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

THOMAS L. TAYLOR III, solely in his capacity as Court-appointed temporary receiver for Breitling Energy Corporation, *et al.*,	§	
Plaintiff,	§	
	§	**CIV. ACTION NO. 3:19-cv-02602-D**
v.	§	
	§	
SCHEEF & STONE, LLP, ROGER CRABB, and MITCH LITTLE,	§	
Defendants.	§	

RECEIVER'S RESPONSE AND BRIEF IN OPPOSITION TO DEFENDANTS SCHEEF & STONE, LLP, ROGER CRABB, AND MITCH LITTLE'S MOTION TO DISMISS RECEIVER'S FIRST AMENDED COMPLAINT

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Plaintiff Thomas L. Taylor III ("Receiver" or "Plaintiff"), solely in his capacity as temporary Receiver for the Breitling group of companies,[1] hereby files this Response and Brief in Opposition to the Motion to Dismiss filed by Defendants Scheef & Stone, LLP, Roger Crabb, and Mitch Little (collectively "Defendants") [Docs. 10 and 11] (collectively the "Motion" or "Brief"), and would respectfully show the Court as follows:

I. BACKGROUND

This action arises out of the massive securities fraud perpetrated by Christopher A. Faulkner ("Faulkner") through which Faulkner used and manipulated the Breitling entities to fraudulently raise tens of millions of dollars from investors through the offer and sale of oil and gas-related securities from 2011 to 2016. During this time period, Faulkner (individually and through separate entities under his control) misappropriated approximately $32.8 million in Breitling entity funds, both through the receipt of transfers directly from Breitling entity accounts and through the payment of Faulkner's personal expenses from Breitling entity bank and credit card accounts. Faulkner made use of the assets of the Breitling entities to fund a lavish lifestyle -- including multiple homes across the country, a fleet of luxury cars, and international travel.

Given the Court's knowledge of the overall Breitling fraud scheme, the Receiver will not burden the Court with a full recitation of the facts outlined in the Receiver's First Amended Complaint [Doc. 7] (the "FAC"), but instead sets forth below in bullet point format the facts most pertinent to the Receiver's claims against Defendants. In summary, the Receiver's FAC alleges that Defendants, with knowledge that Faulkner was routinely and consistently directing and causing the Breitling entities to engage in rampant fraud and securities laws violations: (i)

[1] Specifically, Plaintiff brings this action in his capacity as court-appointed Receiver for Breitling Oil & Gas Corporation ("BOG"), Breitling Royalties Corporation ("BRC"), Breitling Energy Corporation ("BECC"), and Crude Energy, LLC ("Crude Energy"), Crude Royalties, LLC ("Crude Royalties") and Patriot Energy, Inc. ("Patriot"). Complaint at ¶ 9.

facilitated Breitling's offer and sale to investors of high risk, unregistered securities by unlicensed securities sales personnel who illegally worked on a commission basis; and (ii) shielded and protected Faulkner and the Breitling Entities from investor claims and regulatory scrutiny in order to keep Faulkner in business selling illicit and illegal securities through the Breitling entities.

Specifically, the FAC alleges that Defendants knew that:

- Faulkner had little to no experience in the oil and gas industry prior to forming Breitling. FAC ¶¶ 36, 97.
- Faulkner's prior business was in Internet services and web-hosting, which business failed and was abandoned by Faulkner, leaving a string of creditors and lawsuits. FAC ¶¶ 36, footnote 2, 41, 113.
- Faulkner directed the Breitling Entities to operate a securities sales "boiler room" operation using unlicensed sales personnel – some with prior documented regulatory violations [FAC ¶¶ 63, 73] - to engage in "general solicitation" of investors via Breitling's Website, internet advertising using Google search engines to promote its offerings, and via "cold calls" to investors. FAC at ¶¶ 4, 6, 7, 42, 57-58 (including footnote 5), 64, 76, 85, 94, 98, 102.
- Faulkner was causing the Breitling entities to pay its unlicensed securities sales personnel transaction-based compensation (sales commissions) as if they were securities brokers in violation of U.S. securities laws. FAC ¶¶ 6, 43, 97, 109.
- Breitling's unlicensed sales personnel, some of whom had prior negative regulatory histories [FAC ¶¶ 63, 73] deceptively marketed and promoted the Breitling securities as, *e.g.*, "virtually risk free", with a "90% success rate", "return of principal in 8-12 months", "low risk and high reward". FAC ¶¶ 42, 57, 85.
- Breitling's unlicensed sales personnel marketed and promoted the unregistered Breitling securities to "unaccredited" and unsophisticated investors, including young investors, "first time" investors, and the elderly, in violation of securities laws. FAC ¶¶ 57, 59, 73.
- Faulkner was inflating the AFEs ("authorization for expenditures") for the oil and gas wells, and not disclosing the actual AFEs to prospective investors. FAC ¶¶ 70-71, and 107 (as to Crude).
- Faulkner was creating the AFEs himself despite not being the operator of the wells (and therefore lacking the necessary information and control over drilling and other operational cost details) and notwithstanding the industry norm of having the operator of the well perform this task. FAC ¶125.

- Breitling didn't have accurate information about the wells it was allegedly investing in. FAC ¶ 76.

- Breitling was not paying the actual well operators the AFE operating expenses (that had supposedly been funded by the investors' moneys) as they came due, leading well operators to threaten to shut-in or place liens on the wells in which the Breitling investors had purchased fractionalized interests. FAC ¶¶ 68, 88, 95.

