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

THOMAS L. TAYLOR, III, in his capacity as Court-appointed temporary receiver for Breitling Energy Corp. et al., Plaintiff v. ROTHSTEIN KASS & COMPANY, PLLC and BRIAN MATLOCK, Defendants.	§ § § § § § § § § § § § §	NO. 3:19-cv-01594-D

DEFENDANTS' MOTION TO DISMISS
RECEIVER'S ORIGINAL COMPLAINT AND BRIEF IN SUPPORT

E. LEON CARTER
State Bar No. 03914300
lcarter@carterarnett.com
LINDA R. STAHL
State Bar No. 00798525
lstahl@carterarnett.com
COURTNEY BARKSDALE PEREZ
State Bar No. 24061135
cperez@carterarnett.com
CARTER ARNETT PLLC
8150 N. Central Expy., Suite 500
Dallas, Texas 75206-1860
(214) 550-8188 (main)
(214) 550-8185 (facsimile)

NICOLAS MORGAN (admitted pro hac vice)
Cal. State Bar No. 166441
nicolasmorgan@paulhastings.com
THOMAS ZACCARO (admitted pro hac vice)
Cal. State Bar No. 183241
thomaszaccaro@paulhastings.com
PAUL HASTINGS LLP
515 South Flower Street, Twenty-Fifth Floor
Los Angeles, CA 90071
(213) 683-6000 (main)
(213) 627-0705 (facsimile)

Attorneys for Defendants
ROTHSTEIN, KASS & COMPANY, PLLC and BRIAN MATLOCK

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Defendants Rothstein Kass & Company, PLLC ("Rothstein Kass") and Brian Matlock ("Matlock") (together, the "Defendants"), through undersigned counsel, hereby move to dismiss the Receiver's Original Complaint ("Complaint"), pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6).

I. INTRODUCTION

The Receiver's complaint seeks damages for alleged professional negligence arising from a financial statement audit conducted by Rothstein Kass, an accounting firm, and Brian Matlock, the principal in charge of that financial statement audit, for an audit engagement that lasted less than one year from September 2013 to June 2014. This case must be dismissed because it was brought after the expiration of the statutes of limitations and repose. Additionally, the case must be dismissed because the Receiver has not alleged, nor can he allege, that anyone relied on the audited financial statements or that the Defendants caused or substantially assisted any wrongdoing, critical elements of the Receiver's claims.

In 2016, the U.S. Securities and Exchange Commission ("SEC") brought suit against Christopher Faulkner ("Faulkner"), Breitling Energy Corporation ("BECC"), and various individuals and entities associated with BECC in *SEC v. Faulkner*, No. 3:16-cv-01735-D (N.D. Tex. June 24, 2016) ("*SEC v. Faulkner*"). *See SEC v. Faulkner*, First Amended Complaint (Dkt. No. 22). The SEC alleged that, since 2011, Faulkner and his co-defendants orchestrated a massive scheme to defraud investors in Faulkner's oil and gas companies and "lied to the auditors with an eye towards obtaining a clean audit opinion for BECC." *Id.* at ¶ 75.

On August 14, 2017, this Court appointed Thomas L. Taylor, III (the "Receiver"), as temporary receiver over the assets of Faulkner and BECC. *SEC v. Faulkner*, August 14, 2017 Order Appointing Temporary Receiver (Dkt. No. 108). The Court entered another Order

appointing Mr. Taylor as the Receiver on September 25, 2017 (Dkt. No. 142), which order was amended on September 12, 2018 (Dkt. No. 320) and again on March 26, 2019 (Dkt. No. 418).

The Receiver brought the instant suit against Rothstein Kass, the former auditor of BECC and two affiliated private companies, and Matlock as a former Principal at Rothstein Kass. The Complaint has four separate counts.

- Count I – Negligence/Gross Negligence;
- Count II – Aiding, Abetting, or Participation in Breaches of Fiduciary Duties;
- Count III – Aiding, Abetting, or Participation in Faulkner's Fraudulent Scheme; and
- Count IV – Avoidance of Fraudulent Transfers.

The Defendants move to dismiss each count because the Receiver has failed to state a claim upon which relief can be granted. Count I should be dismissed for two separate reasons: (i) the statute of limitations for professional negligence claims has expired and (ii) the Receiver has failed to allege a factual basis for the Breitling Entities' reliance.[1] Reliance is a critical prerequisite to the element of causation for any negligence claim. Accordingly, this pleading deficiency is fatal.

Counts II and III should be dismissed for three reasons: (i) they impermissibly violate Texas's anti-fracturing rules; (ii) the Receiver has failed to allege that the Defendants substantially assisted Faulkner in committing tortious acts; and (iii) they cannot satisfy the "concert of action" theory of aiding and abetting liability required under Texas law, which should be pursued only for claims regarding dangerous, deviant, or antisocial conduct. In addition, Count III should be dismissed for the independent reason that it unsuccessfully attempts

[1] Defendants use the term "Breitling Entities" to refer to the various entities associated with Breitling now included among the Receivership Entities, as that term is defined in the various Orders appointing the Receiver, including Breitling Royalties Corporation, Breitling Oil & Gas Corporation, and Breitling Energy Corporation.

to state a cause of action for "participating in a fraudulent scheme" without providing the specificity required under Fed. R. Civ. P. 9(b).

