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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION



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| SECURITIES AND EXCHANGE COMMISSION, | § | |
| Plaintiff, | § | |
| v. | § | |
| CORNERSTONE PRODIGY GROUP, INC., GARY D. REEDER and SANDRA M. REEDER, | § | CIVIL ACTION NO. 499-CV-0978-Y |
| Defendants. | § | |
| and | § | |
| EXECUTIVE NETPROFITS, INC. | § | |
| Defendant Solely for the Purpose of Equitable Relief | § | |

**RECEIVER'S OBJECTION TO CLAIMS OF CREDIT CARD COMPANIES, REQUEST FOR HEARING AND BRIEF IN SUPPORT**

TO THE HONORABLE TERRY R. MEANS, UNITED STATES DISTRICT JUDGE:

COMES NOW, Michael J. Quilling (the "Receiver"), the Receiver appointed by the Court in these proceedings, and files this Objection to Claims of Credit Card Companies, Request for Hearing and Brief in Support as follows:

## I.

## PROCEDURAL BACKGROUND

1.1 On November 24, 1999 this Court appointed the Receiver in this case by virtue of its Order Appointing Receiver Pendente Lite (hereinafter "Order Appointing Receiver"). On that same date the Court entered the *Ex Parte* Temporary Restraining Order, Order Freezing Assets,

Repatriation Order, Order for Accounting, Order Granting Expedited Discovery and for Other Emergency Relief ("*Ex Parte* Order").

1.2 On January 21, 2000 the Receiver filed his Motion to Turnover Reserve Accounts, Prohibit Charge-Backs, Establish Date For Presentation of Charge-back Claims, Request For Hearing and Brief in Support (the "Motion"). The Motion was served on all the credit card associations and intermediate processing entities (collectively, the "Credit Card Companies") that, at least to the Receiver's knowledge, were processing charge-backs attributable to Defendant Cornerstone Prodigy Group, Inc. ("Cornerstone").[1] The Court held a status conference relative to the Motion on January 28, 2000 and set the Motion for hearing on February 11, 2000.

1.3 At the February 11, 2000 hearing, the Court was apprised of the current status of settlement negotiations between the Receiver and the Credit Card Companies and the issues remaining before the Court that were identified by the Receiver in the Motion and by the parties at the hearing. Accordingly, by written order of that same date, the Court adjourned the hearing on the Motion, reset the hearing for March 17, 2000 and established a briefing schedule whereby briefs on the charge-back issues were ordered to be submitted.

1.4 On March 17, 2000 the Court reconvened the hearing on the Motion and, having considered the submitted briefs, took the Motion under advisement. Subsequently, on March 22, 2000, the Court entered an order establishing a bar date whereby the Credit Card Companies were ordered to submit to the Receiver their written claims of all amounts they contend are owed by the receivership estate by June 30, 2000.

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[1]The Credit Card Companies consist of the following entities: Superior Bankcard Services ("Superior"), Visa, MasterCard, American Express, Discover/Novus , Quad City Bancard, Inc. and "Chargeback Department." The Receiver first became aware of the latter entity approximately two weeks ago, after having received a charge-back request from a company that only identified itself as "Chargeback Department." Upon becoming aware of this company, the Receiver immediately served the Order Appointing Receiver and the Order Establishing a Bar Date.

1.5 The Receiver hereby objects to any and all claims of the Credit Card Companies, same arising out of the charge-backs in issue, to the extent that they are asserted as a priority or preferential claim over those of the defrauded investors. The Credit Card Companies' claims arising out of the subject charge-backs are general, not priority, claims, and these entities are only entitled to a pro-rata distribution of receivership assets along with the those defrauded investors who did not receive a charge-back.

## II.

## FACTUAL BACKGROUND

2.1 While the Court is aware of the basic factual framework concerning the subject charge-backs, it will be helpful to restate the issues presently before the Court. In the typical credit card transaction, the purchaser, in this case the defrauded investors, gives the merchant a credit card draft in exchange for service or merchandise. The merchant sells the credit card draft to an intermediary bank for the face value of the draft less a processing fee. The intermediary bank then sells the credit card draft to the sponsoring bank at face value less a processing fee. The sponsoring bank in turn collects payment for the credit card draft from the credit card purchaser. *Federal Trade Comm'n v. Overseas Unlimited Agency, Inc.*, 873 F.2d 1233, 1234 (9th Cir. 1989).