- An oil and gas industry publication serving the Bakken shale region, Petroleum News, published an article reporting that it could find no evidence that Breitling had any interests in any oil and gas wells in the Bakken field despite its sales of fractional interests in such alleged wells to investors. FAC ¶ 92.

- A Dallas-based blogger reported that Faulkner was a self-invented "hoax" with no experience in the oil and gas industry who was selling oil and gas interests in wells that didn't even exist, and that Faulkner had sued Petroleum News for defamation and his case had been dismissed and he had been ordered to pay the publication's attorneys' fees in the amount of $100,000. FAC ¶ 113.

- Faulkner was spending between 50% and 60% of Breitling sales revenues on "lead generation and advertising" expenses or "professional services". FAC ¶ 82.

- The SEC had launched an investigation of Breitling, and requested documents including Breitling's bank records. FAC ¶ 78.

- Faulkner refused to turn over Breitling's bank records to the SEC and instead wanted to just give the SEC "*more BS info*". FAC ¶ 78 and footnote 6.

- Faulkner lied to the SEC that no investors had ever claimed to have been misled by Breitling. FAC ¶ 80.

- Some 17 different Breitling investors made claims against Breitling for, *inter alia*, securities fraud, including for fraudulently inflating and "fabricating" the AFEs, moving investors out of their contracted-for well prospects without authorization, substituting wells without authorization, and misrepresenting other material facts – including whether the well prospects offered by Breitling even existed. FAC ¶¶ 52, 53, 57, 61, 62, 69-71, 77, 87-89, 91, 95, 100, 103, 104, 106, 110, 112, 113.

- Multiple (at least 8) state securities regulators accused Breitling of engaging in illegal securities sales practices including sales of unregistered securities to unaccredited investors using "general solicitation". FAC ¶¶ 36-37, 56, 59, 63, 67, 74, 85, 98, 102, 104, 111.

- The SEC investigation had converted into a formal fraud investigation, allowing the SEC to issue subpoenas for Breitling's financial information, and the SEC was going to (and eventually did) focus its investigation on Breitling's inflation of its AFEs,

heavy spending on advertising and promotional expenses, and illegal payment of sales commissions to its unlicensed securities sales staff. FAC ¶¶ 83, 97, 122.

- Faulkner decided to spin off the existing Breitling businesses (and liabilities) to the newly created Crude entities as part of the creation of the public company Breitling Energy Corporation through a reverse merger. FAC ¶105.

Despite such knowledge, Defendants assisted Faulkner to perpetrate his illicit securities sales schemes by:

- Counseling and assisting Faulkner to establish the "bonus" compensation program to enable Breitling's unlicensed securities sales staff to disguise that they were receiving transaction-based compensation (sales commissions) for the sale of securities in violation of U.S. securities laws. FAC ¶¶ 4, 6, 34, 43, 49, 97.

- Filing fraudulent Reg D statements with the SEC on Breitling's behalf that omitted to disclose the illegal commissions being paid to Breitling's unlicensed securities sales staff. FAC ¶ 46.

- Preparing, reviewing and "blessing" the Breitling offering documents ("CIMS") used by Faulkner to lure investors, which CIMs were replete with material misrepresentation, and continuing to issue and/or approve the fraudulent CIMs *even after* receiving evidence and/or allegations that the CIMs contained fraudulent misrepresentations and omissions and were being sent to investors as part of a general solicitation campaign. FAC ¶¶ 17, 34, 40, 51, 57, 62, 66, 70, 81, 104, 111, 115.

- Ensuring that the CIMs included language that would make it difficult if not impossible for defrauded investors to recover their investment funds from Breitling and to "assist in confidentiality" in case investors made claims against Breitling. FAC ¶¶ 51, 66, 90.

- Advising Breitling that its unlicensed sales representatives' sales practices did not constitute "general solicitation" despite Breitling's use of the Internet to promote its securities offerings and use of "cold calls" as a sales tactic. FAC ¶¶ 42, 54.

- Defending the Breitling entities against some 17 investor fraud claims and preparing rescission settlement agreements designed to conceal the wrongdoing and "*keep [the investors'] mouth shut*". FAC ¶¶ 53, 57, 61, 62, 69-71, 87-89, 91, 95-96, 100, 103, 104, 106, 110, 112, 113.

- Defending the Breitling entities (including Crude) against claims of illegal securities sales practices made by multiple state securities regulators, including securities regulators in Texas [FAC ¶¶ 36-37], Pennsylvania [FAC ¶¶ 56, 59, 63], Arkansas [FAC ¶ 67], South Dakota [FAC ¶¶ 74, 79], Nebraska [FAC ¶ 85], Kansas [FAC ¶¶ 93, 98, 102], North Dakota [FAC ¶ 104], and Wisconsin [FAC ¶ 111].

- Lying to regulators and/or allowing Faulkner to lie to regulators (the SEC) in Defendants' presence [FAC ¶¶ 59, 80, 93].

- Repeatedly counseling and advising Faulkner on ways to keep his wrongdoing from being discovered by investors, securities regulators and the general public – including through confidential settlements with investors and state securities regulators. FAC ¶¶ 55, 56, 60-63, 101, 103, 112.

- Counseling and assisting Faulkner on document production to the SEC, including counseling Faulkner to hold back documents requested by the SEC, including Breitling's bank records, and advising Faulkner that there was only a 30% chance that the SEC would take action to force Faulkner to produce the requested documents. FAC ¶ 78 and footnote 6.