Count IV should be dismissed because the Receiver's right to bring an action for fraudulent conveyance under Texas law has been extinguished by a statute of repose. While this Court tolled the applicable *statutes of limitations* in its Orders appointing the Receiver, the Texas Uniform Fraudulent Transfer Act ("TUFTA") is governed by a statute of repose, not a statute of limitations. Once the four-year period ran, which it has, any claims for fraudulent conveyance were extinguished.

II. PERTINENT ALLEGATIONS

The Receiver has alleged that Faulkner orchestrated a massive fraud through the Breitling Entities, raising approximately $150 million in gross proceeds from purchasers through the offer and sale of oil and gas-related securities. (Receiver's Original Complaint (Dkt. No. 1) ("Complaint"), ¶¶ 2, 7.) Faulkner served as President and Chief Executive Officer of two private companies, Breitling Oil & Gas Corporation ("BOG") and Breitling Royalties Corporation ("BRC"). (*Id.* at ¶ 13.) Faulkner controlled BOG's and BRC's overall direction and managed their day-to-day operations. (*Id.*) According to the SEC, Faulkner made use of the assets of the Breitling Entities to fund a lavish lifestyle. (*Id.* at ¶ 2.)

In or about 2013, Faulkner conceived of taking BOG and BRC public through a "reverse merger" transaction. (Complaint, ¶ 23.) On December 9, 2013, BOG and BRC acquired the publicly traded company Bering Exploration, Inc. through the reverse-merger, renaming it Breitling Energy Corporation (and changing its ticker symbol to BECC). (*Id.*)

The Receiver has alleged that the Breitling Entities retained the Defendants to conduct an audit of BOG and BRC's financial statements for the years ending December 31, 2011 and December 31, 2012, in anticipation of the reverse-merger. (Complaint, ¶ 33.) The Receiver has

alleged that Rothstein Kass's engagement began in or about September 2013, and on or about April 14, 2014, Rothstein Kass issued an unqualified audit opinion with respect to the financial statements of BOG and BRC. (*Id.* at ¶ 34.) Rothstein Kass resigned from auditing the Breitling Entities on or about June 2014. *(Id*.) Thus, the Receiver concedes that Rothstein Kass's engagement concluded more than five years before he filed his Complaint.

The Receiver sets forth eight discrete areas in which the Defendants allegedly violated their duty to exercise the ordinary care, skill, or diligence that a certified public accountant commonly possesses:

1. Materially Misleading Cost Estimates in the Authorizations for Expenditures ("AFEs") Included in the Confidential Information Memoranda ("CIMs");
2. Comingling of Investor Proceeds in General Operating Accounts;
3. Overselling of Interests in Numerous Offerings;
4. Material Reimbursements to Faulkner;
5. Complete Lack of Internal Controls;
6. Failure to Track the Use of Proceeds in Auditing the Financial Statements in Accordance with Generally Accepted Auditing Standards ("GAAS");
7. Failure to Require Going Concern Disclosure and Modify Audit Opinions; and
8. Failure to Classify and Disclose Crude as a Consolidated Entity/Variable Interest Entity.

(Complaint, ¶¶ 33 – 75.) The Defendants' actions in these eight discrete areas form the basis for the Receiver's claims for relief in Counts I – IV.

The Receiver has also alleged that the Breitling Entities were not able to bring the causes of action against the Defendants because the Breitling Entities were not "freed of Faulkner's coercion" until this Court ordered the appointment of the Receiver. (Complaint, ¶ 80.)

III. LEGAL STANDARD

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (*quoting Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (*citing Twombly*, 550 U.S. at 556). "A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.'" *Id*. (*quoting Twombly*, 550 U.S. at 555). "Nor does a complaint suffice if it tenders 'naked assertion[s]' devoid of 'further factual enhancement.'" *Id.* (*quoting Twombly*, 550 U.S. at 557) (alteration in original). "Factual allegations must be enough to raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555 (citation omitted) (citing 5 Wright & Miller, *Federal Practice & Procedure* § 1216 (3d ed. 2004)).

A statute of limitations defense supports dismissal under Fed. R. Civ. P. 12(b)(6) when it is evident from the plaintiff's pleadings that the action is barred and the pleadings fail to raise some basis for tolling or the like. *See Taylor v. Books A Million, Inc.*, 296 F.3d 376, 378-79 (5th Cir. 2002).

Similarly, a dismissal for failure to plead fraud with particularity pursuant to Fed. R. Civ. P. 9(b) is treated the same as a Fed. R. Civ. P. 12(b)(6) dismissal for failure to state a claim. *Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1017 (5th Cir. 1996)). Rule 9(b) contains a heightened pleading standard that "requires 'the who, what, when, where, and how' to be laid out" with respect to a fraud claim. *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 724 (5th Cir. 2003).

IV. LEGAL ANALYSIS

A. Count I (Negligence) Must Be Dismissed Because It Was Brought After the Expiration of the Statute of Limitations

A suit for professional negligence must be brought no later than two years from the date the cause of action accrues. Tex. Civ. Prac. & Rem. Code Ann. § 16.003(a); *See also Won Pak v. Harris*, 313 S.W.3d 454, 459 (Tex. App.—Dallas 2010). The Receiver alleges that Rothstein Kass began the engagement in or about September 2013 and issued an unqualified audit opinion with respect to the financial statements of BOG and BRC on or about April 14, 2014.[2] (Complaint, ¶ 34.) The Receiver further alleges that Rothstein Kass resigned from auditing the Breitling Entities in or about June 2014. (*Id.*) The Receiver has not alleged that Rothstein Kass took any actions vis-à-vis the Breitling Entities after June 2014. Therefore, the latest the statute of limitations began running was June 2014. While the August 14, 2017 Order appointing the Receiver specifically tolled "any applicable statute of limitations," the relevant two-year statute of limitations had already lapsed.