2.2. All transactions in the "charge loop" are subject to ostensible rights of charge back which run the other way. In cases where a credit card customer is dissatisfied with goods or services purchased on credit, and in certain other situations, the customer may have recourse not against the merchant but against the sponsoring bank. The customer may refuse to pay the sponsoring bank. The sponsoring bank may attempt to make good its loss by charging it back to the intermediary bank, such as Superior Bankcard Services ("Superior"), which in turn may attempt pass the loss back to

the merchant, in this case Cornerstone. This claim for indemnification against the merchant is what is referred to as a "charge-back."[2] *Id.*

2.3. Many of the investors in this case who have paid Cornerstone by means of a credit card have disputed the charges after becoming aware of these proceedings and the SEC's allegations regarding the true nature of the business that Cornerstone conducted. As a result, the Receiver has been inundated with charge-back notifications from the Credit Card Companies, or the intermediate processing banks. At least one of the Credit Card Companies, Superior, maintained a reserve account, whereby a certain amount of Cornerstone's funds that were charged on the credit cards were held in reserve to pay charge-backs. Superior would then indemnify themselves by debiting the reserve account for the charge-backs.

2.4 The Credit Card Companies have clearly indicated, both to the Receiver and the Court, that they will be asserting claims against Receivership Assets for full indemnification for the charge-backs they have paid to the cardholders/investors. These "priority" claims will be based on contracts between the Credit Card Companies and Cornerstone which purportedly provide that Cornerstone is obligated to indemnify the Credit Card Companies for the charge-backs. By allowing a claim against receivership assets for the charge-backs in full, the funds available for remuneration of the defrauded investors as a whole would be reduced, to the detriment of the receivership estate. In other words, the more claimants who are paid back 100% dollars, in this case the Credit card Companies, the less is available to pay back to the other investors who did not pay by credit card or who did pay by credit card but have not requested a charge-back. Accordingly, the Receiver requests that the Court disallow any priority claims by the Credit Card Companies and order that such claims be allowed only on a ratable basis, along with those of the defrauded investors

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[2]The relationships between Cornerstone and Discover and American Express did not contain an intermediate processing bank, such as Superior. With these companies, the ostensible rights of charge-back run directly between Cornerstone and these entities.

(at least those who have not already received complete remuneration by means of the charge-back process), pursuant to the Court's 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 Ass'n,*, 577 F.2d 600, 606 (9th Cir. 1978); *accord, SEC v. Elliott,* 953 F.2d 1560, 1569-70 (11th Cir. 1992).

## III.

### ARGUMENTS AND AUTHORITIES

3.1 The Receiver has previously submitted voluminous briefing to the Court regarding the charge-back issues in this case, by virtue of the Motion, the Receiver's Brief Regarding Charge-Back Issues, and its Reply to the responsive briefs filed by the Credit Card Companies. The Receiver incorporates by reference the arguments and authorities cited in these instruments as if set forth fully herein. However, a short summary of the legal bases requiring disallowance of any purported priority claims by the Credit Card Companies is included for the benefit of the Court.

### A. The Credit Card Companies Do Not Have Priority Claims.

THE CLAIMS OF THE CREDIT CARD COMPANIES ARE SUBROGATION CLAIMS, WHICH CANNOT HAVE ANY HIGHER PRIORITY THAN INVESTOR CLAIMS.

3.2 Subrogation is the legal fiction through which a person or entity, the subrogee, is substituted, or subrogated, to the rights and remedies of another by virtue of having fulfilled an obligation for which the other is liable. *E.g., General Star Indem. Co. v. Vesta Fire Ins. Corp.*, 173 F.3d 946, 949 (5th Cir. 1999). Subrogation is a broad concept that includes every instance in which one person, not acting voluntarily, has paid a debt for which another is primarily liable and which in equity and good conscience should have been discharged by the latter. *E.g., In re Ted True, Inc.*, 94 B.R. 423, 427 (Bankr. N.D. Tex. 1988); *Argonaut Ins. Co. v. Allstate Ins. Co.*, 869 S.W.2d 537, 541-42 (Tex. App.-Corpus Christi 1993, writ denied).

