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

SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	
vs.	Civil Action No. 3:08CV499-N
W FINANCIAL GROUP, LLC, ADLEY H. ABDULWAHAB a/k/a Adley Wahab, MICHAEL K. WALLENS, SR., and MICHAEL K. WALLENS, JR.	
Defendants,	

MEMORANDUM IN SUPPORT OF MOTIONS FOR APPOINTMENT OF A RECEIVER, ORDER FREEZING ASSETS, REPATRIATION ORDER, ORDER REQUIRING ACCOUNTINGS AND OTHER EQUITABLE RELIEF

JEFFREY B. NORRIS
Washington, D.C. Bar No. 424258
U.S. SECURITIES & EXCHANGE COMMISSION
801 Cherry St., 19th Floor
Fort Worth, Texas 76102
Office: (817) 978-6452
Fax: (817) 978-4927
Norrisj@sec.gov

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I. PRELIMINARY STATEMENT

This case involves the Commission's effort to recover millions of dollars stolen by defendants from victims, primarily elderly investors, through the unregistered, fraudulent offer and sale of securities denominated "Secured Debt Obligations" ("SDOs"). Plaintiff United States Securities and Exchange Commission ("Commission") submits this Memorandum in support of equitable relief to prevent the dissipation of funds and assets that would otherwise be available to provide monetary relief to defrauded investors.

From at least September 2006 through February 2007, defendants W Financial Group, LLC ("WFG"). Adley H. Abdulwahab a/k/a Adley Wahab ("Wahab"), Michael K. Wallens, Sr. ("Wallens, Sr.") and Michael K. Wallens, Jr. ("Wallens Jr.") represented to investors that the SDOs were comparable in safety to certificates of deposit insured by the Federal Deposit Insurance Corporation ("FDIC"). According to defendants, the SDOs were protected from loss by multiple layers of insurance and the risk of loss was minimized by use of the funds only to purchase a specified list of safe investments. Defendants further represented that each investor's funds would be protected by collateral. Finally, the defendants impressed investors by touting WFG's long history of financial responsibility.

In reality, customers' investments were not protected by many layers of insurance, as defendants claimed; in fact, they were not insured at all. Moreover, investor funds were pervasively misused for unauthorized and undisclosed purposes. Millions of investor dollars were diverted into risky ventures such as an electrical power company, an automobile dealership and residential home construction. Additionally, funds were misappropriated for the benefit of defendants. Finally, WFG, contrary to the description provided by defendants, was created immediately before defendants launched the fraudulent scheme.

As this Court is aware, the Commission and defendants, through their counsel David Fielder, entered into an agreement to permit the defendants to liquidate assets that they had purchased with investor funds. [App. at 007-008][Oses Dec. at ¶ 34]. Pursuant to this agreement, the Court, on March 28, 2008, entered an Agreed Order Appointing Special Master to Monitor the Sale of Assets Held by Defendants ("Special Master Order"). The Commission acquiesced in this course of action based on its belief that the defendants were acting in good faith and were following the guidance of counsel. Accordingly, the Commission concluded in March 2008 that investors would be adequately protected by a Special Master who would oversee the liquidation process and take custody of the proceeds of these transactions. [*id.*].

Unfortunately, as set forth herein, the Commission and Special Master have concluded that the defendants, rather than cooperating honestly, have engaged in a pattern of deception and continued mismanagement of investor funds. In the wake of these revelations, Mr. Fielder chose to withdraw from representation of the defendants, who are now *pro se.*[1] The Commission submits that only more muscular remedies, including the appointment of a Receivership and imposition of an asset freeze, will adequately ensure that funds and assets remain available during the course of the litigation for the monetary relief of defrauded investors.

II. DEFENDANTS AND RELATED ENTITIES

A. Defendants

Adley H. Abdulwahab a/k/a Adley Wahab was the managing member of WFG from its inception until January 18, 2007, when he was replaced by Wallens, Sr. [App. at 002, 049-063][Oses Dec. at ¶ 5, Exhs. 2 and 3]. Wahab remained a member of WFG and was

[1] Though Mr. Fielder did not disclose his reason for withdrawing, the timing of his action strongly suggests that he believed he had been misled by his clients and could no longer convey their representations with sufficient confidence to remain their agent. [App. at 009][Oses Dec. at ¶ 40].

involved in all aspects of the company's operations. [*id.*]. Wahab asserted his Fifth Amendment right against self incrimination and declined to testify in the investigation. [App. at 002, 064][Oses Dec. at ¶ 6, Exh. 4].

Michael K. Wallens, Sr. became the managing member of WFG on January 18, 2007 and is described as its president in offering materials. [App. at 002.-003, 049-056, 067-068][Oses at ¶¶ 5 and 12, Exhs. 2 and 5]. Wallens, Sr. was involved in all aspects of the company's operations. [App. at 002, 049-063][Oses Dec. at ¶ 5, Exhs. 2 and 3]. Wallens, Sr. asserted his Fifth Amendment right against self incrimination and declined to testify in the investigation. [App. at 002, 066][Oses Dec. at ¶ 6, Exh. 4].

Michael Wallens, Jr. was a member of WFG and was involved in many of its activities, including distributing offering materials to sales agents and communicating with investors. [App. at 002, 049-063][Oses Dec. at ¶ 5, Exhs. 2 and 3]. He asserted his Fifth Amendment right against self incrimination and declined to testify in the investigation. [App. at 065][Oses Dec. at ¶ 6, Exh. 4].

W Financial Group, LLC is a Texas limited liability company located in Houston and formed in May 2006 for the purpose of conducting the SDO offering. [App. 002, 049-51][Oses Dec. at ¶ 5, Exh. 2]. WFG was in the business of offering the SDOs and was an issuer of these securities. [App. at 001-003, 038-043, 067-085][Oses Dec. at ¶¶ 3 and 8-12, Exhs. 1 and 5].