- Representing the newly formed Crude entities to carry on the same illegal unregistered securities offering business previously performed by the Breitling entities prior to the reverse merger, including the preparation of new CIMs for Crude, and counseling and assisting Faulkner to establish the same "bonus" compensation program for Crude to enable Crude's unlicensed securities sales staff (formerly employed by Breitling) to disguise that they were receiving transaction-based compensation for the sale of securities in violation of U.S. securities laws. FAC ¶¶ 107, 108, 111, 115.

- Neglecting to investigate or follow up on the veracity of the article published by Petroleum News reporting that it could find no evidence that Breitling had any interests in any oil and gas wells in the Bakken field, despite its sales of fractional interests in such alleged wells to investors. FAC ¶¶ 92, 123.

- Neglecting to advise Faulkner to cease and desist from directing and causing the Breitling entities' sales personnel to promote and offer unregistered securities via "general solicitation" in violation of U.S. securities laws, including by promoting its oil and gas offerings on its Website, using radio spots, cold calls, and using Google search engines to advertise its offerings on the Internet. FAC ¶¶ 127, 129.

- Neglecting to advise Faulkner to cease and desist from directing and causing the Breitling entities (and, later, Crude) to pay their unlicensed securities sales personnel transaction-based compensation (sales commissions) in violation of U.S. securities laws. FAC ¶¶ 127, 129.

- Neglecting to advise Faulkner that he needed to disclose to investors that Breitling was spending between 50% and 60% of their money on "lead generation and advertising" expenses or "professional services". FAC ¶¶ 82, 129.

- Neglecting to advise Faulkner that he needed to disclose to investors that some 17 different Breitling investors had made claims against Breitling for, *inter alia*, securities fraud, including for fraudulently inflating and "fabricating" the AFEs, moving investors out of their contracted-for well prospects without authorization, substituting wells without authorization, and misrepresenting other material facts –

including whether the well prospects offered by Breitling even existed. FAC ¶¶ 52, 53, 57, 61, 62, 69-71, 77, 87-89, 91, 95, 100, 103, 104, 106, 110, 112, 113, 126-127, 129.

- Neglecting to advise Faulkner that he needed to disclose to investors that multiple state securities regulators had accused Breitling of engaging in illegal securities sales practices including sales of unregistered securities to unaccredited investors using "general solicitation". FAC ¶¶ 36-37, 56, 59, 63, 67, 74, 85, 98, 102, 104, 111, 126-127, 129.

- Neglecting to advise Faulkner that he needed to disclose to investors that the SEC had launched an investigation of Faulkner and the Breitling entities which converted into a formal fraud investigation, allowing the SEC to issue subpoenas for Breitling's financial information, and that the SEC was going to (and eventually did) focus its investigation on Breitling's inflation of its AFEs, heavy spending on advertising and promotional expenses, and illegal payment of sales commissions to its unlicensed securities sales staff. FAC ¶¶ 83, 97, 122, 126-127, 129.

The facts set forth above support the Receiver's claims for professional negligence/malpractice, as well as for participation in breach of fiduciary duty and fraudulent schemes. The bottom line is that a jury should be charged with both sets of claims, and a jury should be allowed to determine whether Defendants knowingly participated in Faulkner's fraudulent schemes using the Breitling entities in violation of the fiduciary duties he owed to the entities, or whether Defendants were merely negligent in not realizing that Faulkner was directing and causing the Breitling entities to commit fraud and violate securities laws and that Defendants were participating therein.

A 12(b)(6) motion is clearly not the appropriate vehicle to resolve such questions. Defendants' arguments in favor of early dismissal fail. As demonstrated below, the Receiver's claims are properly pled and well-stated under applicable law.

II. ARGUMENT AND AUTHORITIES

A. Standard for Dismissal under Rule 12(b)(6)

In reviewing a motion to dismiss under FED. R. CIV., the Court must accept all well-pleaded allegations as true and view them in the light most favorable to the plaintiff. *Martin K. Eby Constr.*

Co., v. Dallas Area Rapid Transit, 369 F.3d 464, 467 (5th Cir. 2004); *SEC v. Reynolds*, 2008 WL 3850550, at *3 (N.D. Tex. Aug. 19, 2008). Motions to dismiss are viewed with disfavor and rarely granted. *Priester v. Lowndes County*, 354 F.3d 414, 418 (5th Cir. 2004); *SR Int'l Bus. Ins. Co. v. Energy Future Holdings Corp.*, 539 F. Supp. 2d 871, 874-75 (N.D. Tex. 2008). A motion under Rule 12(b)(6) should be granted only if the complaint does not include "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). "Factual allegations must be enough to raise a right to relief above the speculative level on the assumption that all of the complaint's allegations are true (even if doubtful in fact)." *Id.* at 545 (internal citations omitted).

The Receiver alleges that the Defendants engaged in conduct that was, at best, negligent and which assisted Faulkner to breach fiduciary duties owed to the Breitling entities and engage in fraud. As such the Receiver is not required to comply with the pleading standard outlined in FED. R. CIV. P. 9(b).[2] But even assuming *arguendo* that the Receiver must comply with Rule 9(b), said rule is not intended "to procure punctilious pleading detail." *SEC v. Brady*, 2006 WL 1310320, at *3 (N.D. Tex. May 12, 2006); *see also SEC v. Sharp Capital, Inc.*, 1999 WL 242691 at *2 (N.D. Tex. Apr. 16, 1999) (noting with respect to Rule 9(b) that "courts have never required a plaintiff to plead detailed evidence in its complaint") (citation omitted).

As demonstrated below, dismissal of the Receiver's claims is unwarranted, as the Receiver easily meets and exceeds all applicable pleading requirements.