The Receiver alleges in conclusory fashion that the Breitling Entities "were not able to bring the causes of action asserted herein until they were 'freed of [Faulkner's] coercion by the court's appointment of [the] Receiver.'" (Complaint, ¶ 80 (citing *Janvey v. DSCC, Inc.*, 712 F.3d 185, 190 (5th Cir. 2013)).) But *Janvey* does not support the Receiver's conclusory statement. The Receiver's substantive factual allegations make clear that, unlike in *Janvey*, Faulkner's actions *benefitted* the Breitling Entities by enriching them with $150 million in gross proceeds. Faulkner's knowledge is thus imputed to the Breitling Entities for statute of limitations purposes.

[2] The audit opinion was issued on February 14, 2014, but Defendants have accepted the Receiver's allegation for purposes of this motion.

For claims brought by a receiver of a company, the limitations period begins to run against a company's claims prior to the receivership only if the knowledge possessed by the company's principals can be imputed to the company. *Janvey*, 712 F.3d at 190 (finding that knowledge of principal perpetuating Ponzi scheme should not be imputed to corporation). As this Court has previously acknowledged, under well-established Fifth Circuit and Texas law, a principal's knowledge is imputed to a company he controls (even for fraudulent purposes) when the principal *acts for the benefit of the company*. *Reneker v. Offill*, No. 3:08-CV1394-D, 2012 WL 2158733, at *10 & 11 (N.D. Tex. June 14, 2012) (Fitzwater, C.J.) (citing *FDIC v. Ernst & Young*, 967 F.2d 166, 170-71 (5th Cir. 1992)). As the Fifth Circuit in *Ernst & Young* explained:

> In Texas, whether an employee's fraud is attributable to a corporation depends on whether the fraud was on behalf of the corporation or against it:
>
> > Fraud on behalf of a corporation is not the same thing as fraud against it. Fraud against the corporation usually hurts just the corporation; the stockholders are the principal if not only victims; their equities vis-a-vis a careless or reckless auditor are therefore strong. But the stockholders of a corporation whose officers commit fraud for the benefit of the corporation are beneficiaries of the fraud ... But the primary costs of a fraud on the corporation's behalf are borne not by the stockholders but by outsiders to the corporation, and the stockholders should not be allowed to escape all responsibility for such a fraud, as they are trying to do in this case.

Id. at 170-71 (alteration in original) (*quoting Greenstein, Logan & Co. v. Burgess Mktg., Inc*., 744 S.W.2d 170, 190–91 (Tex. App.—Waco 1987, writ denied)). In *Ernst & Young*, the Court imputed the knowledge of Woods (the officer) to Western (the corporation) because of their close connection and—crucially—because Woods acted on Western's behalf:

> Woods acted on the corporation's behalf because by serving Western, he served himself, Western's sole owner. As the sole

> owner, Woods' fraudulent activities on Western's behalf benefitted himself and injured outsiders to Western—i.e. depositors and creditors. Accordingly, under *Greenstein*, Woods acted on Western's behalf, and, therefore, his knowledge is imputable to Western.
>
> Not only do the facts of this case satisfy the *Greenstein* standard for imputation, but common sense also supports imputing Woods' knowledge to Western. Woods is Western's sole shareholder, and, as the FDIC's complaint stated, Woods "dominated and controlled Western's board of directors from the time he took control of Western." As evidence of his domination and control, Woods, upon acquiring Western, expanded the board of directors and made himself chairman of the board.

Id. at 171.

The 5th Circuit's holdings in *Ernst & Young/Greenstein* and *Janvey* differ in one important aspect: the control person in *Ernst & Young* acted for the benefit of the company he controlled (and thereby also benefitted himself as a shareholder) whereas the control person in *Janvey* was operating a Ponzi scheme, which merely perpetuated the fraudulent enterprise and did not benefit the company under control. *Janvey*, 712 F.3d at 188 (*citing Scholes v. Lehmann*, 56 F.3d 750, 752 (7th Cir. 1995) ("Although some trading of commodities was done, most of the money raised from the sale of the limited-partner interests was used simply to pay the promised return. These payments gave the scheme credibility, enabling Douglas to sell additional limited-partner interests")).

In this case, neither the SEC nor the Receiver has alleged that BECC or Faulkner perpetuated a Ponzi scheme as in *Janvey*. To the contrary, the facts as alleged by the Receiver, if true, show that Faulkner benefitted the Breitling Entities by raising approximately $150 million in gross proceeds for "entities under his control," BOG and BRC, which Faulkner and his two co-founders owned, and BECC, which they "owned over 90% of." (Complaint, ¶¶ 2, 23.) In addition, the Receiver alleges that Faulkner totally controlled the Breitling Entities—just like

Woods controlled Western in *Ernst & Young*—by serving as President and Chief Executive Officer of BOG and BRC, controlling their overall direction, managing their day-to-day operations, and conceiving to take the private companies public through a "reverse-merger" transaction. (*Id.* at ¶¶ 13, 23.) And, just as Woods benefitted from Western's profits in *Ernst & Young*, the Receiver alleges that Faulkner used some of the $150 million he raised for the Breitling Entities to fund a lavish lifestyle. (*Id.* at ¶ 2.)

