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Receiver

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. DIVERSIFIED LENDING GROUP, INC.; APPLIED EQUITIES, INC.; AND BRUCE FRIEDMAN, Defendants, and TINA M. PLACOURAKIS, Relief Defendant.	Case No. CV 09-01533-R-SS **EX PARTE APPLICATION OF RECEIVER FOR APPROVAL OF CONTINGENCY FEE ARRANGEMENT WITH SALL LAW FIRM, APC, AND WALDRON & BRAGG, LLP, FOR CERTAIN LITIGATION; MEMORANDUM OF POINTS AND AUTHORITIES; DECLARATIONS OF DAVID A. GILL, ROBERT K. SALL AND GARY A. WALDRON** [No hearing requested]

PLEASE TAKE NOTICE THAT I, David A. Gill, the Permanent Receiver (the "Receiver") of Diversified Lending Group, Inc. ("DLG"), and Applied Equities, Inc., and their subsidiaries, hereby submit my Ex Parte Application (the "Application") to retain Sall Law Firm, APC and Waldron & Bragg, LLP ("Proposed Malpractice Counsel"), pursuant to a contingent fee agreement, a copy of which is attached to the Declaration of Robert K. Sall as Exhibit "2." A copy of the proposed

Order on this Application is attached to the Declaration of David A. Gill as Exhibit "1." This Application requests that the Court permit me to enter into a contingent fee arrangement with Proposed Malpractice Counsel for certain litigation to be commenced by me if they deem it appropriate against third parties as more fully defined herein. The contingent fee agreement calls for payment of a total of 25% of all Recoveries (as defined in the contingent fee agreement) if the matter is settled before the filing of a lawsuit, 35% of all Recoveries if the matter is settled after the filing of a lawsuit, up to 120 days before the first scheduled trial date, and 40% of all Recoveries if the matter is resolved thereafter.

I believe that the contingent fee arrangement set forth herein will help to preserve cash available to pay creditors and finance other activities while providing fair treatment for my Proposed Malpractice Counsel. This Application specifies the proposed terms of the fee arrangement and requests authority to reimburse on a monthly basis actual, reasonable and necessary "hard costs" advanced in connection with such investigation and litigation, and subject to reporting by me as required by law and the rules of this Court.

The Application is based upon this Notice, the Application, the Memorandum of Points and Authorities, the Declarations of David A. Gill, Robert K. Sall and Gary A. Waldron attached thereto, and upon such other evidentiary matters as may be presented to the Court at the time of hearing, if any.

PLEASE TAKE FURTHER NOTICE that pursuant to the prior order of this Court entered May 4, 2009, this notice and Application were served upon the approved Limited Service List on October 11, 2010, as reflected in my declaration. No opposition has been received.

PLEASE TAKE FURTHER NOTICE that any interested party may request paper or electronic copies of the entire service package by contacting me in writing, and I shall comply with all such requests by first-class mail. A copy of the Omnibus Order and Application can be viewed by accessing my website:

www.diversifiedreceivership.com. Inquiries may be directed to my office at the above address, attention Ms. Jessica Ramos, Paraprofessional.

Dated: October 11, 2010

David A. Gill, Receiver

MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTION

I am the Permanent Receiver of Diversified Lending Group, Inc. ("DLG"), and Applied Equities, Inc., and their subsidiaries. By this motion, I seek leave to retain The Sall Law Firm, APC, and Waldron & Bragg, LLP ("Proposed Malpractice Counsel") on a contingent fee basis to investigate and, if appropriate, to prosecute, professional liability claims against certain former counsel to Diversified and its affiliates.

I have been unable to find competent counsel willing to handle this matter on a contingency basis without reimbursement of costs advanced by counsel. The proposed terms of the employment are a 100% contingency fee as set forth herein plus reimbursement of actual, reasonable and necessary costs on a monthly basis. I shall report all costs paid pursuant to the terms of this agreement according to law and the rules of this Court.

II.