B. Other Related Entities

National Power Company ("NPC"), a Texas corporation, was a retail power provider licensed by the Texas Public Utility Commission. [App. at 006, 009-010, 149-168][Oses Dec. at ¶¶ 31 and 41, Exh. 11].]. WFG claimed to own 85% of NPC's stock.[2] [App. at 009-010,

[2] Although WFG produced documents showing that it owned 75% of NPC, counsel advised the staff that WFG recently acquired an additional 10% of NPC's stock after NPC's president defaulted on an

169][Oses Dec. at ¶ 41, Exh. 12]. NPC shared a Houston office with WFG. [App. at 009-010][Oses Dec. at ¶ 41]. NPC ceased operations on May 23, 2008 and its retail customers were switched to other providers. [App. at 184][Jones Dec. at ¶ 30].

W Custom Builders is the assumed name under which WFG operated its home building business. [App. at 010, 171-174][Oses Dec. at ¶ 42, Exh. 14]. W Custom Builders acquired approximately ten lots in a Houston suburb and has been building homes on the lots. [App. 006-007][Oses Dec. at ¶ 31]. The homebuilding operations are controlled by Wallens, Sr. [App. at 010, 063][Oses Dec. at ¶ 42, Exh. 3].

III. THE WFG FRAUD

A. The SDO Offering in General

From at least September 2006 to February 2007, Wahhab, Wallens Sr. and Wallens Jr., through WFG, conducted an unregistered, fraudulent securities offering, raising at least $17.4 million from the sale of SDOs to at least 182 investors located primarily in Texas, with pockets of investors in Wisconsin and other states as well.[3] [App. at 003, 007; 223 and 225][Oses Dec. at ¶¶ 8 and 32; Rector Dec. at ¶ 6, Exh. A]. Most of WFG's customers were elderly or seeking

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earlier loan from WFG that was secured by some of his NPC stock. [App. at 009-010, 169][Oses Dec. at ¶ 41, Exh. 12].

[3] The W Financial fraud was patterned after the fraudulent scheme that is currently the subject of another Commission enforcement action commenced in the Northern District of Texas in July 2007. *See SEC v. AmeriFirst Funding, Inc., et al.,* Civil Action No. 3:07-CV-1188-D. After learning about the elements of the AmeriFirst fraud from one of AmeriFirst's sales agents, the principals created W Financial and perpetrated the same scheme. In its fall 2006 through early winter 2007 SDO offering, WFG copied the Amerifirst offering documents virtually word-for-word, changing only the names of the company, its principals and some of the purported insurers. W Financial then persuaded some AmeriFirst sales agents to offer the W Financial SDO by offering commissions larger than those paid by AmeriFirst. In July 2007, the Commission obtained a temporary restraining order, appointment of a receiver, and other emergency relief to halt the ongoing Amerifirst offering fraud, which had raised approximately $55 million from mostly senior investors. *See SEC v. Amerifirst Funding Corp.*, Lit. Rel. No. 20181 (July 5, 2007). The Receiver in the *AmeriFirst* action has already been able to return $25 million to defrauded investors and the Commission anticipates further distributions.

to invest retirement funds. [App. at 003][Oses at ¶ 10]. Wahab, Wallen Sr. and Wallens Jr. controlled all aspects of WFG's operations. [App. at 002, 049-063][Oses Dec. at ¶ 5, Exhs. 2 and 3].

While WFG's principals were directly responsible for the offer and sale of the securities, WFG also relied on a network of agents in Texas and Wisconsin. [App. at [App. at 009][Oses Dec. at ¶ 9]. These sales agents were paid a commission of 5% of the amount invested. [*id.*]. Many of the sales agents selected by WFG held themselves out as specializing in providing low-risk investments to the elderly and others seeking a safe-haven for retirement funds. [App. at 001-002, 045-048][Oses Dec. at 3 and 4, Exh. 1]. WFG and its agents presented the SDOs as a higher-yielding, but equally safe, alternative to bank CDs, offering rates of 7%, 7.75% and 9% APR on notes with two, three and year four terms, respectively. [App. 001-003, 016- 019, 038, 067-071][Oses Dec. at ¶¶ 3, 4 and 12, Exhs. 1 and 5].

The elderly customers who purchased WFG investments were often lured to the offices of the sales agents by advertisements in local newspapers touting the availability of comparatively high-yielding FDIC-insured certificates of deposit. [App. at 006, 115-119][Oses Dec. at ¶¶ 27-30, Exh. 7]. When conservative prospective investors responded to the advertisement, they instead were pitched SDOs as an attractive alternative, paying a higher rate of interest and offering safety comparable to an FDIC-insured CD. [*id.*].

At the time of the investment, WFG investors elected to either receive monthly interest payments or to compound their earnings by rolling over interest payments into the SDO. [App. at 006, 027][Oses Dec. at ¶ 30, Exh. 1] Most investors elected to compound their returns. [*id.*]

B. False and Misleading Statements and Omissions in the Offer and Sale of the SDOs

WFG and its sales agents made numerous false and misleading statements about the investment program and failed to disclose material information. The following statements from WFG sales literature, correspondence to investors and potential investors, and the investment contracts themselves are illustrative of the defendants' representations:

a. "Your investment is guaranteed not only by W Financial Group, but is also reinsured by two A rated insurance companies"; [App. at 003, 068][Oses at ¶ 12, Exh. 5].

b. "Reinsurers consist of Lloyd's of London and The Republic Group..." [App. at 003, 069] [*id.*].

c. "we hold a single interest bond issued by Lloyd's of London which insures all receivables." [App. at 003, 069][*id.*].

d. "Secondly, W Financial Group holds a Surety Bond through The Republic Group who insures company payables"; [App. at 003, 068][*id.*]

e. "For the insured notes, [W Financial Group) agrees to keep a fully covered single interest coverage policy on all uninsured receivables at all times by Lloyd's or an A or better rated company"; [App. at 003, 076][*id.*]

f. "parent Company and management group have been conducting business for over 17 years without one customer complaint or late payment"; [App. 003, 069][*id.*]

g. "the SDO offers liquidity and income based on the term that is chosen"; [*id.*].

h. WFG will keep investor funds "separate and apart" from its property [App. at 003, 076][*id.*];

i. "at all times, any funds advanced by investors shall be held either in cash in the investor's separate account, government or corporate AAA bonds, qualified receivables or insured" notes (the car notes). [*id.*];

j. "All accounts are insured up to 1.5 million dollars"; [App. 001-002, 016][Oses at ¶ 3, Exh. 1] and

k. "W Financial Group is regulated by the SEC and meets all requirements herein." [*id.*].