Given these facts, it is not surprising that in seeking to have this Court appoint the Receiver, the SEC argued that Faulkner's state of mind should be imputed to the entities he controlled:

> A company's scienter can be imputed from its management. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972); *see, e.g., Southland Sec. Corp. v. INSpire Ins. Solution, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004). . . . Faulkner's scienter is imputed to BOG . . . [and] is also imputed to BECC.

SEC v. Faulkner, Brief in Support of Plaintiff's Motion for Preliminary Injunction, *Ex Parte* Temporary Restraining Order, Asset Freeze, Appointment of Receiver, and Other Ancillary Relief (Dkt. No. 103) at 17 & 19. Without addressing the imputation issue, this Court granted the SEC's request and appointed the Receiver. *SEC v. Faulkner*, August 14, 2017 Order Appointing Temporary Receiver (Dkt. No. 108). A court may take judicial notice of the existence (but not the truth) of the occurrences and positions taken in the SEC action. *Reneker v. Offill*, 08-CV-1394 D, 2012 WL 2158733 * 14 (N.D. Texas June 14, 2012) (Fitzwater, C.J.).

Given the fact that Faulkner's fraud benefitted the Breitling Entities, his ownership and control over those entities and the personal benefit he derived from this ownership and control require Faulkner's knowledge to be imputed to the Breitling Entities under the standards set forth in *Greenstein* and *Ernst & Young*. To the extent that the Defendants committed professional negligence, it was only in failing to identify Faulkner's fraudulent scheme. As Faulkner is the

purported mastermind of the fraudulent scheme, he must have been aware of any such negligence when the financial statements were allegedly issued April 14, 2014. The Receiver alleges no factual basis to toll the running of the statute of limitations until a later time, and therefore cannot assert that the two-year statute of limitations began to run more than three years later on August 14, 2017. Therefore, Count I, for professional negligence must be dismissed as untimely.

B. Count I (Negligence) Fails to Plead Reliance, an Essential Prerequisite to the Element of Causation

The Receiver has failed to plead that anyone—Faulkner, BOG, BRC, BECC, or even the Receiver himself—relied upon the financial statements audited by Rothstein Kass.

Under Texas law, a negligence claim requires proof of causation, among other things. *Lucas v. Texas Indus., Inc*., 696 S.W.2d 372, 376 (Tex. 1984). The Fifth Circuit in *Ernst & Young*, 967 F.2d at 170, found that reliance was a critical component in causation: "a claim that reliance is not a component of causation strains credulity." *Id*. If nobody relied upon the audit, then the audit could not have been a "substantial factor in bringing about the injury." *Id., see also Craig v. Metro Bank of Dallas*, 601 S.W.2d 734, 736 (Tex. Civ. App.—Dallas 1980, no writ).

To survive a motion to dismiss, a plaintiff must plead enough "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678. The Receiver does not provide a single *factual* allegation that would indicate how, or whether, anyone relied upon Rothstein Kass's audit. Nor is it plausible that Faulkner or any of the Breitling Entities relied upon the audited financial statements in committing the alleged fraudulent scheme. In order to avoid dismissal pursuant to a Rule

12(b)(6) motion, the plaintiff must provide "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action[.]" *Twombly*, 550 U.S. at 555 (citation omitted).

Throughout the entire 101-paragraph Complaint, there is not a single *factual* allegation that any person (or any entity) relied upon Rothstein Kass's audit of BOG and BRC's financial statements. Nor can the Receiver make such an allegation. The Receiver's theory is that Faulkner defrauded purchasers of oil and gas interests and that he made use of the assets of the Breitling Entities to fund a lavish lifestyle. (Complaint, ¶ 2.) Rothstein Kass issued the audit opinion after BOG and BRC completed their sales of oil and gas interests and, therefore, the audit had no impact on Faulkner's alleged scheme. Nor does the Receiver make any allegations that the financial statements assisted Faulkner.

To be sure, the Receiver makes the unsupported conclusory statement: "[t]he Audit Entities relied on the Defendants to conduct this audit through the exercise of 'the degree of care, skill and competence that reasonably competent members of their profession would exercise under similar circumstances.'" (Complaint, ¶ 3.) However, under Fed. R. Civ. P. 8(a)(2), a pleading must contain "a short and plain statement of the claim showing that the pleader is entitled to relief." *Id.* Although "the pleading standard Rule 8 announces does not require 'detailed factual allegations,'" it demands more than "labels and conclusions." *Iqbal*, 556 U.S. at 678. The court should not "rely upon conclusional allegations or legal conclusions that are disguised as factual allegations." *Jackson v. Fed. Express Corp.*, No. 3:03-CV-2341-D, 2006 WL 680471, at *14 (N.D. Tex. Mar. 14, 2006) (Fitzwater, J.) (*quoting Jeanmarie v. United States*, 242 F.3d 600, 602 (5th Cir.2001)). Because the Receiver has failed to allege any factual support for a critical element of its professional negligence claim, Count I must be dismissed.

C. Count IV (Fraudulent Conveyance) Must Be Dismissed Because the Statute of Repose Has Extinguished the Claim

As with Count I (Negligence), the Receiver's Count IV (Fraudulent Conveyance) is untimely and must be dismissed. The Fraudulent Conveyance claim is untimely because it expired pursuant to a statute of repose rather than a statute of limitation.