ARGUMENT

I believe, after preliminary investigation, that the receivership estate may have claims against certain law firms or attorneys who provided services to Diversified Lending Group, Inc., where the services aided in the Ponzi scheme or aided the insiders in what I allege to constitute the looting of the business. I have entered in tolling agreements with them, but these extensions are to end shortly, as early as October 25, 2010. I currently have an agreement in principal to a further extension but have no assurance of continued agreements to further toll the statute of limitations. Hence I am under considerable pressure to retain counsel and, if I cannot timely retain counsel, I will be unable to file the litigation.

contingency basis to handle the litigation at issue. Several of those firms declined to bid at all in light of the identity of the defendants, expressing the view that they would not file litigation against those professional defendants. A few law firms bid the engagement on a modified contingency basis providing for payment of reduced hourly rates, a contingency fee, and payment of costs as they are incurred. Not one of the firms that I contacted was willing to handle this matter on a 100% contingency basis including costs. Given the nature of this case and the claims to be asserted and the complexity of the facts, no firm contacted by me or of which I am aware has indicated a willingness to handle this litigation in the absence of reimbursement of costs on a monthly basis as those costs are incurred. In my experience in this case, and as an attorney, I believe that it is not unusual for such counsel to receive at least reimbursement of their costs, and that experienced (and hence busy) counsel will not act without such provision. As a practical matter, I have no feasible alternative at this time. In my judgment the preservation of such claims justifies the request made, and is reasonable.

I previously asked the Court for permission to retain the Sall Law Firm, APC and Waldron & Bragg, LLP to represent me in advising whether I had cognizable malpractice claims against certain persons and entities not identified in that document. The matter was noticed for hearing, and no objections were filed. However, the Court took the matter off calendar, perhaps out of concern over a cost retainer that had been requested. The Court gave me permission to file an ex parte motion with additional information and a new proposal if I so wished. Proposed Malpractice Counsel have now agreed, at my request, to waive the requirement of a deposit for costs, but are not willing to waive reimbursement of hard costs actually, reasonably and necessarily advanced on a current basis. They understand that all of my payments are subject to confirmation of the court at a later date in connection with my accounting or in some other appropriate manner.

My general counsel, Danning Gill Diamond & Kollitz, LLP, and my special counsel, Susman Godfrey LLP, do not generally pursue legal malpractice claims. Proposed Malpractice Counsel have substantial experience and are considered experts in pursing legal malpractice claims. Mr. Sall has been prosecuting legal malpractice claims for 30 years, and has acquired a substantial reputation in that field. He has experience in prosecuting hundreds of such claims, as well as defending lawyers in such cases and serving as an expert witness. As indicated by his supporting declaration and professional resume, Mr. Sall has a powerful background in legal malpractice, legal ethics and attorney-client fee disputes.

Due to the complexity of these matters and the anticipated time commitment in prosecuting them, Mr. Sall has proposed to associate with another attorney, Gary A. Waldron, of Waldron & Bragg, LLP, who has extensive civil trial experience in business law matters. Mr. Waldron has 30 years experience as a trial attorney and has tried over 100 cases to verdict, including over 35 jury trials. Mr. Sall and Mr. Waldron have worked together as co-counsel in the past, including the trial of a business tort case in 2008 that resulted in a $9 million judgment. Mr. Sall has indicated to me that the difficulty of these legal malpractice cases is anticipated to be such as to require the resources of both Mr. Sall's firm and Mr. Waldron's firm, and hence the proposed association of counsel.

I am informed and believe that costs in legal malpractice matters can be higher than costs in ordinary commercial litigation. I am informed that legal malpractice cases are particularly difficult to handle on a contingent fee basis, because it is often necessary to try several cases, first being the liability of the attorney, and then the proof of what would have happened differently if the attorney had not engaged in the wrongful conduct. That is often referred to as the "case within the case." Legal malpractice cases are complex because of having to prove these multiple underlying matters, in addition to the defendant attorney's negligence or breach of fiduciary duty. I am informed that legal malpractice claims are typically vigorously and

expensively defended, and from my own contacts with certain possible defendants, this will most certainly be the case. It is difficult to find attorneys who are willing to handle complex business related legal malpractice claims. Although I am sure that there must be such, I am not aware of any lawyers of the caliber and experience needed in this matter who are willing to advance costs in such claims, without current reimbursement by the client, and am facing imminent time related problems.