As set forth in detail below, none of these claims are true.

1. Safety and Liquidity of the Investment

WFG promotional materials and contracts emphasized repeatedly the complete safety and substantial liquidity of the SDOs. Defendants represented that investors were insulated from risk by several layers of insurance coverage. [App. 001-005, 011-045, 067-085][Oses Dec. at 12-21, Exhs. 1 and 5].

As the name of the security implies, WFG represented that investor accounts would be protected by collateral. The Agreement states that WFG will "provide mutually agreeable collateral to secure this note within one month of the date of execution of this Note." [App. at 001-002, 033][Oses Dec. at ¶ 3, Exh. 1].

To add credibility to their claims about insurance coverage, defendants provided investors and potential investors with copies of certificates from Lloyd's and Republic that purportedly demonstrated that WFG had the insurance policies touted to investors. [001-003, 020-021, 071-072][Oses Dec. at 3 and 12, Exhs. 1 and 5]. This insurance coverage, defendants claimed, made the SDOs the "perfect investment vehicle for someone in a conservative financial position." [App. at 003, 068][Oses at ¶ 12, Exh. 5].

WFG also purported to assure the safety of investor funds through its conservative investment policy. Defendants promised that the "funds advanced by investors shall be held either in cash in the investor's separate account, government or corporate AAA bonds, qualified receivables or insured notes." [App. at 003, 076][Oses at ¶ 12, Exh. 5].

Defendants' contentions that investor accounts were virtually risk-free were false and misleading. The SDOs had neither the liquidity nor the safety represented to investors. In reality, investors could only request return of up to 25% of their invested principal during the

term of the SDO. [App. at 005, 070][Oses Dec. at ¶ 21, Exh. 5]. Moreover, WFG did not carry any insurance that guaranteed the principal or interest promised to the purchasers of WFG notes. [App. 004-005, 086-114][Oses Dec. at ¶¶ 16-21, Exh. 6].

John Marks, an underwriter at Lloyds of London, provided a declaration explaining the nature of the coverage obtained by defendants. [App. at 086-114][Oses Dec. at Exh. 6]. The Lloyd's policies in effect during the offering period did not protect investors against loss or guarantee their financial return. [App. at 087-088][Oses Dec. at Exh. 6 (Marks Dec. at ¶¶ 9, 10, 13 and 14)]. The Lloyd's policies insured only against losses from damage to the automobiles that served as collateral for notes generated by WFG's used car business. [*id.*]. Moreover, the Lloyd's coverage was limited to an annual aggregate maximum of $100,000, a fraction of the face value of SDOs sold to WFG investors. [App. at 086-087][Oses Dec. at Exh. 6 (Marks Dec at 6-8 and 10)]. According to Marks, moreover, the defendants redacted the Lloyd's certificates to conceal these policy limitations. [App. at 088, 112-113][Oses Dec. at Exh. 6 (Marks Dec. at ¶ 15, Exh. D)].

Similarly, the Republic surety bond did not insure WFG receivables or provide coverage that guaranteed investor returns or protected investors against loss of principal or interest. [App. at 004-005][Oses Dec. at ¶ 20]. Moreover, the total amount of annual coverage provided by Republic was $25,000, again a fraction of the funds owed to investors.

In addition, WFG did not even collateralized its debt to investors. No assets, including automobile loan receivables, were ever legally assigned to secure the SDOs purchased by WFG investors. [Oses Dec. at ¶ 11].

Furthermore, defendants' claim that WFG had been in business for over 17 years was a blatant falsehood. WFG, in fact, was formed on September 5, 2006, apparently for the sole

purpose of offering and selling the SDOs. [App. at 002 and 006, 049-051][Oses Dec. at Dec. at ¶¶ 5 and 26, Exh. 2].

WFG, moreover, consistently deviated from its promise to place funds in specified low-risk investments. As set forth more fully below, defendants used millions of dollars collected from clients to purchase unauthorized and speculative investments. [App. at 006-007][Oses Dec. at ¶¶ 25 and 31].

Finally, at least one agent promoted the safety of the SDOs and the legitimacy of its WFG with the misleading claim that WFG was regulated by the SEC and met all SEC requirements.[4] In fact, neither WFG nor any of its securities offerings have ever been registered with the Commission in any capacity. [App. at 007][Oses at ¶ 32].

2. Misappropriation and Misuse of Investor Funds

WFG did not use investor funds as represented to investors. Contrary to their promise to investors, defendants did not maintain separate accounts on behalf of each of WFG investor. WFG commingled investor funds in accounts controlled by defendants. [App. 005-006][Oses Dec. at ¶¶ 22-25].

Defendants, moreover, placed only a fraction of funds in the investment vehicles disclosed to investors. Instead, defendants secretly used millions of investor dollars to fund risky business enterprises. Defendants diverted at least $1.7 million to purchase a controlling interest in NPC, a licensed retail energy service provider, and an additional $3.4 million to purchase electricity and operate the company.[5] [App. at 007, 223-227][Oses Dec. at ¶ 31; Rector Dec. at ¶ 6, Exh. A]. Defendants also used investor funds to purchase several home lots

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[4] The Commission has not traced this particular representation back to the defendants themselves.