The Receiver has asserted that amounts paid to Rothstein Kass from December 1, 2013 through April 1, 2014, were fraudulent conveyances and that the Receiver is entitled to recover those funds under TUFTA. (Complaint, ¶ 93.)[3] Causes of action arising under TUFTA may be extinguished under Section 24.010, which is appropriately titled, "Extinguishment of Cause of Action." TUFTA § 24.010(a) states that a claim "is extinguished unless" it is brought:

> (1) under Section 24.005(a)(1) of this code, within four years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant;
>
> (2) under Section 24.005(a)(2) or 24.006(a) of this code, within four years after the transfer was made or the obligation was incurred; or
>
> (3) under Section 24.006(b) of this code, within one year after the transfer was made.

TUFTA § 24.010 is a statute of repose. *Nathan v. Whittington*, 408 S.W.3d 870, 874 (Tex. 2013). Categorizing TUFTA § 24.010 as a statute of repose rather than simply a statute of limitations is a significant distinction. "[W]hile statutes of limitations operate procedurally to bar the enforcement of a right, a statute of repose takes away the right altogether, creating a substantive right to be free of liability after a specified time." *Id.* at 873 (*quoting Methodist*

[3] TUFTA § 24.005(a)(1) deems a transfer fraudulent when the debtor makes the transfer "with actual intent to hinder, delay, or defraud any creditor of the debtor . . . ." TUFTA §§ 24.005(a)(2) and 24.006(a) require a transfer be made "without receiving a reasonably equivalent value in exchange for the transfer or obligation, ..." when the debtor is (or is nearly) insolvent. TUFTA § 24.006(b) requires a transfer be made to an insider for an antecedent debt where the debtor is insolvent, and the insider should have known the debtor was insolvent.

Healthcare Sys. of San Antonio, Ltd. v. Rankin, 307 S.W.3d 283, 287 (Tex. 2010) ("*Rankin*")).

As the Texas Supreme Court noted in *Galbraith Eng'g Consultants, Inc. v. Pochucha*, 290 S.W.3d 863, 864 (Tex. 2009):

> Statutes of repose typically provide a definitive date beyond which an action cannot be filed. Unlike traditional limitations provisions, which begin running upon accrual of a cause of action, a statute of repose runs from a specified date without regard to accrual of any cause of action. Repose then differs from limitations in that repose not only cuts off rights of action after they accrue, but can cut off rights of action before they accrue. And while statutes of limitations operate procedurally to bar the enforcement of a right, a statute of repose takes away the right altogether, creating a substantive right to be free of liability after a specified time. Thus, the purpose of a statute of repose is to provide absolute protection to certain parties from the burden of indefinite potential liability.

Bankruptcy Court Judge Robert Jones in *In re Am. Hous. Found.*, 543 B.R. 245, 260 (Bankr. N.D. Tex. 2015) provided this insightful analysis regarding TUFTA's statute of repose:

> Both the discovery exception, which is explicit, and its treatment as an affirmative defense are contrary to the purpose of repose. "[T]he essential function of all statutes of repose is to abrogate the discovery rule…. More to the point, a statute of repose serves no purpose unless it has this effect." *Methodist Healthcare Sys. of San Antonio, Ltd., L.L.P. v. Rankin*, 307 S.W.3d 283, 290 (Tex. 2010); *accord CTS Corp. v. Waldburger*, —— U.S. ——, 134 S.Ct. 2175, 2182, 189 L.Ed.2d 62 (2014) ("The statute of repose limit is 'not related to the accrual of any cause of action; the injury need not have occurred, much less have been discovered.'" (*quoting* 54 C.J.S., Limitations of Actions § 7, p. 24 (2010))), reh'g denied, —— U.S. ——, 135 S.Ct. 23, 189 L.Ed.2d 874 (2014).
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> * * *
>
> A defendant should not have to raise an affirmative defense to avoid a claim extinguished by repose. An "affirmative defense" is defined as "[a] defendant's assertion of facts … that, if true, will defeat the plaintiff's … claim." Affirmative defense, Black's Law Dictionary (10th ed. 2015) (emphasis added). A statute of repose extinguishes the claim; it ceases to exist. To construe TUFTA's statute of repose to require a defendant to come-up with conclusive evidence dating back indefinitely to avoid protracted litigation is at odds with the purpose of such a statute. *See Rankin*, 307 S.W.3d at

> 290 ("To hold that a statute of repose must yield to the plaintiff's inability to discover her injury would treat a statute of repose like a statute of limitations, and would effectively repeal this and all other statutes of repose." (emphasis added)); *accord Galbraith*, 290 S.W.3d at 866 ("[T]he purpose of a statute of repose is to provide absolute protection to certain parties from the burden of indefinite potential liability." (quotation omitted and emphasis added)); *CTS Corp*., 134 S.Ct. at 2187 ("[A] statute of repose can prohibit a cause of action from coming into existence." (emphasis added)); *Goad v. Celotex Corp.*, 831 F.2d 508, 511 (4th Cir.1987) ("In contrast to statutes of limitation, statutes of repose serve primarily to relieve potential defendants from anxiety over liability for acts committed long ago." (emphasis added)).

Id. (alterations in original). Given this precedent from, among other sources, the Texas Supreme Court regarding statutes of repose, the most appropriate reading of TUFTA § 24.010(a)(1) is that a discovery exception would be entirely inconsistent with the nature of a statute of repose. Therefore, a purported discovery exception should not be given any legal effect.