I believe that the risk that many such lawyers are willing to take in complex contingency matters is of compensation for their time invested in the case, not the costs. They are in essence financing the case with their time, a principle that is discussed at length in a California appellate court decision, *Cazares v. Saenz,* 208 Cal. App. 3d 279, 287-288 (1989). As noted in *Cazares*, another contingency risk is that the lawyer agrees to delay receiving his fee until the conclusion of the case, which is often years into the future, and runs the risk that the amount recovered will yield a percentage fee that does not provide adequate compensation. *Id.*, at 288. In addition, the lawyer in effect "finances the case" for the client during the pendency of the litigation, with the lawyers' time and the work of their staff. *Id.*

I expect that these legal malpractice cases, if filed, will be vigorously defended, especially if brought against at least one major national law firm. Because of this investment of time and risk, I have been informed by Mr. Sall that his firm, like many contingency lawyers, is not willing to advance the substantial costs that will be incurred in legal malpractice cases until the end of the case, and therefore expect the client to pay the costs currently.

I must deal with costs in the proposed contingent fee agreement. By law, the timing and responsibility for costs must be made a matter of the agreement between the client and counsel. California Business and Professions Code section 6147(a)(2) requires that a contingency fee agreement set forth "how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client's recovery." The issue of costs in a contingent fee

incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client's recovery." The issue of costs in a contingent fee case is a matter of contract between the attorney and the client, and is governed in part by case law and the Rules of Professional Conduct. Rule 4-200 of the Rules of Professional Conduct generally prohibits a member of the bar from paying the expenses of a client, but does not prohibit advancing costs for a litigation matter. Unless the fee agreement expressly provides otherwise, the client must reimburse the attorney for expenses and costs of suit paid or incurred on the client's behalf. *Cooley v. Miller & Lux,* 156 Cal. 510, 525-526 (1909).

I have negotiated the proposed contingent fee agreement with Proposed Malpractice Counsel to waive any deposit of funds for costs. The proposed contingent fee agreement provides that the attorneys may reasonably advance necessary costs on a short term basis, but will be reimbursed by the estate currently. This is the same arrangement I made, with Court approval, with Susman Godfrey LLP, relative to other litigation. Of course, all of my disbursements are subject to review by the Court of my compliance with the terms of employment including the reasonableness and necessity thereof. I will continue to report on all of these in my semi-annual reports and at other times.

I have attempted to and cannot persuade Proposed Malpractice Counsel to bear the costs of investigation and, if appropriate, litigation, and to wait until eventual resolution of the case to be reimbursed their costs. Indeed, I feel that this would be unfair to them, given the magnitude of the task before them and the overall contingency risks they are undertaking.

Tolling agreements I have with several lawyers and law firms expire starting on October 25, 2010, although I have an agreement to extend in principal with one of the firms. If I cannot retain expert counsel, I may be forced to abandon these claims.

Accordingly, I request that the Court approve the revised Contingent Fee Agreement, a copy of which is attached to the Sall Declaration as Exhibit "2".

III.

CONCLUSION

Based on the foregoing, I respectfully request entry of an order: (a) granting this Application; (b) approving the employment of the Proposed Malpractice Counsel as set forth herein; and (c) for all other appropriate relief.

Dated: October 11, 2010

David A. Gill, Receiver

DECLARATION OF DAVID A. GILL

I, David A. Gill, declare as follows:

1. I am the Permanent Receiver appointed by this Court for Diversified Lending Group, Inc. ("Diversified"), and Applied Equities, Inc., pursuant to the Order of Preliminary Injunction and Orders: (1) Continuing Asset Freeze, (2) Appointing a Permanent Receiver, (3) Prohibiting the Destruction of Documents, (4) Granting Expedited Discovery, and (5) Requiring Accountings, signed and entered by this Court on March 10, 2009, in *Securities and Exchange Commission v. Diversified Lending Group, Inc., et al.*, case number CV 09-01533-R-SS, pending in the United States District Court, Central District of California.

2. This declaration is made in support of Ex Parte Application of Receiver for Approval of Contingency Fee Arrangement with Sall Law Firm, APC, and Waldron & Bragg, LLP, for Certain Litigation ("Application").

3. I have personal knowledge of the facts in this declaration and, if called as a witness, I could competently testify to these facts.