B. The Receiver States Valid Claims for Participation in Torts

[2] FED. R. CIV. P. 8 applies to Plaintiffs' claims for negligence. *See Smith v. Texas*, 2012 WL 5868657 at *12 (S.D. Tex. 2012) (applying Rule 8 to malpractice claim); *see also Randolph v. Resolution Trust Corp.*, 995 F.2d 611, 616 n.3 (5th Cir. 1993; *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 339 (5th Cir. 2008) Rule 8 also applies to the Receiver's fraudulent transfer claims. *See GE Capital Comm., Inc. v. Wright & Wright, Inc.*, 2009 WL 5173954, at *10 (N.D. Tex. 2009)

Ignoring this Court's recent decision in the related *Taylor v. Rothstein Kass* case,[3] Defendants argue that Texas no longer recognizes claims for participation in breach of fiduciary duty and participation in fraud. But as the Court recognized in *Taylor*, such argument is meritless. The Texas Supreme Court long ago recognized the cause of action for participation in breach of fiduciary duty as being the "***settled law***" of Texas and has never reversed or withdrawn that decision. *Taylor*, 2020 U.S. Dist. LEXIS 17435 at *17-19 and footnote 4; *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 514 (1942) ("It is settled law of this State that where a third party knowingly participates in the breach of duty of a fiduciary, such third party becomes a joint tortfeasor with the fiduciary and is liable as such."). Over the ensuing years, numerous Texas intermediate appellate courts and federal courts have consistently recognized participation in breach of fiduciary duty as a valid cause of action under Texas law.[4]

The Fifth Circuit has also recognized this cause of action under Texas law. *Meadows v. Hartford Life Ins. Co.*, 492 F.3d 634, 639 (5th Cir. 2007) ("Under Texas law, 'where a third party knowingly participates in the breach of duty of a fiduciary, such third party becomes a joint tortfeasor with the fiduciary and is liable as such'"). As such, Defendants' Motion must be denied as to the Receiver's claim for knowing participation in breach of fiduciary duty.

Based on this Court's decision in *Taylor*, the Receiver concedes that recent developments in Texas law as interpreted by the Fifth Circuit arguably call into question his common law aiding

[3] *Taylor v. Rothstein Kass & Co. PLLC*, 2020 U.S. Dist. LEXIS 17435 (N.D. Tex. 2020) ("*Taylor*").

[4] *See, e.g., Milligan v. Salamone*, No. 1:18-CV-327-RP, 2019 WL 1208999 *7 (W.D. Tex. 2019) (denying law firm's motion to dismiss knowing participation claim because plaintiff plausibly alleged lawyers' knowledge of officer's and director's violation of fiduciary duties); *Hunter Bldgs. & Mfg., L.P. v. MBI Global L.L.C.*, 436 S.W.3d 9, 15 (Tex. App.—Houston [14th Dist.] 2017, pet. denied) ("Under Texas common law, if a third party knowingly participates in a defendant's breach of a fiduciary duty owed to a plaintiff, the third party is jointly liable with the defendant for damages to the plaintiff proximately caused by this breach of fiduciary duty. . . ."); *CBIF Ltd. P'ship v. TGI Friday's Inc.,* No. 05-15-00157-CV, 2017 Tex. App. LEXIS 3605, *42-45 (Tex. App.—Dallas Apr. 21, 2017, pet. denied) ("When a defendant knowingly participates in the breach of fiduciary duty, he becomes a joint tortfeasor and is liable as such"); *James J. Flanagan Shipping Corp. v. Del Monte Fresh Produce, N.A. Inc.*, 403 S.W.3d 360, 368 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Graham Mortg. Corp. v. Hall*, 307 S.W.3d 472, 479 (Tex. App.—Dallas 2010, no pet.). *see also Nelson v. Vernco Constr., Inc.*, No. 08-10-00022-CV, 2018 Tex. App. LEXIS 3938 (Tex. App.—El Paso May 31, 2018, pet. filed) (affirming jury verdict for participation in breach of fiduciary).

and abetting fraud claim, and the Receiver hereby notifies the Court that he will no longer pursue his claim for common law aiding and abetting fraud.[5] Nevertheless, in *Taylor* this Court distinguished between a claim of aiding and abetting fraud (which the Court held not to exist under Texas law) and a claim for participation in a fraudulent scheme. *Taylor*, 2020 U.S. Dist. LEXIS 17435 at *22-24. In analyzing the latter claim, the Court concluded that because the Receiver in *Taylor* had not plead that the Rothstein Kass defendants had, themselves, "engaged in fraud", the Receiver's claim had to be dismissed. *Id*., at *22-23.

In contrast, here the Receiver has plead that Defendants directly engaged in fraud (in concert with Faulkner) by (i) assisting Faulkner to sell his illicit, unregistered securities through the fraudulent CIMs that were prepared or "blessed" by Defendants;[6] (ii) filing fraudulent Reg D statements with the SEC on Breitling's behalf that omitted to disclose the illegal commissions being paid to Breitling's unlicensed securities sales staff;[7] and (iii) lying to regulators and otherwise conspiring with Faulkner to cover up and conceal his fraudulent activities.[8] Courts in Texas have held such conduct sufficient to support a claim for participation in a fraudulent scheme. See e.g., *Airport Blvd. Apts., Ltd. v. NE 40 Partners, L.P., (In re NE 40 Partners, Ltd.)*, 411 B.R. 352, 360-361 (Bankr. S.D. Tex. 2009) (Texas recognizes third party liability for participation in fraud, even where the third party made no misrepresentations itself, including through "*silent acquiescence for the fraudulent misrepresentations of a third party*") (citing *Corpus Christi Area Teachers Credit Union v. Hernandez*, 814 S.W.2d 195, 198 (Tex. App.-- San Antonio 1991, no

[5] *Taylor*, 2020 U.S. Dist. LEXIS 17435 at *14 (citing, *inter alia*, *Midwestern Cattle Mktg. LLC v. Legend Bank NA*, 2019 U.S. App. LEXIS 36966 (5th Cir. 2019)).