[5] As set forth below, the defendants deceived the Commission about the details of this acquisition. Moreover, the Special Master, after a careful evaluation, determined that NPR had no value as an ongoing business concern. Recently, NPC ceased operations.

for $2.78 million and, through W Custom Builders, spent at least $900,000 more building homes on the lots. [*id.*] WFG also invested at least $350,000 with a "life-settlement" company. [App. at 007, 223-227][Oses Dec. at ¶¶ 25 and 31; Rector Dec. at ¶ 6, Exh. A].

Defendants also diverted funds for their own personal benefit. Between October 2006 and January 2007, WFG paid its principals approximately $450,000 in compensation. [App. at 007, 171][Oses Dec. at ¶ 31]. In addition, defendants used investor funds to provide a $300,000 loan to Wahab personally and to make a $2 million loan to a company associated with Wahab. [*id.*] Finally, the evidence strongly suggests that Wahab siphoned off a significant portion of money, perhaps $1 million or more, from the $1.7 million supposedly paid for NPC. [App. at 007-009, 120-148, 223-227][Oses Dec. at ¶¶ 31 and 36-38, Exhs. 8, 9 and 10; Rector Dec. at ¶ 6, Exh A].

Finally, WFG operated as a Ponzi scheme. An analysis of WFG's sources and uses of funds reveals that WFG returned $3.6 million to investors in the form of principal returns and purported interest payments. [App. 222-227][Rector Dec. at ¶ 6, Exh. A]. WFG, however, did not earn sufficient revenue from investment activities to cover these payments; instead, WFG used new investor funds to make at least a portion of these payments to existing investors. [*id.*].

IV. THE CONDUCT OF DEFENDANTS IN DEALING WITH THE COMMISSION AND SPECIAL MASTER DEMONSTRATES THAT MORE STRINGENT EQUITABLE RELIEF IS NECESSARY TO PROTECT INVESTORS

In light of the egregious nature of defendants' fraudulent conduct and their misappropriation of funds, the Commission would typically have requested that the District Court marshal and converse funds and assets for the benefit of investors through potent equitable relief, including an asset freeze and the appointment of a Receiver. In this case,

however, the Commission elected initially to accede to the requests of defendants and their counsel for less potent remedies. Subsequent events have demonstrated that the Commission's original assessment was mistaken.

Since the Court appointed the Special Master, the defendants have engaged in a pattern of deception, withholding relevant information from the Special Master, from the Commission and from their own counsel. Moreover, the Commission recently discovered that defendants are in the possession of substantial liquid assets, previously undisclosed, that they characterize as "personal assets," purportedly not related to their fraudulent conduct. In addition to their misleading conduct, the defendants have failed and refused to provide specific financial information requested by the Commission and the Special Master.

A detailed declaration by the Special Master, Vernon Jones, is included in the Appendix to this Memorandum. [App. at 175-186]. The discussion below summarizes the events that have convinced the Commission that the Court's Special Master Order provides insufficient protection to investors.

As set forth above, defendants misapplied the vast majority of investor funds. In addition to diverting funds for their own personal benefit, the defendants acquired or created several businesses. These included NPC, a retail power provider licensed by the Texas Public Utility Commission.

The defendants represented to the Commission and the Special Master that NPC had a value of between $5 million and $8 million. [App. at 177][Jones Dec. at ¶ 6]. Upon assuming his duties, the Special Master, Vernon Jones, arranged a mark-to market assessment of the value of NPC's retail sales portfolio, one of the best indications of the company's market value.

The analysis concluded the NPC sales contract portfolio had a value of negative $1.75 million.[6] [App. at 178-179][Jones Dec. at ¶¶ 9-11].

In spite of efforts to attract a buyer for NPC, the defendants received no offers. Based on the disinterest of potential purchasers and the company's ongoing losses, Jones made a determination that investors would be best served by shuttering NPC. [App. at 179][Jones Dec. at ¶ 12]. Jones warned defendants that they should refrain from significant expenditures of proceeds from the sale of other assets to operate NPC, as the end result would likely be a net decrease in funds available to WFG investors. [App. at 179][Jones Dec at ¶¶ 13 and 14]. He also requested that they formulate a plan and budget to implement shutting down the business. [App. 179][Jones Dec. at ¶ 15].

In spite of this assessment, in late April, the defendants abruptly informed Jones that David Barrett, NPC's Senior Accountant, had offered to purchase the business for $1 million. On April 28, Barrett submitted a written offer to buy 100% of NPC stock for $1 million. [App. at 180][Jones Dec. at ¶ 16]. Jones had some concerns about the transaction, in part because Barrett had been the source of all financial information on NPC provided to the Special Master. [App. at 180][Jones Dec. at ¶ 17]. When Jones asked Barrett and/or the defendants to disclose the source of the funds to purchase the company, Jones was told that the funds were pooled from various "friends and family" of Barrett. [*id.*]. Jones also requested that the defendants immediately provide all documents relating to the transaction; defendants, however, failed to comply. [*id.*]. Nonetheless, based on the oral representations made to him and the fact that another equally lucrative offer was highly improbably, Jones did not object to the completion of

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[6] The defendants had entered into contracts to provide customers with electric power at rates below the industry average, but had failed to secure a long-term source of electrical power. Accordingly, as energy costs increased, NPC was suffering growing losses each month. [App. 178-179][Jones Dec. at ¶ 11].

the sale. [*id.*]. On May 5, exactly $1 million was transferred from the WFG account to the Special Master account. [App. at 180][Jones Dec. at ¶ 18].

In the aftermath of the NPC sale, a number of events have undermined the confidence of both the Commission and the Special Master in the good faith, honesty and competence of the defendants. The Special Master received calls from third parties, informing him of two pending lawsuits in Texas state courts involving NPC. [App. at 180, 181, 200-221][Jones Dec. at ¶¶ 19-21, Exh. 2 and 3]. In one lawsuit, the Lateef family, which sold NPC to WFG, is seeking to rescind the transaction on the basis that the sale was procured by fraud. [App. at 181, 200-212][Jones Dec. at ¶ 20, Exh. 2]. The claimants in the second lawsuit, minority owners of NPC, allege, among other things, that their interest in the company was as much as 40%, not 15% as defendants consistently represented to the Commission and the Special Master. [App. at 181, 213-221][Jones Dec. at ¶ 21, Exh. 3].