3.3 A classic form of subrogation is the "charge-back" claim a credit card issuer asserts against a merchant after the issuer reimburses the customer/cardholder for a disputed charge. *In re Mid-American Travel Serv., Inc.*, 145 B.R. 969, 972 (Bankr. E.D. Ark. 1992); *In re P.J. Nee Co.*, 36 B.R. 60, 611 (Bankr. D. Md. 1983). The charge-back is a subrogation claim, even if there is a direct contractual obligation for the merchant to reimburse or indemnify the issuer for amounts the issuer refunds to customers/cardholders. *Mid-American*, 145 B.R. at 972; *P.J. Nee*, 36 B.R. at 610-11. Under the general definition of subrogation and case law dealing specifically with credit card charge-backs, the claims the Credit Card Companies assert against the Receiver in this case are garden-variety subrogation claims. Accordingly, these subrogation claims are not entitled to any greater rights or priority than the claim of the primary creditor. *E.g., Admiral Towing and Barge Co. v. Seatrain Int'l, S.A.*, 767 F.2d 243, 250 (5th Cir. 1985); *National Union Fire Ins. Co. of Pittsburgh v. John Zink Co.*, 972 S.W.2d 839, 543-44 (Tex. App.-Corpus Christi 1998, writ denied). In other words, a subrogee "stands in the shoes" of the subrogor. *E.g., General Star*, 173 F.3d at 949. Because the defrauded investors who have received charge-backs, as subrogors, are only entitled to a ratable distribution as general creditors, the Credit Card Companies, as subrogees, are only entitled to a ratable distribution as well. *Admiral Towing and Barge*, 767 F.2d at 250; 3 Clark on Receivers (3rd Ed.), § 667 (1967).

3.4 The Credit Card Companies have asserted that they have a contractual right of indemnification arising out of the various merchant agreements with Cornerstone. There is simply no way that the contractual indemnification rights of the Credit Card Companies are of a more substantial intrinsic nature that the rights afforded to the victims of fraudulent investment schemes under federal securities laws, so as to provide them with priority claims. *Berthold-Jennings Lumber Co. v. St. Louis I. M. & S. R.. Co.* 80 F.2d 32, 39 (8th Cir. 1935)(holding that in order to warrant the enforcement of one creditor over another, there must be something in the intrinsic nature of such

claim conferring an equity superior to that of the latter claim). The essence of the Credit Card Companies' contractual indemnification argument is that the disallowance of their priority claims would operate to abrogate their contractual indemnification rights. The Receiver does, in fact, recognize Superior's right to contractual indemnification. What cannot be recognized, however, is that such a right elevates Superior's contract claim above the claims of the defrauded investors. There is no authority for that proposition.

THE CREDIT CARD COMPANIES DO NOT HAVE SECURED CLAIMS AGAINST RECEIVERSHIP ASSETS.

3.5 The Credit Card Companies simply do not have any security interest in any Receivership Asset, or funds traceable thereto. The only potential secured claim held by any of the Credit Card Companies in this case is the purported security interest held by Superior against the Cornerstone reserve account. That account has already been dissipated by Superior notwithstanding the fact they had been notified of the appointment of the Receiver last December when the reserve account contained funds in the amount of $129,083.20. The Receiver has taken possession and control of all other Cornerstone accounts. Assuming, *arguendo*, that a valid security interest in liquid Receivership Assets existed, it certainly has not been perfected. The Uniform Commercial Code provides that possession of a bank account is an absolute prerequisite to perfecting a security interest in funds held in that account. Tex. Bus. & Com. Code § 9.305. The Receiver maintains all possessory rights in the accounts of Cornerstone by virtue of the orders of this Court. Accordingly, Superior, or any other Credit Card Company, cannot have any perfected security interests in the liquid Receivership Assets constituting Cornerstone bank accounts seized by the Receiver, and thus, no priority claim to these funds based on any theory arising out of a security interest.