[6] FAC ¶¶ 17, 34, 40, 51, 57, 62, 66, 70, 81, 104, 111, 115,

[7] FAC ¶ 46.

[8] FAC ¶¶ 59, 80, 93; FAC 55, 56, 60-63, 101, 103, 112. This includes counseling and assisting Faulkner to establish the "bonus" compensation program to enable Breitling's unlicensed securities sales staff **to disguise** that they were receiving transaction-based compensation (sales commission) for the sale of securities in violation of U.S. securities laws [FAC ¶¶ 4, 6, 34, 43, 49, 97], and counseling Faulkner to hold back documents requested by the SEC, including Breitling's bank records. FAC ¶ 78 and footnote 6.

writ); *Healthcare Corp. v. Cottey*, 72 S.W.3d 735, 745 (Tex. App.--Waco 2002, no pet.)).[9] And such a claim does not require proof that the participant profited from the fraud.[10] *Id.*, *see also Crawford v. Ancira*, 1997 Tex. App. LEXIS 2263 at *8-9 (Tex. App. – San Antonio 1997, no writ).

As such, the Receiver has sufficiently plead a claim that Defendants participated in Faulkner's fraudulent scheme to survive the present Motion.

C. The Receiver's Tort Claims Do Not Violate Texas' Anti-Fracturing Rules

Defendants next argue that the Receiver has improperly "fractured" the professional negligence claim into several causes of action, including participation in breach of fiduciary duty, and participation in a fraudulent scheme. But the Receiver's bullet point summary of allegations from his FAC detailed above clearly demonstrates that Defendants' conduct (as alleged) goes well beyond mere negligence and, similar to the court's determination as to Rothstein Kass in *Taylor*, would "exceed…negligence, and, *at a minimum*, give rise to a separate claim for participation in breaches of fiduciary duties." *Taylor*, at *18 (emphasis added). Indeed, in the latter portion of his bullet point summary of allegations detailed above, the Receiver splits out what he considers to be allegations of negligent conduct from the allegations that would support a claim for participation in Faulkner's fraud and breaches of fiduciary duty. See *supra* at pps. 2-6. It is the Receiver's position that Defendants' conduct rises to the level of direct participation in Faulkner's fraud and breaches of fiduciary duties owed to the entities, but that, at a minimum, Defendants were negligent in not realizing that they were assisting Faulkner to manipulate and cause the

[9] S*ee also Matis v. Golden*, 228 S.W.3d 301, 310 (Tex. App. – Waco 2007, no pet.); *In re Arthur Andersen LLP*, 121 S.W. 3d 471, 481 (Tex. App. – Hous. [14th Dis.] 2003, orig. proceeding [mand. Denied]); *Skrepnek v. Shearson Lehman Bros. Inc.*, 889 S.W. 2d 578, 580 (Tex. App. – Hous. [14th Dis. 1994, no writ).

[10] At any rate, the Receiver has alleged in the FAC that Defendants were more concerned with ensuring that Faulkner pay their fee bills than ensuring that they weren't participating in a fraudulent securities scam. FAC at ¶ 118.

Breitling entities to commit fraud and violate securities laws.[11] The jury should be instructed and charged on both theories of the case and should be permitted to decide the question of Defendants' knowledge, i.e., whether it rises to the level of "knowing participation" or constitutes mere negligence.[12]

This alternative theory of liability is entirely consistent with Texas law, which is clear that "when cases say that clients cannot divide or fracture their negligence claims against their attorneys into other claims, this does *not* mean that clients can sue their attorneys *only* for negligence." *Beck v. Law Offices of Edwin J. Terry*, 284 S.W. 3d 416, 427 (Tex. App. – Austin 2009)) citing *Deutsch v. Hoover, Bax & Slovacek, LLP*, 97 S.W. 3d 179, 190 (Tex. App. – Hous. [14th Dis.] 2003) (emphasis added). Nor does the anti-fracturing rule necessarily bar a client from ***simultaneously*** asserting professional negligence and non-negligence claims against an attorney that are predicated on some common or overlapping facts. *Id.; see also Floyd v. Hefner*, 556 F. Supp. 2d 617, 659 (S.D. Tex. 2008)(holding that Texas law permits a party to bring ***both*** a malpractice action against its attorney and a separate claim for the lawyer's assistance with the breach of ***another's*** fiduciary duties); *In re TOCFHBI, Inc.*, 413 B.R. 523, 534 (N.D. Tex. 2009) (same).

In the Stanford MDL litigation, Judge Godbey followed the line of authority cited above in declining to dismiss, based on the anti-fracturing argument, the Stanford Receiver's claims

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[11] The Receiver notes that Defendants attempt to misconstrue the FAC by telling the Court that all the Receiver has alleged is that Defendants "*should have known*" of Faulkner's misconduct. Motion (Brief) at page 9 (citing FAC ¶¶s 119, 120, 121, 124, 125). But every one of those cited paragraphs alleges (in one form or another) that Defendants ***either knew of should have known*** of Faulkner's misconduct - which is entirely consistent with the Receiver's theory of this case as articulated herein and in the FAC.