Although one or more of the defendants must have been aware of these lawsuits, they failed to disclose this material information to the Special Master. Indeed, the defendants withheld this information even though it was responsive to questions Jones had asked prior to the NPC transaction. [App. at 181][Jones Dec. at ¶ 22].

The Special Master also learned that the defendants had claimed to sell Barrett 100% ownership in NPC without discussing the sale with the minority shareholders. After learning of the sale, the minority shareholders demanded a share of the funds from the sale. [App. at 181][Jones Dec. at ¶ 22].

Alarmingly, the Special Master learned that the defendants and Barrett had deceived him concerning source of funds to purchase NPC. On May 21, 2008, Jones was scheduled to meet with defendants and their counsel concerning, among other issues, defendants continuing

failure to provide documentation relating to the NPC transaction. [App. at 182-183][Jones Dec. at ¶ 25]. Hours before the meeting, defendants' then-counsel, David Fielder, telephoned Jones to reveal that his clients had just disclosed to him that *they* had, in fact, financed Barrett's purchase of NPC. [*id*]. During the meeting, defendants admitted that they had not only provided the $1 million purchase price, but had also, collectively, provided Barrett with an additional $1.2 to $1.5 million to operate NPC. [*id.*]. Defendants characterized these funds as "their own money" received from "their other jobs," purportedly unrelated to the WFG fraud. [*id.*].

In spite of numerous requests from the Special Master and the Commission, defendants have still failed to provide documents specifying the source of the $2.2 to 2.3 million they contributed to the purchase and subsequent operation of NPC. [App. at 183][Jones Dec. at ¶ 26]. Accordingly, defendants' assertion that the funds are not related to the WFG fraud cannot be substantiated. [*id.*].

Whether or not this representation is accurate, however, it is extremely troubling that the defendants failed to disclose the existence of substantial liquid assets to the Commission or the Special Master in the course of numerous discussions. [App. at 008, 183-184][Oses at ¶ 35; Jones at ¶ 28]. Defendants' ability to produce $2.2 to $2.5 million with little delay was material to a number of discussions that defendants had with both the Commission and the Special Master. For weeks, the defendants insisted that they must use proceeds from the sale of the WFG assets to provide working capital to operate NPC and other companies created with investor funds. [App. at 183-184][Jones Dec. at ¶ 28]. Moreover, in the course of extensive discussions about the propriety of using WFG funds to pay defendants' attorney's fees, defendants insisted that they needed these funds to retain counsel. [*id.*]. At no time during

these discussions did defendants disclose that they had access to millions of dollars of purportedly "personal funds" to contribute to these expenses. [App. at 008, 183-184][Oses at ¶ 35; Jones at ¶ 28].

The defendants' use of their "secret stash" of money also demonstrates that, regardless of their motives, they are not capable of preserving assets for the benefit of their victims. Defendants provided the additional $1.25 to $1.5 million to operate NPC when defendants purportedly no longer even had an ownership interest in the company [App. at 184][Jones Dec. at ¶ 29]. Defendants must have been aware that there was a high probability that any additional money invested in NPC would be lost; the Special Master had repeatedly advised them that NPC was insolvent and should be shuttered to prevent further loss—as, indeed, it was also immediately thereafter. Even assuming the truth of defendants' assertion that the $1.2 to 1.5 million came from a source other than WFG, the profligate use of this money was detrimental to investors. Had these funds been protected by an asset freeze and receivership, they could have been preserved to provide additional restitution to investors, rather than wasted on an insolvent enterprise. [*id.*].

In the absence of an asset freeze and receivership order, the defendants appear to take a cavalier attitude toward any obligation to preserve or disgorge funds and assets other than those derived directly or indirectly from the WFG scheme. During the May 21 meeting when defendants finally disclosed their inexplicable payments to NPC, the Special Master suggested that, had he been informed about the expenditures before the sale, he would have had the opportunity to object and request that the funds be transferred to the Special Master to provide relief to investors, rather than wasted on additional investment in NPC. [App. at 184][Jones

Dec. at ¶ 29]. According to the Special Master, Wahab became belligerent and asked why he should give all his money to investors. [*id.*].

Defendants have not disclosed the amount or location of their purported "personal funds." In spite of requests by both the Commission and Special Master, neither Barrett nor the defendants have supplied the documents related to defendants' payments to Barrett. [App. at 183][Jones Dec. at ¶ 26]. At this time, the Commission does not have sufficient information to quantify the value of undisclosed funds and assets controlled by the defendants. The defendants' ability to produce approximately $2.5 million within a brief period of time, however, suggests that defendants may be concealing funds and assets of considerable value.

As anticipated, without the diversion of funds from another source, such as WFG investors, NPC was unable to continue operations as determined by state utility regulators. On May 28, 2008, NPC closed its doors and its customers were switched to other retail electric companies. [App. at 184][Jones Dec. at ¶ 30].

When confronted with these facts, defendants' counsel made a credible denial that he had any prior knowledge of any of the undisclosed and misleading information relating to the purchase or sale of NPC. Shortly after discovering that his clients had misled him and prevented him from negotiating honestly with the Commission or the Special Master, counsel withdrew from representation of any of the defendants. They are now proceeding on a *pro se* basis. [App. at 010][Oses at ¶ 40].

During the course of discussions with defendants, the Special Master also discovered examples of self-dealing by defendants in the connection with the liquidation process. For example, he learned that the wife of Michael Wallens, Sr. was the listing real estate agent for the real estate properties acquired with investor funds. [App. at 184-185][Jones at ¶ 31]. After

discussions with the SEC, it was agreed that Mr. Wallens' wife would continue to handle the listing, but would waive any commission. [*id.*]. In addition, the NPC buy/sell agreement between WFG and Barrett stated that Wallens Sr. would remain for a six month period to provide consulting services. [App. at 185][Jones Dec. at ¶ 32]. The Special Master received conflicting and equivocal responses when he asked whether Wallen Sr. would be paid for these purported services. [*id.*].