Moreover, the Court's orders appointing the Receiver do not have any impact on TUFTA's statute of repose. The plain language of the orders only tolled *statutes of limitations*. *See, e.g.*, *SEC v. Faulkner*, Sept. 25, 2017 Order (Dkt. No. 142), ¶ 34 ("[A]s to a cause of action accrued or accruing in favor of one or more of the Receivership Defendants against a third person or party, any applicable statute of limitation is tolled during the period in which this injunction against commencement of legal proceedings is in effect as to that cause of action."). Even if these orders intended to extend beyond statutes of limitations, statutes of repose are not subject to judicially crafted rules of tolling or deferral. *Rankin*, 307 S.W.3d at 286. Statutes of repose generally may not be tolled, even in cases of extraordinary circumstances beyond a plaintiff's control. *CTS Corp. v. Waldburger*, 573 U.S. 1, 9 (2014); 4 Wright & Miller, *Federal Practice and Procedure* § 1056, p. 240 (3d ed. 2002) ("[A] critical distinction is that a repose period is fixed and its expiration will not be delayed by estoppel or tolling"); Restatement (Second) of Torts § 899, cmt. g (1977).

The consequence for the Receiver is that any fraudulent conveyance claims that could have been pursued against Rothstein Kass were extinguished on or about April 1, 2018, four years from the date of the last transfer alleged. Therefore, Count IV must be dismissed as the Receiver no longer has this cause of action.

D. Count IV (Fraudulent Conveyance) Must Be Dismissed Because the Receiver Fails to Allege Claims to Support Faulkner or the Breitling Entities' Fraudulent Intent

The Receiver has not sufficiently alleged facts that enable the court to draw the reasonable inference that Faulkner or the Breitling Entities acted with constructive or actual fraudulent intent when payments were made to Rothstein Kass to conduct the audit. Such threadbare recitations of the elements of a fraudulent transfer cause of action are insufficient to enable the court to reasonably infer that there were fraudulent transfers under TUFTA. *Basic Capital Mgmt., Inc. v. Dynex Capital, Inc.*, No. 3:17-CV-1147-D, 2018 WL 2100041, at *4 (N.D. Tex. May 7, 2018) (Fitzwater, J.). Thus, the fraudulent conveyance claim must be dismissed because the Receiver has not plead enough facts "to state a claim to relief that is plausible on its face." *Twombly*, 550 U.S. at 570.

E. Counts II and III (Aiding/Abetting/Participating in Faulkner's Tortious Activity) Violate Texas's Anti-Fracturing Rules

In Counts II and III, the Receiver alleges that the Defendants aided, abetted, or participated in Faulkner's breach of fiduciary duty (Count II) or his fraudulent scheme (Count III). Both of these counts must be dismissed because they violate the Texas rule prohibiting the fracturing of claims. The anti-fracturing rules prevent plaintiffs from converting what are actually professional negligence claims into other claims such as fraud, breach of contract, breach of fiduciary duty, or violations of the Deceptive Trade Practices Consumer Protection Act. *Won Pak*, 313 S.W.3d at 457. For the anti-fracturing rules to apply, the gravamen of a client's complaint must focus on the quality or adequacy of the professional's

representation. *Murphy v. Gruber*, 241 S.W.3d 689, 692–93 (Tex. App.—Dallas 2007, pet. denied). "If the gist of a client's complaint is that the attorney did not exercise that degree of care, skill, or diligence as attorneys of ordinary skill and knowledge commonly possess, then that complaint should be pursued as a negligence claim, rather than some other claim." *Deutsch v. Hoover, Bax & Slovacek, L.L.P*, 97 S.W.3d 179, 189 (Tex. App.—Houston 2002, no pet.). While most of the cases applying the anti-fracturing rules deal with claims against attorneys, the anti-fracturing rules apply equally to accountants. *See J.A. Green Dev. Corp. v. Grant Thornton, LLP*, No. 05-15-0029-CV, 2016 WL 3547964, *8 (Tex. App.—Dallas June 28, 2016) (anti-fracturing rules barred claims for breach of fiduciary duty, fraud, and negligent misrepresentation against accounting firm).

Without exception, all of the Receiver's claims focus on the quality or adequacy of Rothstein Kass's audit as demonstrated by the eight discrete areas in which the Receiver alleges that the Defendants failed "to exercise the degree of care, skill and competence that reasonably competent members of their profession would exercise under similar circumstances in conducting their audit of the Audit Entities, which audit was not conducted in accordance with Generally Accepted Auditing Standards." (Complaint, ¶ 1.)

The Receiver's focus on the audit's adequacy becomes apparent through his repetitive, near-verbatim allegations for each of the eight discrete subjects that form the basis for his claims:

- The Receiver contends that the Defendants were aware that the AFEs included with the CIMs and provided to potential investors were inflated, and the Defendants' solution to the inflated-AFE issue to defer the recognition of the revenues only delayed the recognition of assets on the financial statements. (Complaint, ¶¶ 37, 42.)

- The Receiver contends that the Defendants knew of Faulkner's practice of comingling investor proceeds from various offerings in the general operating accounts. (*Id.* at ¶ 44.)
- The Receiver contends that the Defendants knew of Faulkner's practice of overselling units in offerings. (*Id.* at ¶ 47.)
- The Receiver contends that Defendants knew that in 2011 and 2012 Breitling had reimbursed Faulkner for approximately $2.5 million in purported company expenses and that Breitling did not have policies in place to assign authority, accountability, or control, for these and other expenses. (*Id.* at ¶ 56.)
- The Receiver contends that Defendants knew of numerous material internal control issues at the Breitling Entities. (*Id.* at ¶ 62.)
- The Receiver contends that Defendants knew that investor funds were obtained through materially misleading AFEs, which grossly inflated, without any reasonable basis, the costs to drill and operate the oil-and-gas interests underlying the offerings. (*Id.* at ¶ 67.)
- The Receiver contends that Rothstein Kass had to consider the Breitling Entities' ability to continue operations as a going concern. (*Id.* at ¶ 71.)
- The Receiver contends that Defendants failed to properly consider and apply GAAP guidance governing consolidation for Breitling's financial statements. (*Id.* at ¶ 73.)