THE CREDIT CARD COMPANIES DID NOT "OWN" THE FUNDS DEPOSITED INTO CORNERSTONE'S ACCOUNTS

3.6 The Credit Card Companies have also asserted that they retained some type of ownership of the funds from processed credit card transactions, deposited into Cornerstone's bank accounts, even after transferring the funds to Cornerstone's accounts. These entities did not have possession, control, or any other indicia of legal ownership once the funds went to Cornerstone. The subject merchant agreements do not even purport to restrict Cornerstone's use or disposition of the funds after being credited to Cornerstone (except for the funds held, and subsequently dissipated, in the reserve account held by Superior).

3.7 Case law unequivocally confirms that when a credit card company transfers funds, even provisionally with a right to offset future charge-backs, the merchant owns the funds. *Sherman v. First City Bank of Dallas*, 84 B.R. 79, 82 (Bankr. N.D. Tex. 1988). This is true even if the credit card company has possession of the account. *Id.*; *United States v. Challenge Air Int'l*, 123 B.R. 661, 664 (S.D. Fla. 1991), *aff'd*, 952 F.2d 384 (11th Cir. 1992).

3.8 One federal court has squarely rejected the exact argument advanced by the Credit Card Companies in this case. *In re Calstar, Inc.*, 159 B.R. 247, 254-55 (Bankr. D. Minn. 1993). In *Calstar*, the court called the argument "creative," but held that the provisional payments to the merchant became the "absolute property" of the merchant, subject to a contingent claim for any appropriate charge-backs. *Id.* at 252-53, 254-55.

3.9 The Credit Card Companies cannot establish even a perfected security interest in Cornerstone's funds (other than possibly the funds in Superior's reserve account), because they did not have possession. Tex. Bus. & Com. Code §§ 9.302(a)(1), 9.305. It follows, *a fortiori*, that they cannot establish ownership of the funds. In other words, if a perfected security interest requires

possession of the funds, then outright ownership would require at least as much. Of course, possession alone is not enough to constitute ownership of funds. *See, e.g., Michigan S.S. Co., supra.*

THE CREDIT CARD COMPANIES ARE NOT ENTITLED TO A CONSTRUCTIVE TRUST, EQUITABLE LIEN OR ANY OTHER EQUITABLE RELIEF

3.10 The Credit Card Companies also contend that they are entitled to equitable relief in the form of a constructive trust and an equitable lien, while simultaneously asserting that their legal rights - those allegedly vested by operation of their contracts with Cornerstone - entitle them to priority claims. A constructive trust is an equitable remedy based upon a legal fiction. *E.g., Vaquero Petroleum Co. v. Simmons*, 636 S.W.2d 762, 767 (Tex. App.-Corpus Christi 1982, no writ). A constructive trust is available as a remedy for a breach of a fiduciary or confidential relationship or for actual fraud. *E.g., Meadows v. Bierschwale*, 516 S.W.2d 125, 128 (Tex. 1974). Courts will not impose a constructive trust absent a showing of fraud, either actual or constructive. *Hamblet v. Coveney*, 714 S.W.2d 126, 131 (Tex. App.-Houston [1st Dist.] 1986, writ ref'd n.r.e.) There is no allegation or proof of a confidential relationship between any Credit Card Company and Cornerstone, a fiduciary duty or fraud on the part of Cornerstone arising out of its dealings with the Credit Card Companies. Cornerstone's fraudulent conduct involving the defrauded investors might support a constructive trust in favor of the investors, but certainly not in favor of the Credit Card Companies. Moreover, the Credit Card Companies cannot explain why a constructive trust should have priority over, in essence, the constructive trust claims of investors.

3.11 The Credit Card Companies have taken great pains in advancing their purported rights and benefits claimed under their merchant agreements with Cornerstone. That gives them a contract claim, period. A mere breach of contract is not a sufficient basis to impose a constructive trust. *Landram v. Robertson*, 195 S.W.2d 170, 174 (Tex. Civ. App.-San Antonio 1946, writ ref'd n.r.e.). Likewise, the Credit Card Companies cannot be entitled to an equitable remedy to get more than

they would under their contracts with Cornerstone. *See, e.g., Huntington Beach Un. High School Dist. v. Continental Info. Sys. Corp.*, 621 F.2d 353, 357 (9th Cir. 1980) (plaintiff asserting contract claim is not entitled to equitable remedies).