[12] Courts have held that the jury should be charged on both claims:

> Though [plaintiff] alleged the same facts in his petition for both his negligence and breach-of-fiduciary-duty claims, this pleading practice is not determinative. **The procedural rules allow a claimant to plead in the alternative**. When, as in this case, the evidence raises a genuine issue of material fact regarding alleged wrongful conduct that sounds in negligence as well as alleged wrongful conduct that sounds in breach of fiduciary duty, the trial court should charge the jury on both claims, regardless of any alternative pleading.

Deutsch v. Hoover, Bax & Slovacek, LLP, 97 S.W. 3d 179, 190-191 (Tex. App. – Hous. [14th Dis.] 2003) (internal citations omitted).

against the law firm Proskauer Rose – which claims were virtually identical to the participation and aiding and abetting tort claims asserted by the Receiver in this case. *Janvey v. Proskauer Rose*, 2015 U.S. Dist. LEXIS 187809 at *11-14 (N.D. Tex. 2015) (declining to dismiss the receiver's claims for, *inter alia*, participation in breaches of fiduciary duties and participation in a fraudulent scheme).

As outlined above, the Receiver has plead that Defendants knew of a plethora of wrongdoing by Faulkner, including outright fraud on investors and violations of securities laws, yet Defendants continued to assist Faulkner keep the Breitling entities in business selling securities.[13] A jury could reasonably infer that Defendants' conduct constitutes negligence, gross negligence, participation in breach of fiduciary duty or a fraudulent scheme, *or all of the above*. Texas law on fracturing permits a jury to be charged as to *all* of the causes of action that are supported by the evidence. *Deutsch*, 97 S.W.3d at 190-191. The Court should deny Defendants' motion to dismiss the Receiver's non-negligence claims based on the anti-fracturing theory.

D. The Receiver's Negligence Claim is not Barred by Limitations

Like Rothstein Kass in *Taylor*, Defendants argue that the Receiver's negligence claim is time barred because (1) Faulkner's fraudulent actions benefitted the Breitling entities by bringing in tens of millions of dollars in investor proceeds and (2) therefore Faulkner's knowledge is imputed to the Breitling entities for limitations purpose.

As a preliminary matter, and as this Court held in *Taylor*, dismissal based on the imputation theory is not appropriate at the pleading stage of the case because the Receiver has clearly plead that Faulkner acted *adversely* to the Breitling entities – including by looting them – and there is no

[13] FAC ¶ 4 (alleging that Defendants' role "devolved into helping shield the Breitling Entities from regulatory inquiries and investigations…while fending off and settling (with strict confidentiality provisions) numerous investor complaints of fraud").

allegation anywhere in the Complaint that Faulkner's actions benefitted the entities.[14] *Taylor*, 2020 U.S. Dist. LEXIS 17435 at *8-9. As the Court noted in *Taylor*, the issue of whether Faulkner acted adversely to the Breitling entities involves questions of fact that are better decided on summary judgment. *Id.*, at *9. Indeed, Defendants' primary case on this subject, *FDIC v. Ernst & Young*, 967 F. 2d 166 (5th Cir. 1992), arose in the context of a summary judgment motion, not a motion to dismiss.[15]

More fundamentally, Defendants' argument is based on a fallacy because it assumes that the Breitling entities *themselves* - as opposed to Faulkner - knew about or intended to allow Faulkner to manipulate and use them to commit fraud, violate securities laws, and steal the money invested with them by third party investors. See Motion (Brief) at p. 15 (arguing that the *Breitling entities* knew they were engaging in fraud). As the Fifth Circuit has held, receivership entities themselves are innocent of wrongdoing and cannot have intended to violate the law or deceive investors. *Janvey v. Democratic Sen. Campaign Comm., Inc*., 712 F.3d 185, 190-92 (5th Cir. 2013) ("*DSCC*") (Stanford entities' actions were "coerced" by Allen Stanford who used them like "robotic tools" and "evil zombies")(citing *Scholes v. Lehman*, 56 F. 3d 750 (7th Cir. 1995); *Janvey v. Alguire*, 847 F. 3d 231, 241 (5th Cir. 2017) (same); *Jones v. Wells Fargo Bank*, 666 F. 3d 955, 965- 967 (5th Cir. 2012) (corporation is entity separate from its individual bad actors).

[14] Similarly there is no allegation in the Complaint that Faulkner *knew* that Defendants' legal advice was wrong or improper, which is another defect in Defendants' arguments. See *Janvey v. Thompson & Knight LLP*, 2003 U.S. Dist. LEXIS 29778 (N.D. Tex. 2003) at *12-13.

[15] Questions of imputation and the adverse interest exception generally involve fact issues that cannot be decided on a motion to dismiss. *See FDIC v. Nathan*, 804 F. Supp. 888, 893-894 (S.D. Tex. 1992) (noting that the question of whether corporate fraudsters acted for the benefit of, or adversely to, their entities is a fact issue more appropriately addressed via summary judgment); *Smith v. Arthur Andersen*, 175 F. Supp. 2d 1180, 1198-1200 (D. Ariz. 2001) (denial of motion to dismiss because allegations of adverse interest exception to imputation doctrine sufficient to avoid dismissal); *Askanase v. Fatjo*, 828 F. Supp. 465, 471 (S.D. Tex. 1993) (a fact issue existed as to whether the officers and directors were acting entirely in their own interest and to the detriment of the corporation).

Indeed, Defendants' imputation and limitations argument is foreclosed by the Fifth Circuit's holding in *DSCC*, in which the Fifth Circuit squarely rejected the argument that the Stanford Receiver's claims accrued prior to his appointment. There the court refused to impute the controlling fraudster's (Allen Stanford's) knowledge to his entities, holding that the entities' claims could not have accrued prior to the date the Stanford Receiver was appointed. *DSCC*,712 F.3d at 192-93.