When the Commission learned about the information withheld by defendants, it reexamined the defendants' account of WFG's purchase of NPC. During negotiations with the staff prior to the entry of the agreed Special Master Order, the defendants, through counsel, represented unequivocally that WFG had paid $1.7 million to the former owners of NPC for a 75 percent ownership interest in the company. [App. at 009, 120-148][Oses Dec. at ¶¶ 37 and 38, Exh. 8, 9 and 10]. Based on recently obtained information, however, the staff concluded that defendants' account of the transaction was extremely misleading. In fact, the new evidence supports the conclusion that Wahab personally purchased the 75 percent interest for approximately $750,000, and then resold the stake to WFG for $1.7 million, misappropriating the difference and depositing the funds in a bank account he controlled. [*id.*].

In the course of examining bank records relating to WFG's purchase of NPC, the Commission also discovered that Wahab, during the course of the scheme, made at least one transfer of $373,000 from one of his Houston accounts to a Jordanian bank, Jordan Ahli Bank, for the benefit of "A.M. Abdelwahab." [App. 009-010][Oses Dec. at ¶ 38, Exh. 9]. At present, the Commission does not have sufficient information to determine whether defendants have transferred additional funds to offshore accounts

Defendants' deceptive conduct and their dissipation of funds indicate that they cannot be trusted to act in good faith on behalf of investors, even under the supervision of a Special Master. WFG assets, as well as defendants' purported "personal" funds and assets, need to be secured through an asset freeze and appointment of a receiver.

V. DEFENDANTS VIOLATED THE FEDERAL SECURITIES LAWS

A. The WFG SDOs are Securities

1. The SDOs are "notes" as Defined in the Securities Act and Exchange Act

The SDOs are securities under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, both of which expressly include "notes" in their definitions of "security." In *Reves v. Ernst & Young*, 494 U.S. 56 (1990), the Supreme Court adopted the "family resemblance" test to determine whether particular notes constitute a security. This test presumes that every note is a security. An issuer can rebut this presumption by showing that a particular note "bear[s] a strong family resemblance" to a list of notes the Court deemed not to be securities. *Id.* at 65.

Reves lists four considerations to determine whether a note is a security: 1) the motivation of the buyer and seller; 2) the plan of distribution in order to determine whether the note is intended for speculation or investment; 3) the reasonable expectations of the investing public; and 4) whether there is any risk-reducing factor, such as the presence of another regulatory scheme. *Id.* at 66-70. Applied here, these factors demonstrate that the SDOs are securities. First, if the seller's motivation is "to raise money for the general use of a business enterprise ... and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'" *Id.* at 66. WFG, despite the representations in offering materials, used offering proceeds for general business purposes, including purchasing

used cars, purchasing additional assets and expanding the company's business. Second, WFG indiscriminately sold the SDOs to investors in Texas and other states through a network of solicited agents, without regard for investors' accredited status or the suitability of the SDOs. This plan of distribution strongly suggests that the SDOs are securities. *See Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 813 (2d Cir. 1994) (broad-based, unrestricted sale of notes suggests that they are securities). Third, the SDOs involved the investment of money with a corresponding expectation of profit. Fourth, there was no other regulatory scheme that significantly reduced the risk associated with purchasing the SDOs, and the purported insurance coverage provided scant, if any, protection. *See Marine Bank v. Weaver*, 455 U.S. 551 (1982); *Int'l Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979). Therefore, the SDOs are securities.[7]

2. The SDOs are also "investment contracts"

The SDOs are also "investment contracts," which are securities under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act. An investment contract is (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *See SEC v. Edwards*, 540 U.S. 389, 393 (2004); *SEC v. W.J. Howey Co.,* 328 U.S. 293, 301 (1946). The Supreme Court has emphasized that the touchstone of an investment contract is the "presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975). This definition "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised

[7] The short-term note exceptions under the Securities Act and the Exchange Act are inapplicable because, among other reasons, the SDOs have one to four year terms.

by those who seek to use the money of others on the promise of profits." *Edwards*, 540 U.S. at 393 (*quoting Howey*).

The SDOs satisfy *Howey*'s three prongs. The first prong was satisfied when investors gave WFG money.

To establish *Howey*'s second prong, the "common enterprise" element, most circuits require either horizontal or vertical commonality. *See SEC v. R.G. Reynolds Enter., Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991); *SEC v. SG Ltd.*, 265 F.3d 42, 49-50 (1st Cir. 2001). "Horizontal commonality" requires an enterprise common to a group of investors, such as a pooling of investor assets, by which their fortunes are linked. *Id.* "Vertical commonality" requires that investor success be linked to the promoter's success. *See SEC v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). The Fifth Circuit, mandates "broad vertical commonality," which requires only that investors' fortunes be linked to the efforts or expertise of the promoter. *See Long v. Schultz Cattle Co.*, 881 F.2d 129, 140-41 (5th Cir. 1989).

Both forms of commonality exist here. Horizontal commonality exists because investor proceeds were pooled and used to pay for WFG's operations and the stated goal of obtaining insured notes. Vertical commonality exists because investors' fortunes were linked with those of WFG.

As for the third prong, investors assumed a purely passive role in the investment with WFG. They expected to receive annual returns of 7% to 9%, based solely on WFG's claimed ability to generate returns through the funding of the insured notes. Beyond making funds available, no investor was required to put forth any effort to generate profits. *See SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 (5th Cir. 1984) (third *Howey* prong satisfied when

"the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise").