3.12 With respect to the claim for an equitable lien, a contracting party cannot resort to an equitable lien to improve upon its legal rights under the contract. *Hoarel Sign Co. v. Dominion Equity Corp.*, 910 S.W.2d 140, 143 (Tex. App.-Amarillo 1995, writ denied). For instance, a contracting party cannot obtain an equitable lien when he had a statutory or constitutional lien available but failed to perfect it. *Id.* When a party fails to invoke or preserve its legal rights under a contract, he cannot turn to equity for a second chance. *Id.*

3.13 The Credit Card Companies could have obtained additional security under applicable law, but it failed to do so. For example, in the case of Superior, it could have required a higher reserve account, required a guaranty or bond, or taken other steps to protect its contractual rights. And like their claims for constructive trust, the Credit Card Companies fail to explain why its equitable lien should have priority over equitable lien claims of investors.

## B. Even Assuming, *Arguendo,* that the Credit Card Companies Have Priority Claims, Such Claims Must Be Subordinated to the Level of the Defrauded Investors.

THE BROAD EQUITABLE POWERS OF THIS COURT PERMIT SUBORDINATION.

3.14 It is abundantly clear that this Court has the expansive authority to subordinate claims against Receivership Assets under the extremely broad powers invested in courts of equity in receivership proceedings. For example, at least one federal court has held that the broad grant of discretion to federal courts in supervising receiverships and protecting receivership assets for the benefit of the creditors as a whole extends not only to the determination of relative priorities of claims, but also permits the Court to subordinate claims. *McFarland v. Winnebago South, Inc.*, 863 F. Supp 1025, 1034 (W.D. Mo. 1994)(citing *SEC v. Hardy*, 803 F.2d 1034, 1040 (9th Cir. 1986) and

*United States v. Arizona Fuels Corp.*, 739 F.2d 455, 458 (9th Cir. 1984)). The power of this Court to do so is conditioned on providing adequate notice to the creditors relative to any proceedings to determine whether subordination of a particular claim is appropriate. *McFarland,* 863 F.2d at 1034; *see also F.T.C. v. Crittenden,* 823 F. Supp. 699, *aff'd* 19 F.3d 26. There can be no doubt that the Credit Card Companies have received more than adequate notice of the Receiver's position regarding the status of the charge-back claims, as evidenced by the filing and service of the Receiver's Motion to Turnover Reserve Accounts, Prohibit Charge-Backs, Establish Date For Presentation of Charge-Back Claims, Request For Hearing and Brief in Support, and the participation of the Credit Card Companies in the numerous hearings that this Court has conducted regarding the issues presented therein. Likewise, there can be no dispute that this Court is authorized to subordinate the priority claims of the Credit Card Companies, assuming that they have priority claims in the first instance.

THE COURT SHOULD SUBORDINATE THE CREDIT CARD COMPANIES' PRIORITY CLAIMS UNDER PRINCIPLES OF EQUITY: EQUALITY *IS* EQUITY

3.15 Under the wide-ranging powers of courts of equity in receivership proceedings, this Court should subordinate any priority claims based on the charge-backs. The purpose of the receivership in this case, as is the purpose of all equity receiverships, is to maximize the receivership estate for the benefit of the creditors of Cornerstone as a whole, especially the defrauded victims of Cornerstone. *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986). Based on general principles of equity, the purported priority claims of the Credit Card Companies should be subordinated to the level of the investors.

3.16 A core issue with respect to the charge-back claims is that by allowing a claim against Receivership Assets for the charge-backs in full, the funds available for remuneration of the defrauded investors as a whole would be reduced, to the detriment of the receivership estate. In

other words, the more claimants who are paid back 100% dollars, in this case any Credit Card Company with allowed priority claim, the less is available to pay back to the other investors who did not pay by credit card and those who paid by credit card but did not request a charge-back.