With unwavering repetition, the Receiver finds fault with each of the foregoing purported shortcomings because Defendants:

- continued to conduct the audit;

- failed to adjust the scope of the audit to account for potentially fraudulent activity;
- failed to apply heightened scrutiny in the audit;
- ultimately issued an unqualified audit opinion of the Audit Entities' financial statements, and, accordingly;
- violated "their duty to exercise the ordinary care, skill, or diligence that a certified public accountant of ordinary skill and knowledge commonly possesses."

(Complaint, ¶¶ 43, 46, 55, 56, 61, 65, 70, 75.)

The "gist" of every single claim by the Receiver "that the [accountant] did not exercise that degree of care, skill, or diligence as [certified public accountants] of ordinary skill and knowledge commonly possess, then that complaint should be pursued as a negligence claim, rather than some other claim." *Deutsch*, 97 S.W.3d at 189. His claims are for professional negligence. Period. Therefore, Counts II and III for allegedly aiding, abetting, and/or participating in a breach of fiduciary duty or fraudulent scheme are nothing more than an attempt by the Receiver to fracture and re-label professional negligence claims, which is forbidden by Texas's anti-fracturing rules. As a result, Counts II and III must be dismissed.

F. Counts II and III Fail to Allege That Defendants Substantially Assisted Faulkner in Tortious Conduct

To aid and abet, one must have "knowledge" of the primary actor's tortious conduct and "substantially assist" in effecting that conduct. *In re Enron Corp. Secs., Derivative & "ERISA" Litig.*, 511 F. Supp. 2d 742, 782 (S.D. Tex. 2005) *citing Morin v. Trupin*, 711 F. Supp. 97, 112 (S.D.N.Y. 1989) (elements of aiding and abetting are (1) existence of a primary fraud, (2) aider and abettor must have knowledge of that fraud, and (3) the aider and abettor must provide substantial assistance to achieve the primary fraud). Generally, substantial assistance means the

secondary party takes affirmative steps to aid the wrong. W. Page Keeton et al., *Prosser & Keeton on the Law of Torts* § 46, at 323-24 (5th ed. 1984).

The Receiver has failed to allege that the Defendants substantially assisted Faulkner with any tortious activity. To be sure, the Receiver repeatedly alleges at great length that Defendants failed to perform an adequate audit, but fails to link this audit to Faulkner's wrongful conduct. The Receiver does not make a single allegation, for example, that Faulkner used the audit opinion or the underlying financial statements to raise "$150 million in gross proceeds from investors through the offer and sale of oil and gas-related securities." (Complaint, ¶ 2.) Indeed, much of Faulkner's wrongful conduct occurred well before the audit opinion was even issued. For example, the Receiver alleges Defendants issued the audit opinion "on or about April 14, 2014" and that the majority of the $150 million Faulkner raised was raised from investors prior to that date. (*See* Complaint ¶¶ 13, 21.) Even after that date, the Receiver alleges that "Faulkner 'outsourced' BECC's sales mechanism (previously undertaken to BOG and BRC directly) to Crude and Patriot," two entities that Defendants did not audit. (Complaint ¶¶ 26-27.) The Receiver fails to allege that the audit opinion or the underlying financial statements assisted Faulkner's wrongful conduct in any way, let alone substantially.

Consequently, Counts II and III should be dismissed because the Receiver has failed to allege that the Defendants substantially assisted Faulkner in his alleged tortious activity.

G. The Causes of Action for Aiding/Abetting Should Not Be Extended to Professional Negligence Claims

The Texas Supreme Court has not expressly recognized a cause of action for aiding and abetting based on professional negligence. *First United Pentecostal Church of Beaumont v. Parker*, 514 S.W.3d 214, 224 (Tex. 2017). The Restatement (Second) of Torts § 876(b) states:

> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he ... knows that the other's conduct constitutes a breach of

> duty and gives substantial assistance or encouragement to the other so to conduct himself . . . .

Id. The Texas Supreme Court in *Juhl v. Airington*, 936 S.W.2d 640, 644 (Tex. 1996), has addressed this provision, stating the Restatement's theory—also called concert of action—has a specific and narrow purpose: to deter anti-social or dangerous behavior. Thus, cases employing the concert of action theory for aiding and abetting have involved drag racing, group assault, reckless driving, and assisting a driver in becoming intoxicated or similar conduct posing a high degree of risk to others. *See id.* at 644-45. Indeed, the Texas Supreme Court has described the type of conduct appropriate for aiding and abetting liability as "highly dangerous, deviant, or anti-social group activity which was likely to cause serious injury or death to a person or certain harm to a large number of people." *Id.*

Other Texas courts have refused to extend the "concert of action" theory that did not involve highly dangerous, deviant, or anti-social group activity. *III Forks Real Estate, L.P. v. Cohen*, 228 S.W.3d 810, 816 (Tex. App.–Dallas 2007) (aiding a misrepresentation of assets on a financial statement is not the type of activity addressed in the concert of action cases noted in *Juhl*); *W. Fork Advisors, LLC v. SunGard Consulting Servs., LLC*, 437 S.W.3d 917, 921–22 (Tex. App.–Dallas 2014) (misappropriation of trade secrets could not be cast as dangerous or deviant or antisocial); *McPeters v. LexisNexis*, No. 4:11-CV-02056, 2013 WL 12320078, at *3 (S.D. Tex. May 1, 2013) (high e-filing fees could be considered an egregious harm, but it is not the type of anti-social or dangerous harm that is contemplated by a concert of action claim.); *Martinez v. Ford Motor Credit Co.*, No. 04-11-03060CV, 2012 WL 3711347, at *5 (Tex. App.–San Antonio Aug. 29, 2012) (failure to inform automobile purchaser of vehicle's prior accident history was not the "highly dangerous, deviant, or anti-social group activity necessary to impose liability under the reasoning of *Juhl*.").