4. I believe, after preliminary investigation, that the receivership estate may have claims against certain law firms or attorneys who provided services to Diversified Lending Group, Inc., where the services aided in the Ponzi scheme or aided the insiders in what I allege to constitute the looting of the business. While I have entered in tolling agreements with them, these extensions are shortly, as early as October 25, 2010, to end and I have no assurance of continued agreements to further toll the statute of limitations. Hence I am under considerable pressure to retain counsel, and if I cannot timely retain counsel, I will be unable to file the litigation.

5. Prior to deciding to seek permission for such employment, my general counsel and I contacted more than ten law firms and lawyers, soliciting competitive bids on a contingency basis to handle the litigation at issue. Several of those firms declined to bid at all in light of the identity of the proposed defendants, expressing

the view that they would not file litigation against those professional defendants. A few law firms bid the engagement on a modified contingency basis providing for payment of reduced hourly rates, a contingency fee, and payment of costs as they are incurred. Not one of the firms that I contacted was willing to handle this matter on a 100% contingency basis including costs. Given the nature of this case and the claims to be asserted and the complexity of the facts, no firm contacted by me or of which I am aware has indicated a willingness to handle this litigation in the absence of reimbursement of costs on a monthly basis as those costs are incurred. In my experience in this case, and as an attorney, I believe that it is not unusual for such counsel to receive at least reimbursement of their costs, and that experienced (and hence busy) counsel will not act without such provision. As a practical matter, I have no feasible alternative at this time. In my judgment the preservation of such claims justifies the request made, and is reasonable.

6. I previously asked the Court for permission to retain the Sall Law Firm, APC and Waldron & Bragg, LLP ("Proposed Malpractice Counsel"), to represent me in advising whether I had cognizable malpractice claims against certain persons and entities not identified in that document. The matter was noticed for hearing, and no objections were filed. However, the Court took the matter off calendar, perhaps out of concern over a cost retainer that had been requested. The Court gave me permission to file an ex parte motion with additional information and a new proposal if I so wished. Proposed Malpractice Counsel have now agreed, at my request to waive the requirement of a deposit for costs, but are unwilling to waive reimbursement of hard costs actually, reasonably and necessarily advanced on a current basis. I am advised that they understand that all of my payments are subject to confirmation of the court at a later date in connection with my accounting or in some other appropriate manner.

7. My general counsel, Danning, Gill, Diamond & Kollitz, LLP, and my special counsel, Susman Godfrey LLP, do not generally pursue legal malpractice

claims. Proposed Malpractice Counsel have substantial experience and are considered experts in pursing legal malpractice claims. Mr. Sall has been prosecuting legal malpractice claims for 30 years, and has acquired a substantial reputation in that field. He has experience in prosecuting hundreds of such claims, as well as defending lawyers in such cases and serving as an expert witness. As indicated by his supporting declaration and professional resume, Mr. Sall has a powerful background in legal malpractice, legal ethics and attorney-client fee disputes.

8. Due to the complexity of these matters and the anticipated time commitment in prosecuting them, Mr. Sall has proposed to associate with another attorney, Gary A. Waldron, of Waldron & Bragg, LLP, who has extensive civil trial experience in business law matters. Mr. Waldron has 30 years experience as a trial attorney and has tried over 100 cases to verdict, including over 35 jury trials. Mr. Sall and Mr. Waldron have worked together as co-counsel in the past, including the trial of a business tort case in 2008 that resulted in a $9 million judgment. Mr. Sall has indicated to me that the difficulty of these legal malpractice cases is anticipated to be such as to require the resources of both Mr. Sall's firm and Mr. Waldron's firm, and hence the proposed association of counsel.

9. I am informed and believe that costs in legal malpractice matters can be higher than costs in ordinary commercial litigation. I am informed that legal malpractice cases are particularly difficult to handle on a contingent fee basis, because it is often necessary to try several cases, first being the liability of the attorney, and then the proof of what would have happened differently if the attorney had not engaged in the wrongful conduct. That is often referred to as the "case within the case." Legal malpractice cases are complex because of having to prove these multiple underlying matters, in addition to the attorney's negligence or breach of fiduciary duty. I am informed that legal malpractice claims are typically vigorously and expensively defended, and from my own contacts with certain

possible defendants that this will most certainly be the case. It is difficult to find attorneys who are willing to handle complex business related legal malpractice claims. Although I am sure that there must be such, I am not aware of any lawyers of the caliber and experience needed in this matter who are willing to advance costs in such claims, without current reimbursement by the client.

