 CONFERENCE

I certify that undersigned counsel for the Receiver conferred with counsel for Plaintiff Securities and Exchange Commission, who does not oppose the relief sought herein.

/s/ Andrew M. Goforth
Andrew M. Goforth

## CERTIFICATE OF SERVICE

I certify that on February 25, 2019 I served the foregoing document pursuant to FED. R. CIV. P. 5(b)(2)(E) by filing it through the Court's CM/ECF filing system, and by sending a true and correct copy via electronic mail to those parties listed below, with written consent:

Jeremy S. Wagers
2400 Augusta Drive, Suite 453
Houston, TX 77057
*jwagers@wagerslaw.com*

PRO SE DEFENDANT

/s/ Andrew M. Goforth
Andrew M. Goforth

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

| | | |
|---|---|---|
| SECURITIES AND EXCHANGE COMMISSION, | § | |
| | § | |
| Plaintiff, | § | |
| | § | Civil Action No. 3:16-CV-1735-D |
| VS. | § | |
| | § | |
| CHRISTOPHER A. FAULKNER, et al., | § | |
| | § | |
| Defendants. | § | |

**NOTICE OF PROPOSED PLAN OF DISTRIBUTION**

**TO: ALL POTENTIAL CLAIMANTS OF THE BREITLING RECEIVERSHIP ENTITIES**

On February 25, 2019, Court-appointed temporary receiver Thomas L. Taylor III ("Receiver") filed a Motion (the "Motion") to approve the Receiver's proposed "Plan" for the ultimate distribution of Receivership Assets[1]; and (2) establish procedures to determine and disallow final claims against the Receivership.

The Motion, all attachments and other information regarding the Claims Confirmation Process have been posted on the Receivership's website (http://breitlingreceivership.com/). This "Notice of Plan" has been mailed by U.S. First Class Mail, postage prepaid, to all potential claimants with postal addresses identified in the Receivership books and records, or sent by electronic mail to all such potential claimants for which the Receiver identifies an email address but is unable to identify a postal address. A notice consistent with this Notice of Plan also has been published for one day in The Dallas Morning News and the national edition of the Wall Street Journal.

[1] Receivership Assets means "[a]ll assets—in any form or of any kind whatsoever—owned, controlled, managed, or possessed by defendants Christopher A. Faulkner [("Faulkner")], Breitling Oil & Gas Corporation ("BOG"), Breitling Energy Corporation ("BECC"), and Patriot Energy, Inc. ("Patriot"), and non-parties Breitling Royalties Corporation ("BRC"), Breitling Ventures Corporation ("BVC"), Breitling Holdings Corporation ("BHC"), Breitling Operating Corporation ("Breitling Ops"), Inwood Investments, Inc. ("Inwood") and Grand Mesa Investments, Inc. ("Grand Mesa"), directly or indirectly." Receivership Assets would also include the assets of any person or entity placed into receivership by the Court after its September 12, 2018 First Amended Order Appointing Receiver (Dkt. 320).

**A. The proposed Plan for the ultimate distribution of Receivership Assets**

As further detailed in the Motion, the Receiver proposes to ultimately distribute Receivership Assets to those investors who have suffered a "net out-of-pocket loss"[2] resulting from investments in or through Breitling Oil & Gas Corporation, Breitling Royalties Corporation, Breitling Energy Corporation, Crude Energy, LLC, Crude Royalties, LLC and Patriot Energy, Inc. -- the "Offering Entities." Distributions would be made "*pro rata*" -- based on 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.

All Investor Claimants would be treated equally, regardless of the manner through which they were induced to invest in the Breitling fraudulent scheme (*e.g.*, participation in a private placement offering, the purchase of BECC shares of stock, etc.)

**B. You have approximately 21 days to oppose the Receiver's proposed Plan**

Once mail and email service of this Notice of Plan and publication are complete, the Receiver will file a Certificate of Service in the above-styled civil action. According to Local Rule 7.1(e) of the U.S. District Court for the Northern District of Texas, once the certificate of service is filed, you will have 21 days to oppose the Receiver's Motion. After that time, the Court may deem the Motion unopposed and grant the Motion.

**C. Claim Bar Date**

The Receiver has requested the Court set a Claim Bar Date, by which potential claimants must give the Receiver written notice of their potential claim against the Receivership. The Receiver has requested the Court set the Claim Bar Date to be the 180th day after the Court enters an Order approving a plan of distribution.

**D. Please visit the Receivership Website for Documents and other information**

As stated above, you may download the Motion, all of its attachments and find other information regarding the Receivership and the Claims Confirmation Process on the Receivership's website (http://breitlingreceivership.com/).

**Thomas L. Taylor III, Receiver**

[2] Calculated as (A) the total amount invested in or through the Offering Entities; less (B) any amounts, or the value of any assets, received with respect to the investment (*e.g.*, payments or assets transferred from an Offering Entity, payments from a third-party oil and gas operating company, the sale of any oil and gas interest received from an Offering Entity, the sale of shares of BECC stock, etc.) ("net out-of-pocket loss").