So too here. Because the knowledge of the Breitling entities' pre-receivership officers and directors like Faulkner cannot be imputed to the Breitling receivership entities on whose behalf the Receiver now sues, the Receiver's claims could not have accrued, as a matter of law, until some date after September 25, 2017, the date on which the Receiver was appointed and empowered to specifically pursue "*all assets – in any form or of any kind whatsoever*". Complaint at ¶ 130-131 (citing ECF 142 in the SEC Action, as defined below).[16]

Defendants attempt to distinguish *DSCC* by arguing that Faulkner's conduct somehow *benefitted* the Breitling entities. But the Receiver clearly alleges that Faulkner acted adversely to the Breitling entities by using and causing said entities to engage in fraud and violate securities laws and then looting the entities of the ill-gotten gains. Complaint, at ¶¶ 2, 16-22, 25, 28-32, 35, 42-44, 52, footnote 4, 57-58, footnote 5, 59, 61, 62-65, 68, 70-74, 76-80, 82-83, 85, 87-88, 91-98, 102-104, 106, 109-110, 112-114, 116-126, 128. Just as the Fifth Circuit held in *Warfield v. Brown*, ***"[i]t takes cheek***" to argue that the Breitling entities "*benefitted from [Faulkner's] efforts to extend the fraud by securing new investments.*" *Warfield v. Brown*, 436 F. 3d 551, 560 (5th Cir. 2006).

[16] Moreover, any such claims were thereafter tolled by this Court's orders in *SEC v. Faulkner et al*., Case No. 3:16-CV-1735-D (the "SEC Action") tolling limitations for receivership claims. Complaint at ¶79 (citing SEC Action, ECF No. 108 at ¶22; ECF No. 142 at ¶34; ECF No. 320 at ¶34; ECF No. 418 at ¶34). This Court has previously recognized in the SEC Action that the Receiver was investigating claims against the Breitling entities' former professionals roughly a year prior to the filing of the instant action on November 1, 2019. *SEC v. Faulkner*, 2018 U.S. Dist. LEXIS 182294 at *9-10 (N.D. Tex. 2018).

Here, the Receiver alleges that Faulkner manipulated and used the innocent Breitling entities to commit fraud and caused them to violate securities laws – which resulted in the entities being sued and shut down by the SEC and exposed to massive liabilities to investor victims. Complaint at ¶¶ 2, 16-22, 25, 28-32, 35, 42-44, 52, footnote 4, 57-58, footnote 5, 59, 61, 62-65, 68, 70-74, 76-80, 82-83, 85, 87-88, 91-98, 102-104, 106, 109-110, 112-114, 116-126, 128, 149. See *Scholes*, 56 F. 3d at 754 (noting that the controlling shareholder fraudster could have ratified the diversion of assets only if no creditors were harmed; but finding that the investors *were* harmed and converted into tort creditors against the entities).

The bottom line is that the facts alleged in this case are no different than the facts set forth in *Scholes* and *DSCC* -- the Receiver alleges that Faulkner used the entities to lure money from investors, and then stole those funds from the entities, sticking the entities with the liabilities to the investors. Complaint, at ¶¶ 2, 16-22, 25, 28-32, 35, 42-44, 52, footnote 4, 57-58, footnote 5, 59, 61, 62-65, 68, 70-74, 76-80, 82-83, 85, 87-88, 91-98, 102-104, 106, 109-110, 112-114, 116-126, 128. The innocent entities wound up in a federal receivership as a result. There's no scenario under which any of that was good for, or benefitted, the Breitling entities. Under these circumstances, Faulkner's knowledge cannot be imputed to the Breitling entities.[17]

The principal case relied on by Defendants as support for their imputation arguments, *Ernst & Young*,[18] is further distinguishable on multiple grounds. *First*, it pre-dates *DSCC* and *Jones v. Wells Fargo Bank*, 666 F. 3d 955 (5th Cir. 2012) and subsequent Fifth Circuit jurisprudence on the issues of imputation and *in pari delicto*. *Second*, it was decided on summary

[17] *See FDIC v. Lott*, 460 F.2d 82, 88 (5th Cir. 1972) (where majority shareholder fraudulently dealt with his entity in his own interest, he is deemed to have an adverse interest and the knowledge possessed by him in the transaction is not imputable to the entity); *see also Wight v. Bank America Corp.*, 219 F 3d 79, 87 (2d Cir. 2000) (debtor's management acted in their own interest and not in company's interest, barring application of the imputation doctrine); *Smith v. Arthur Anderson*, 175 F Supp. 2d 1180, 1199 (D. Ariz. 2002)(scheme to continue a company in business past its point of insolvency cannot be said to benefit the company); *FDIC v. Nathan*, 804 F. Supp. 888 (S.D. Tex. 1992) (imputation not applicable where directors milked company and pushed it into insolvency).

[18] *FDIC v. Ernst & Young*, 967 F. 2d 166 (5th Cir. 1992).

judgment, not a motion to dismiss. And *third*, in *Ernst & Young* the FDIC's role was purposefully limited to acting as an assignee of the defunct entity's claims and consequently did not equate to the role of an SEC equity receiver seeking to recover funds for the benefit of defrauded investor creditors such as is the situation here (and in *DSCC* and *Scholes*). Indeed, the Fifth Circuit underscored that distinguishing characteristic in its *Ernst & Young* opinion, noting that it was "critically important" to its decision [967 F. 2d at 169],[19] and made sure to narrowly limit its holding to the facts of that case. *Id.*, at 172.