10. I expect that these legal malpractice cases, if filed, will be vigorously defended, especially if brought against at least one major national law firm. Because of this investment of time and risk, I have been informed by Mr. Sall that his firm, like many contingency lawyers, is not willing to advance the substantial costs that will be incurred in legal malpractice cases until the end of the case, and therefore expect the client to pay the costs currently.

11. I have negotiated the proposed contingency fee agreement with Proposed Malpractice Counsel to waive any deposit but to provide that the attorneys may reasonably advance necessary costs on a short term basis, but will be reimbursed by the estate currently. This is the same arrangement I made, with Court approval, with Susman Godfrey LLP, relative to other litigation. Of course all of my disbursements are subject to review by the Court of my compliance with the terms of employment including the reasonableness and necessity thereof. I will continue to report on all of these in my semi-annual reports and at other times.

12. I have attempted to and cannot persuade Proposed Malpractice Counsel to bear the costs of investigation and, if appropriate, litigation, and to wait until eventual resolution of the case to be reimbursed their costs. Indeed, I feel that this would be unfair to them, given the magnitude of the task before them, and the overall contingency risks they are undertaking.

13. Attached hereto as Exhibit "1" is the proposed order approving the Application.

14. My general counsel, Danning, Gill, Diamond & Kollitz, LLP ("Danning-Gill"), served notice of the proposed notice and Application to the Limited Service List and by posting the notice and the Application on the receivership website at www.DiversifiedReceivership.com.

15. On October 11, 2010, all parties on the Limited Service List were notified of this Court's ex parte procedure as set forth in *Order Re Notice to Counsel*, at paragraph 3. The parties were advised that any opposition to the Application must be filed with the Court within twenty-four hours of receiving the filed Application. No opposition has been received.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed at Los Angeles, California, on October 11, 2010.

DAVID A. GILL

DECLARATION OF ROBERT K. SALL

I, Robert K. Sall, declare and state as follows:

1. I am an attorney at law duly qualified and licensed to practice before this Court. I am a shareholder of the law firm of The Sall Law Firm, A Professional Corporation, 32351 Coast Highway, Laguna Beach, California 92651 (the "Firm"). I have personal knowledge of the facts stated herein, and if called as a witness, could competently testify to these facts.

2. David A. Gill, the Permanent Receiver in the matter of *Securities and Exchange Commission vs. Diversified Lending Group, Inc.; Applied Equities, Inc.; Bruce Friedman and Tina M. Placourakis*, U.S.D.C. Case No. CV 09-01533-R-SS (the "Receiver") is seeking to retain the Firm's services (and the services of the Associated Counsel described below) by the foregoing Application. The Application is for the purpose of employing counsel to pursue claims on behalf of the Receiver and the estate, against the certain firms which provided legal services to Diversified Lending Group, Inc. and related entities (the "target parties"). I have read the Application and to the best of my knowledge, all the facts stated therein are true and correct.

3. The Firm is a disinterested party in this matter and is not a creditor or in any way affiliated or associated with the defendants in this matter, or the target parties.

4. The Firm has not had any business dealings with or represented the defendants or the target parties in this matter.

5. The Firm neither holds nor represents any interest materially adverse to the interest of the receivership estate by reason of any direct or indirect relationship to, connection with, or interest in, the receivership defendants, the target parties, or for any other reason.

6. The Firm has agreed with the Receiver to work on the investigation, and if appropriate, the prosecution of the matters described in the Application, against the target parties, in association with the law firm of Waldron & Bragg, LLP, with both firms working together as Associated Counsel. I have proposed to work in association with Gary A. Waldron of Waldron & Bragg, because I anticipate that the time and effort involved will be substantial, and that the staffing and resources of both our law firms will be necessary to investigate and prosecute the matters described in the proposed fee agreement. Mr. Waldron and I have worked together in a number of matters, including the trial of a business tort case in 2008 that resulted in a $9 million judgment. Mr. Waldron has extensive civil trial experience in business law matters, 30 years experience as a trial attorney and has tried over 100 cases to verdict, including over 35 jury trials.