3.17 With respect to non-secured creditors of Cornerstone whose claims are to be paid out of the general funds of the receivership estate, the predominate rule is that all unsecured creditors stand on the same basis, and as to them "equality is equity." *Berthold-Jennings Lumber Co. v. St. Louis I. M. & S. R.. Co.* 80 F.2d 32, 39 (8th Cir. 1935); *see also Progress Press Brick & Machine Co. v. Sprague*, 65 S.W.2d 154 (Mo. App. 1933); *Lewis & Dalin, Inc. v. E.H. Clarke Lumber Co.*, 204 P.2d 130, (Or. App. 1949). The court must not permit one creditor to obtain an inequitable or unlawful preference over other creditors. *Berthold-Jennings Lumber Co.*, 80 F.2d at 39. More importantly, to warrant the enforcement of one creditor over another, there must be something in the intrinsic nature of such claim conferring an equity superior to that of the latter claim. *Id.; Van Raatlte v. Enterprise Transp. Co.*, 169 F. 606 (1st Cir. 1909).

3.18 Nothing in the intrinsic nature of the charge-back claims would warrant the allowance of these claims as priority claims, either by this Court's determination that the claims are priority claims in the first instance or the determination not to subordinate the claims. Allowing such a result would be tantamount to a determination that the alleged contractual indemnification rights of the Credit Card Companies is of a more substantial intrinsic nature that the rights afforded to the victims of fraudulent investment schemes under federal securities laws. Certainly, the mere fact that the Credit Card Companies will not be able to receive the full benefit of its bargain with Cornerstone is a much more equitable result than not remunerating the defrauded investors, as a whole, to the greatest extent possible, especially considering the fact that the Credit Card Companies will *at least* receive a partial indemnification by sharing ratably with the defrauded investors.

3.19 The overarching principle of "equality is equity" is particularly controlling in this case when considered in light of the risks that the Credit Card Companies took that any contract of indemnification would not be enforceable against Cornerstone. It is a fundamental tenet of American jurisprudence that a party to a contract assumes the risk that the other party may not perform or may be unable to perform. *Kneeland v. American Loan & Trust Co.*, 136 U.S. 89, 97-98 (1890); *In re P.J. Nee Co.*, 36 B.R. at 612. While it can be said that the victims of Cornerstone also took a risk that the securities they purchased would be worthless, these victims have been afforded superior protection against fraudfeasors by the enactment of federal securities laws. It thus cannot be said that the contractual indemnification rights of the Credit Card Companies are inherently superior to that of the victims of Cornerstone's illegal Ponzi scheme. To conclude otherwise would contravene the basic purpose of an equitable receivership in that it would result in a diminution of the ultimate distribution to the defrauded investors who did not receive charge-backs. Accordingly, the Credit Card Companies should only be indemnified ratably.

THE COURT SHOULD SUBORDINATE THE CREDIT CARD COMPANIES' ALLEGED PRIORITY CLAIMS BASED ON THEIR OWN CONDUCT

3.20 The conduct of the Credit Card Companies, particularly that of Superior, merits subordination of any alleged priority claim. As established in the declarations and exhibits attached to the Receiver's Brief Regarding Charge-Back Issues, the Credit Card Companies, particularly Superior, have been extremely recalcitrant in providing requested information regarding the charge-backs. Without repeating the evidence and the lengthy factual recitation contained in the brief, Superior made numerous representations that it would cooperate with the Receiver by providing certain documentation in order to allow him to respond to any charge-back notices in a timely fashion so as to prevent the automatic accrual of pending and future charge-backs. The documenta-

tion was furnished weeks after it was promised and was woefully incomplete when it was ultimately received. Moreover, Superior had assured the Receiver, and this Court, that charge-back notices and related documentation would be transmitted directly to the Receiver's offices, instead to the Cornerstone mailing address in Fort Worth, Texas. As of May 17, 2000, the Receiver was still receiving charge-back documentation at the Fort Worth address. Likewise, Superior's promise to provide a contact person with whom the Receiver could communicate regarding any logistical problems arising from the charge-back process has proved ineffectual, at best. Superior has changed the identity of the contact person on numerous occasions and the contact persons who were eventually designated proved difficult, if not impossible, to reach.