In sum and substance, the Receiver's claims are for professional negligence. Auditing financial statements, no matter how purportedly negligent, does not implicate the highly dangerous, deviant, or anti-social group activity required by Texas Supreme Court precedent. Therefore, Counts II and III that allege aiding or abetting of a breach of fiduciary duty or a fraudulent scheme must be dismissed.

H. The Claim for "Participation in Faulkner's Fraudulent Scheme" Must Be Dismissed for Lack of Specificity

The Receiver alleges that Defendants participated in the fraud with Faulkner. (Complaint, ¶ 89.) To the extent the Receiver intended this claim to assert direct liability for fraudulent conduct by either Defendant, the Receiver has utterly failed to set forth any such allegations, let alone allegations identifying Defendants' specific fraudulent conduct. The Receiver makes the following conclusory allegations (repeatedly) about Rothstein Kass:

- The myriad red flags that Defendants encountered during their audit *should* have triggered heightened scrutiny. (*Id.*)
- Defendants *failed* to adjust the scope of the audit to account for potentially fraudulent activity. (*Id.*)
- Defendants *failed* to resign from the audit. (*Id.*)
- Rothstein Kass issued an unqualified audit opinion notwithstanding that it knew, or but for its gross negligence would have known, that Faulkner was using Breitling to implement a vast fraudulent scheme. (*Id.* at ¶ 34.)

These actions or omissions by Rothstein Kass do not rise to the level of fraud. And even if they did, the Receiver has failed to plead this claim with the required particularly because none of his allegations address the "who, what, when, where, and how" of this purported fraud claim as required by Rule 9(b). *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 724 (5th Cir. 2003).

V. CONCLUSIONS

For the foregoing reasons, Count I should be dismissed because the Receiver has failed to allege reliance by the Breitling Entities and the statute of limitations for professional negligence claims has expired. Counts II and III should be dismissed because (i) they impermissibly violate Texas' anti-fracturing rules; (ii) the Receiver has failed to allege substantial assistance; and (iii) in Texas, an aiding and abetting theory of liability may not be premised on professional negligence because it is not dangerous, deviant, or antisocial. Count III should further be dismissed to the extent it alleges without the requisite specificity that Defendants participated in fraudulent conduct. Count IV should be dismissed because the Receiver's right to bring an action for fraudulent conveyance under Texas law has been extinguished and because the Receiver has failed to allege sufficient facts to establish fraudulent conveyances.

Date: September 3, 2019 Respectfully submitted

By: */s/ Nicolas Morgan*

E. LEON CARTER
State Bar No. 03914300
lcarter@carterarnett.com
LINDA R. STAHL
State Bar No. 00798525
lstahl@carterarnett.com
COURTNEY BARKSDALE PEREZ
State Bar No. 24061135
cperez@carterarnett.com
CARTER ARNETT PLLC
8150 N. Central Expy., Suite 500
Dallas, Texas 75206-1860
(214) 550-8188 (main)
(214) 550-8185 (facsimile)

NICOLAS MORGAN (*admitted pro hac vice*)
Cal. State Bar No. 166441
nicolasmorgan@paulhastings.com
THOMAS ZACCARO (*admitted pro hac vice*)
Cal. State Bar No. 183241
thomaszaccaro@paulhastings.com
PAUL HASTINGS LLP
515 South Flower Street
Twenty Fifth Floor
Los Angeles, CA 90071
(213) 683-6000 (main)
(213) 627-0705 (facsimile)

Attorneys for Defendants
ROTHSTEIN, KASS & COMPANY, PLLC and
BRIAN MATLOCK

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing document has been served to all counsel of record in accordance with the Federal Rules of Civil Procedure on September 3, 2019 via ECF notification.

/s/ Nicolas Morgan
Nicolas Morgan

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

THOMAS L. TAYLOR, III, in his capacity as Court-appointed temporary receiver for Breitling Energy Corp. et al., Plaintiff v. ROTHSTEIN KASS & COMPANY, PLLC and BRIAN MATLOCK, Defendants.	§ § § § § § § § § § § §	NO. 3:19-cv-01594-D

[PROPOSED] ORDER GRANTING DEFENDANTS' MOTION TO DISMISS

Upon the Defendants' Motion to Dismiss dated September 3, 2019 and Plaintiff having opposed the motion, the Court, having considered the papers submitted and the oral argument presented by counsel,

HEREBY ORDERS THAT:

1. Defendants' Motion to Dismiss is GRANTED. Plaintiff's Original Complaint is dismissed pursuant to Federal Rule of Civil Procedure 12(b)(6) because the Complaint fails to state any claims upon which relief can be granted.

IT IS SO ORDERED:

Dated: _____

_____
Sidney A. Fitzwater
Senior Judge