7. I will be the attorney at the Firm who will be principally responsible for performing the legal services on behalf of the Receiver. My current professional resume is attached hereto as Exhibit 3, incorporated herein by this reference. I have substantial experience in professional liability matters and prosecuting claims against law firms. During the past thirty years, I have prosecuted hundreds of legal malpractice claims, and have substantial experience in attorney-client fee disputes, breach of fiduciary duty claims involving lawyer conduct, serving as an expert witness in legal malpractice matters and fee disputes, and in defending claims against lawyers. The Firm will also utilize the services of its associate attorneys, who work under my direct supervision.

8. In the negotiations with the Receiver for this proposed engagement, I informed the Receiver that the Firm, and Mr. Waldron's firm, would not accept the engagement if required to advance costs the reimbursement of which would be delayed until, or contingent upon, the outcome of the case. Mr. Waldron and I, and our respective firms, are willing to take on the contingent risk of advancing our time, and the professional time of our attorneys and staff, in which we delay the receipt of

any compensation until the contingent outcome of the case. We would be in effect financing the case with the advancement of our time. However, as a matter of policy, we do not generally advance costs that are contingent upon the recovery, and are not willing to do so in this matter. I have informed the Receiver that costs in legal malpractice matters can be higher than costs in ordinary commercial litigation. I have informed the Receiver that legal malpractice cases are particularly difficult to handle on a contingent fee basis, because of their complexity and that it is often necessary to try the "case within the case" approach, being the liability of the attorney, and then the proof of what would have happened differently if the target party had not engaged in the wrongful conduct. Legal malpractice claims typically are vigorously and expensively defended. It is often difficult to find attorneys willing to handle complex business related legal malpractice claims on a contingent fee basis, and in my experience, few are willing to advance costs in such claims without current reimbursement by the client.

9. In the proposed team effort with the Firm and Mr. Waldron's firm as associated counsel, there is an agreement to share the contingent fee compensation, which has been fully disclosed to the Receiver, and set forth in the proposed Retention Agreement, attached as Exhibit 2. As specified by Rule 2-200 of the California Rules of Professional Conduct, the written consent of the Receiver is required to such fee sharing, subject only to the Court's approval of this Application. In essence, the fee sharing agreement provides for the Firm and Waldron & Bragg, LLP to jointly investigate prosecute the action or actions as Associated Counsel, and to share the contingent fees on a proration of time and dollar value spent by each of the lawyers and paralegals in the respective firms. Except for this fee sharing arrangement, there is no other agreement to share any compensation for this engagement with any other person except as among the employed attorneys and contract attorneys of the Firm.

10. The terms and source of the proposed compensation and reimbursement of The Sall Law Firm and Waldron & Bragg, LLP are set forth in the Retention Agreement, attached as Exhibit 2. In summary, these terms are a contingency fee arrangement upon which the Receiver will compensate the Firm and the Associated Counsel on a contingent fee basis, is 25% of the Recovery, if any, that is derived prior to filing of a lawsuit; 35% of the Recovery, if any, that is obtained prior to that date which is 120 days before the first date that the matter is set for trial; or 40% of the Recovery, if any, which is obtained thereafter. The Recovery shall include the gross amount of any monies or other consideration obtained from defendants, or their sureties, whether by judgment, settlement, levy or otherwise and includes any monies obtained as a refund or disgorgement of fees previously paid to the target parties and/or as a distribution from any sums that may be held in those law firms' trust accounts, or as an award of attorney's fees, costs, interest or damages of any kind. If a portion of the recovery is non-monetary, but has monetary value, the recovery shall include the reasonable value of the non-monetary recovery.

11. Under the Retention Agreement, the Sall Law Firm and Waldron & Bragg, LLP will be reimbursed by the Receiver for costs reasonably and necessarily incurred, which shall be invoiced monthly as they are invoiced, without the need for further court approval.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed at Laguna Beach, California, on October 11, 2010.

ROBERT K. SALL