B. Defendants Violated the Registration Provisions: Sections 5(a) and 5(c) of the Securities Act

Absent an exemption, Section 5(a) of the Securities Act prohibits any person from selling a security in interstate commerce without an effective registration statement. Further, Section 5(c) prohibits offers to sell a security unless a registration statement for the offering has been filed with the Commission. A *prima facie* case for a violation of these provisions is established by showing that: (1) no registration statement was in effect or had been filed as to the offering; (2) the defendants, directly or indirectly, sold or offered to sell the securities; and (3) the offer or sale was made through the use of interstate facilities or the mails. *SEC v. Spence & Green Chemical Co.*, 612 F.2d 896, 901-02 (5th Cir. 1980). Once a *prima facie* violation is established, the defendants bear a heavy burden of proving an exemption to registration, *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953), since courts construe such exemptions narrowly to further the Act's purpose "[t]o provide full and fair disclosure of the character of the securities ... and to prevent frauds." *SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980).

WFG and its principals violated the registration provisions because they directly offered and sold, through interstate facilities or the mails, securities to which no registration statement or registration exemption applied.

The Section 3(a)(11) and Rule 147 exemptions are unavailable because they are limited to purely in-state offerings and WFG offered and sold the SDOs in at least two states. The "private placement" exemption of Section 4(2) of the Securities Act likewise is inapplicable. Availability of this exemption turns on four factors: (1) the number of offerees and their relationship to each other and to the issuer; (2) the number of units offered; (3) the offering

size; and (4) the manner of the offering. *Murphy*, 626 F.2d at 644; *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 899 (5th Cir. 1977). WFG sold the SDOs to at least 182 investors in at least two states, raising at least $17.9 million. None of these investors appear to have had any relationship with WFG or its principals before investing, and WFG made little effort to determine investor suitability or sophistication. WFG simply accepted money from anyone willing to invest. In addition, WFG utilized a network of sales agents, who placed newspaper advertisements, to obtain investors. Such activity constitutes a general solicitation, and strongly identifies the offering as public rather than private. Therefore, Section 4(2) is inapplicable.

Regulation D exemptions also do not apply. The amount raised through the offering far exceeds the $1 million limitation in Rule 504 and the $5 million limitation in Rule 505. Rule 505 and 506 exemptions are unavailable because WFG offered the SDOs through general solicitation, and because non-accredited offerees (of which there appear to be many) were not provided financial statements or other information required in a registration statement filed under the Securities Act, as required by Rule 502(b)(2). Rule 506 does not apply for the additional reason that it requires each non-accredited investor or his representative have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to his making any sale that such purchaser comes within this description." Based on investor questionnaires and the staff's interviews of a number of investors, many were unsophisticated and financially inexperienced seniors who did not meet these criteria. Further, WFG made no attempt to determine investors' business or financial knowledge or experience.

Finally, the Section 4(6) exemption, for offerings of up to $5 million to accredited investors, is available only "if there is no advertising or public solicitation in connection with the

transaction by the issuer or anyone acting on the issuer's behalf." WFG raised well over $5 million through a general solicitation and offered and sold SDOs to numerous unaccredited investors. This renders Section 4(6) inapplicable.

C. Defendants Violated the Antifraud Provisions: Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

Section 17(a) of the Securities Act prohibits employing fraudulent schemes or making material misrepresentations or omissions in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibits the same conduct if committed in connection with the purchase or sale of securities. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). A violation of these provisions requires that the alleged misrepresentations or omissions be material. Information is material if a reasonable investor would consider it significant to making an investment decision. *Basic v. Levinson*, 485 U.S. 224, 230 (1988).

Actions under Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder also require proof of *scienter*, *Aaron v. SEC*, 446 U.S. 680, 691 (1980), a "mental state embracing intent to deceive, manipulate or defraud." *Hochfelder*, 425 U.S. at 193. Actions under Sections 17(a)(2) and 17(a)(3) of the Securities Act require no such a showing. *Aaron*, 446 U.S. at 691. *Scienter* is established by showing by a preponderance of the evidence that the defendants acted intentionally or with severe recklessness. *See, e.g.*, *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir.), *cert. denied*, 454 U.S. 965 (1981). The *scienter* of a company's management is imputed to the company. *See, e.g., SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082 (2d Cir. 1972).

As outlined above, WFG, Wahab, Wallens, Sr. and Wallens, Jr. made numerous misrepresentations and omissions to entice investors into purchasing the SDOs. The

defendants misrepresented the true status of insurance coverage, the safety of the investment and the uses of investor funds. These misrepresentations and omissions were material, indeed critical, to the WFG investors, who uniformly sought safety and security for their investment. Wahab, Wallens, Sr. and Wallens, Jr. disseminated offering documents that falsely claimed that the SDO investments were insured and/or reinsured by Lloyd's and Republic Group when they were not, and diverted the funds raised through these misrepresentations to undisclosed, risky investments in a retail electric company and a custom homebuilder. These facts demonstrate that Wahab, Wallens, Sr. and Wallens, Jr. acted with a high degree of *scienter*, which is imputed to WFG.

VI. FURTHER RELIEF IS NEEDED TO PROTECT INVESTORS

A. An Asset Freeze is Appropriate

An immediate asset freeze is necessary, pending final judgment. Part of the relief the Commission seeks is an order requiring the defendants to disgorge their ill-gotten gains. A disgorgement order can be rendered uncollectible and thus meaningless, however, unless a freeze is imposed to prevent the defendants from secreting or dissipating assets prior to final judgment. *SEC v. Manor Nursing Centers*, 458 F.2d at 1106; *Commodity Futures Trading Comm'n v. Muller*, 570 F.2d 1296, 1300-01 (5th Cir. 1978). In addition, where defendants' conduct involves fraud, and there is the risk of asset depletion, a freeze is particularly warranted. *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d at 1106 ("Because of the fraudulent nature of appellants' violations, the court not be assured that appellants would not waste their assets prior to refunding public investors' money"). *See also SEC v. Am. Bd. of Trade, Inc.*, 645 F. Supp. 1047, 1051 (S.D.N.Y. 1986), *modified on other grounds*, 830 F.2d 431 (2d Cir. 1987), *cert. denied*, 485 U.S. 938 (1988) (imposing freeze to prevent depletion of assets).