3.21 While these omissions may appear *de minimis*, they have severely hampered, if not precluded altogether, the Receiver's ability to contest the charge-backs by providing the necessary supporting documentation to the Credit Card Companies to halt the charge-back process, to the detriment of the Receivership estate. Should the Court allow the Credit Card Companies' claims as priority claims, the Credit Card Companies will be rewarded for sitting on their hands while the Receiver went through considerable expense to formulate an agreed upon process whereby future charge-backs could be avoided. For these reasons, the charge-back claims, the large majority of which are held by Superior, should be subordinated under the equitable doctrines of laches and unclean hands.

**C. Any Claim by Superior Should Be Reduced by the Amount of the Depleted Reserve Account.**

THE RESERVE ACCOUNT WAS PROPERTY OF THE RECEIVERSHIP ESTATE AND WAS SUBJECT TO THIS COURT'S INJUNCTION AND FREEZE ORDER.

3.22 With respect to the reserve account held by Superior, the Receiver respectfully submits that Superior's claim, whether determined to be a priority claim resulting in a 100% indemnification or a general claim resulting in a ratable distribution along with the victims of Cornerstone, should be reduced by $129,083.20. As set forth in detail in the Receiver's Brief Regarding Charge-Back Issues and associated exhibits, Superior was given notice of the appointment of the Receiver and the *Ex Parte* Order, but nonetheless dissipated the amount of $129,083.20 that was in the reserve account. The reserve account clearly constitute Receivership Assets as defined in the Order Appointing Receiver because the funds held therein represent investor proceeds. The Receiver is entitled to possession of the funds held in the reserve account because they constitute funds collected from investors but temporarily held in reserve as, at the most, a security interest. Although Superior might assert a security interest in, or some other claim to, the funds in the reserve account, the account was unquestionably property of this receivership estate. *See United States v. Challenge Air Int'l*, 123 B.R. 661, 664 (S.D. Fla. 1991), *aff'd*, 952 F.2d 384 (11th Cir. 1992) (reserve account held by credit card company to offset potential charge-back claims held to be property of bankruptcy estate); *World Comm., Inc. v. Direct Marketing Guar. Trust*, 72 B.R. 498, 501 (D. Utah 1987) (escrow account set up by credit card company to cover potential charge-back claims held to be property of bankruptcy estate).

3.23 The only proper forum to adjudicate the issue of Superior's potential security interest in the funds held in the reserve account was this Court. Instead of surrendering the reserve account to the Receiver, which it was clearly obligated to do under the Order Appointing Receiver, Superior ignored this Court's orders and dissipated funds which clearly constitute Receivership Assets.

Accordingly, under the extremely broad powers granted to this Court in equity receiverships to determine and subordinate claims, Superior's claim, of whatever nature it may be, should be reduced by $129,083.20.

## IV.

## REQUEST FOR HEARING

4.1 The Receiver requests that a hearing on its Objection to Claims of Credit Card Companies be set for hearing as soon as possible after June 30, 2000, the bar date for the Credit Card Companies' claims. The resolution of this Objection is the only obstacle to the Receiver proceeding with the distribution process, which he hopes to have completed by the end of July, 2000.

WHEREFORE, PREMISES CONSIDERED, Michael J. Quilling, the Receiver in this action, requests that: (1) the Court set this Objection for hearing as early in July as possible; (2) the Court issue an order determining that the claims of the Credit Card Companies for the subject charge-backs are general claims to be paid pro-rata with those of the defrauded investors; (3) the Court reduce the amount of Superior's claim by $129,083.20 for the reasons set forth herein and in the Receiver's Brief Regarding Charge-Back Issues; (4) the Court take judicial notice of the Motion, the Receiver's Brief Regarding Charge-Back Issues and the Receiver's Reply to the responsive briefing filed by the Credit Card Companies; and (5) the Court further grant such other and further relief, general or special, at law or in equity, as appropriate.

Respectfully submitted,

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By: _____
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## CERTIFICATE OF SERVICE

I certify that on May 16, 2000 a true and correct copy of the foregoing was served via certified mail, return receipt request, on:

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