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

| | | |
|---|---|---|
| SECURITIES AND EXCHANGE COMMISSION, | § | |
| | § | |
| Plaintiff, | § | |
| | § | Civil Action No. 3:16-CV-1735-D |
| VS. | § | |
| | § | |
| CHRISTOPHER A. FAULKNER, et al., | § | |
| | § | |
| Defendants. | § | |

**ORDER GRANTING RECEIVER'S MOTION TO APPROVE PROPOSED PLAN OF DISTRIBUTION AND ESTABLISH PROCEDURES TO DETERMINE AND DISALLOW FINAL CLAIMS**

This Court has considered temporary receiver Thomas L. Taylor III's ("Receiver") February 25, 2019 Motion to (1) approve the Receiver's proposed plan for the ultimate distribution of Receivership Assets[1]; and (2) establish procedures to determine and disallow final claims against the Receivership (the "Motion"), and all opposition, responses or objections thereto, if any. Having determined that full notice and opportunity to respond to the Motion has been given by the Receiver to all potentially affected parties, and that the Motion is fully supported by the written submissions and record before the Court, the Motion is hereby GRANTED in all respects. It is therefore:

[1] Receivership Assets means all assets—in any form or of any kind whatsoever—owned, controlled, managed, or possessed, directly or indirectly, by defendants Christopher A. Faulkner ("Faulkner"), Breitling Oil & Gas Corporation ("BOG"), Breitling Energy Corporation ("BECC") and Patriot Energy, Inc. ("Patriot"), and non-parties Breitling Royalties Corporation ("BRC"), Breitling Ventures Corporation ("BVC"), Breitling Holdings Corporation ("BHC"), Breitling Operating Corporation ("Breitling Ops"), Inwood Investments, Inc. ("Inwood") and Grand Mesa Investments, Inc. ("Grand Mesa"), and any person or entity placed into receivership by this Court subsequent to the Court's September 12, 2018 First Amended Order Appointing Receiver (Dkt. 320) (collectively, excluding Faulkner, the "Receivership Entities").

ORDERED that the Receiver shall separately move the Court with respect to the invalidation of certain conveyances of assets from Receivership Entities to investors in or through Receivership entities through summary proceedings before this Court. Notice of all such motions shall be served pursuant to FED. R. CIV. P. 5(b) on all affected parties, who shall be afforded the opportunity to respond to the relief sought by the Receiver. It is further

ORDERED that Receivership Assets shall ultimately be distributed to those parties that have suffered a "net out-of-pocket loss" (the "Investor Claimants") as a result of an investment in BOG, BRC, BECC, Crude Energy, LLC, Crude Royalties, LLC or Patriot (the "Offering Entities"). An Investor Claimant's "net out-of-pocket loss" is equal to the gross amount of an Investor Claimant's investment in an Offering Entity, less any amount, or the value of any asset, received by the Investor Claimant with respect to the investment. Receivership Assets shall ultimately be distributed to the Investor Claimants on a *pro rata* basis based upon 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 (the "Plan of Distribution"). It is further

ORDERED that unsecured claims against the Receivership Entities which do not arise from investments in the Offering Entities are subordinated to the claims of the Investor Claimants. It is further

ORDERED that all parties who assert a claim against a Receivership Entity or Offering Entity shall have one hundred and eighty (180) days following the date of this Order (the "Claim Bar Date") to contact the Receiver[2] and identify themselves to him (all parties who identify themselves to the Receiver on or before the Claim Bar Date are hereinafter referred to as the

[2] Contact with the Receiver shall be made in writing by electronic mail to *claims@breitlingreceivership.com* or by U.S. Certified Mail, Return Receipt Requested, to Thomas L. Taylor III, Receiver; The Taylor Law Offices, P.C.; 245 West 18th Street; Houston, Texas 77008.

"Potential Claimants"). In identifying themselves to the Receiver, all Potential Claimants shall provide the Receiver with an electronic mail address or physical address at which they consent to receive future claims-related communications. It is further

ORDERED that the estates of the Receivership Entities shall be forever discharged from any indebtedness or liability to all parties that do not identify themselves to the Receiver as a Potential Claimant on or before the Claim Bar Date. It is further

ORDERED that following the Claim Bar Date the Receiver shall establish a "Final Claim Amount" for all Potential Claimants (equal to the greater of zero (0) or the net out-of-pocket loss of each). The Receiver shall first give all Potential Claimants notice of a notional claim amount, in writing, as calculated by the Receiver. Each notional claim amount shall become a "Final Claim Amount" unless, within (30) days of the date of the Receiver's notice, the Potential Claimant properly disputes it: (i) in writing, (ii) asserting an alternative claim amount and the calculation for same, and (iii) with documentation supporting the calculation. The Receiver shall respond in writing to a properly disputed notional claim amount with a final notional claim amount. This final notional claim amount shall become a "Final Claim Amount" unless, within (30) days of the date of the Receiver's notice of the final notional claim amount, the Potential Claimant moves the Court to determine a "Final Claim Amount." It is further

ORDERED that the Receivership Entities shall be forever discharged from any indebtedness or liability to the Potential Claimants, and the Potential Claimants shall not be permitted to receive any distribution, except with respect to their Final Claim Amounts as expressly provided for under the Plan of Distribution.

Signed at Dallas, Texas this _____ day of _____, 2019.

SIDNEY A. FITZWATER
SENIOR JUDGE