The evidentiary showing needed to justify an asset freeze is less than the showing needed to justify a preliminary injunction, because injunctive relief raises the specter of future liability for contempt, while an asset freeze only preserves the *status quo*. SEC v. *Unifund*, 910 F.2d 1028, 1039 (2nd Cir. (N.Y.) 1990). Moreover, the funds or assets affected by the freeze need not be traceable to the illegal activity. *Id.* at 1041. *See also SEC v. Grossman*, 887 F. Supp. 649, 661 (S.D.N.Y. 1995).

Here, the nature of defendants' violations and their conduct since the institution of the Special Master Order shows that they cannot be trusted to pay what they owe. Defendants misused and misappropriated the majority of funds provided to WFG by elderly investors. They have continued to squander millions of dollars during the tenure of the Special Master. While erecting a façade of cooperation, defendants concealed from both the Commission and the Special Master millions of dollars that may or may not be related to the WFG fraud. Whatever the source of these funds, however, defendants cannot be trusted to preserve them during litigation to pay their likely disgorgement obligations and facilitate their use to provide monetary relief to defrauded victims. Unless an asset freeze is imposed on these defendants immediately, they are likely to dissipate money or transfer assets abroad. In these circumstances, defendants' assets must be frozen to prevent further dissipation of money and real and personal property remaining in the United States that will be needed to satisfy a final judgment of disgorgement in the future.

B. Orders Requiring Accountings and Preserving Records Are Appropriate

In order to effectuate completely a freeze of defendants' assets, an accounting of all of defendants' assets and of the funds they received from the investors is also necessary. To determine accurately the scope of a defendant's fraud and ability to return illegal profits, courts

frequently require an accounting of all money or property obtained as a result of the fraudulent activity set forth in the Commission's Complaint, as well as his current financial resources or assets. *See, e.g., Manor Nursing Ctrs., Inc.*, 458 F.2d at 1105. Given the amount of investor funds involved in this matter and defendants' proven inclination to conceal financial information, an accounting is appropriate. Accordingly, the Commission requests an order requiring all defendants to provide a comprehensive accounting of their current assets and all assets obtained from January 1, 2006 to date.

Furthermore, the Commission requests an order prohibiting defendants from altering, removing or destroying their books and records in order to preserve the body of evidence for review by this Court. In light of defendants recent refusal to provide the Commission or Special Master with records relating to the sale of NPC, this order is essential to the Commission's efforts to provide relief to defrauded investors.

C. A Repatriation Order is Appropriate

The Commission also seeks a repatriation order requiring that the defendants return to identified accounts in the United States, all monies they have outside this Court's jurisdiction. Such equitable relief is especially appropriate where the Commission is seeking an accounting and disgorgement in its prayer for relief as in the case at bar. *SEC v. R.J. Allen & Assoc., Inc.*, 386 F. Supp. 866, 880-881 (S.D. Fla. 1974).

The evidence in this matter supports a repatriation order. There is already evidence that defendants sent hundreds of thousands of dollars to an offshore account. Moreover, defendants have demonstrated their propensity to misuse and hide assets, even while under the supervision of a Special Master. There is reason to suspect that defendants have, before or after the filing of the Commission's Complaint, concealed funds and assets in foreign venues;

these should be repatriated to make them available, at the appropriate time, to compensate WFG investors.

D. Appointment of a Receiver is Appropriate

As set forth above, pursuant to their general equity powers, courts may order ancillary relief to effectuate the purposes of the federal securities laws, to preserve defendants' assets and to ensure that wrongdoers do not profit from their unlawful conduct. In this regard, the power of the district court to appoint a receiver to marshal and preserve assets and perfect property rights is well established. *SEC v. Materia,* 745 F.2d 197 (2d. Cir. 1984); *SEC v. First Fin.* Group, 645 F.2d 429, 438 (5th Cir. 1981). *See also* 12 C. Wright, A. Miller & R. Marcus, "Federal Practice & Procedure" §2983 at 23-24 (2d Ed. 1997). An evidentiary hearing is not required on Plaintiff's request to appoint a Temporary Receiver where the record discloses sufficient facts to warrant such an appointment. *Bookout v. Atlas Fin. Corp.,* 395 F. Supp. 1338, 1342 (N.D. Ga. 1974), *aff'd*, 514 F.2d 757 (5th Cir. 1975); *United States v. Mansion House Ctr. N. Redevelopment Co.,* 419 F. Supp. 85, 87 (E.D. Mo. 1976).

As discussed already, the evidence presented here establishes that defendants misused and misappropriated the majority of funds collected from WFG investors. The Commission initially accepted defendants' protestations of good faith, asking the Court to appoint a Special Master, but permitting defendants to remain in possession of funds and assets. As the evidence presented here demonstrates, this was a grave error. Defendants have demonstrated that their own greed is a far more potent motivation than their commitment to make investors whole. Defendants have concealed assets from the Commission and the Special Master and continued to squander millions of dollars in spite of the presence of the Special Master.

Defendants have violated the letter and spirit of the Special Master Order by concealing material information about the transactions they have been allowed to control.

In light of the egregious nature of defendants' fraudulent conduct, this Court would have been justified in appointing a receiver over defendants' assets in March. Instead, the Court accepted the Commission's recommendation of the less stringent remedy of appointing a Special Master. Defendants' have abused the opportunity afforded them by the Court. Under these circumstances, only the appointment of a receiver is sufficient to marshal and conserve defendants' property for the benefit of defrauded investors.

VII. CONCLUSION

Based on the foregoing facts and for the reasons set forth above, the Commission respectfully requests that the Count enter the orders proposed providing the relief requested.

Dated and signed on the 5th day of June, 2008.

JEFFREY B. NORRIS
Washington, D.C. Bar No. 424258
U.S. SECURITIES & EXCHANGE COMMISSION
801 Cherry St., 19th Floor
Fort Worth, Texas 76102
Office: (817) 978-6452
Fax: (817) 978-4927
Norrisj@sec.gov