Finally, the imputation doctrine is designed to benefit and protect innocent third parties, and does not protect those who collude with the agent (here, Faulkner) to defraud the principal (the Breitling entities).[20] For example, where a plaintiff alleges that a law firm defendant colluded with the sole shareholder to defraud a bank, the shareholder's knowledge will not be imputed to the bank. *Shrader & York*, 991 F.2d at 226. In the present case, the Receiver has explicitly stated a claim against Defendants for, *e.g.*, knowing participation in Faulkner's fraud and breaches of fiduciary duties owed to the Breitling entities. Thus, the Defendants are not the "innocent third parties" the imputation doctrine is designed to protect, and therefore the imputation doctrine cannot be used as a shield to protect the Defendants from their own illicit acts.

E. The Receiver States a Valid Claim for Professional Negligence

Relying exclusively on this Court's 2009 decision in *Reneker v. Offill*,[21] Defendants argue that the Receiver's negligence claim fails as a matter of law because the Receiver has failed to

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[19] The Fifth Circuit noted that as a result of the FDIC's decision to sue the auditors only as an assignee of claims, "*the effect of the auditor's alleged negligence on third parties is legally irrelevant*". *Ernst & Young*, 967 F. 2d at 169

[20] *FDIC v. Shrader & York*, 991 F.2d 216, 226 (5th Cir. 1993) citing *Crisp v. Southwest Bancshares Leasing Co*., 586 S.W. 610, 615 (Tex. App. – Amarillo 1979)); *FDIC v. Nathan*, 804 F. Supp. 888, 893 (S.D. Tex. 1992) (the equitable imputed knowledge rule applies only to innocent third parties, not to culpable defendants acting in collusion with the wrongdoer*); United States v. Aubin*, 87 F.3d 141, 46-147 (5th Cir. 1996) ("the rule of Texas law on which this Court relied in *Ernst & Young* that an agent's knowledge is imputed to his principal--does not protect those who collude with an agent to defraud the principal)".

[21] *Reneker v. Offill*, 2009 U.S. Dist. LEXIS 97338 ((N.D. Tex. 2009) ("*Reneker I*").

plausibly plead proximate cause, *i.e.*, that but for Defendants' negligence the Breitling entities would have otherwise complied with the law and not suffered injury.

In making this argument Defendants again conflate the innocent Breitling entities, who were Defendants' clients (FAC ¶ 37), with Faulkner, who was not. Once again, Defendants argue that this Court should ignore the separateness and presumed innocence of the Breitling entities and impute Faulkner's knowledge and intent to violate the law and commit fraud directly to the entities for purposes of eliminating the Receiver's negligence claim.[22] Such an argument is a thinly disguised attempt to backdoor an *in pari delicto* defense by improperly imputing Faulkner's (who, again, was *not* Defendants' client) knowledge, intent and conduct to the Breitling entities. As described above, such position has been squarely rejected by the Fifth Circuit in the years since this Court issued its *Reneker* decision.[23]

As Judge Godbey held in one of the Stanford MDL cases, "[l]awyers owe their clients a duty to protect them from liability in every possible way," which includes a duty to "help them avoid wrongdoing", "urge cessation" of violative conduct by management and withdraw from the representation "where the firm's legal services may *contribute to the continuation of such conduct*".[24]

Here the Receiver has alleged, *inter alia*, that:

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[22] As described above, issues of imputation involve questions of fact unsuitable for resolution via a motion to dismiss. *See FDIC v. Nathan*, 804 F. Supp. 888, 893-894 (S.D. Tex. 1992) (noting that the question of whether corporate fraudsters acted for the benefit of, or adversely to, their entities is a fact issue more appropriately addressed via summary judgment); *Smith v. Arthur Andersen*, 175 F. Supp. 2d 1180, 1198-1200 (D. Ariz. 2001) (denial of motion to dismiss because allegations of adverse interest exception to imputation doctrine sufficient to avoid dismissal); *Askanase v. Fatjo*, 828 F. Supp. 465, 471 (S.D. Tex. 1993) (a fact issue existed as to whether the officers and directors were acting entirely in their own interest and to the detriment of the corporation).

[23] *Jones v. Wells Fargo Bank*, 666 F. 3d 955, 965- 967 (5th Cir. 2012) (corporation is entity separate from its individual bad actors). *DSCC*, 712 F.3d 185, 190-92 (5th Cir. 2013) (entities' actions were "coerced" by principal who used them like "robotic tools" and "evil zombies")(citing *Scholes v. Lehman*, 56 F. 3d 750 (7th Cir. 1995); *Janvey v. Alguire*, 847 F. 3d 231, 241 (5th Cir. 2017) (same).

[24] *Official Stanford Investors Committee v. Greenberg Traurig*, 2014 U.S. Dist. LEXIS 190621 at *8-11 (N.D. Tex. 2014) (citations omitted) (emphasis added).

- Defendants were specifically retained to assist the Breitling entities comply with state and federal securities laws [FAC ¶¶ 4, 37] but instead ultimately assisted Faulkner to use the Breitling entities to violate securities laws. FAC ¶¶ 7-8, 121-129.

- Defendants created the "bonus" programs for Breitling and, later, Crude, to assist Faulkner to use unlicensed securities salespersons to sell in excess of $100 million of unregistered securities in violation of securities laws. FAC ¶¶ 6, 34, 43, 49, 97, 108.

- Defendants consistently advised Faulkner that his Internet-based securities sales tactics did not constitute "general solicitation" in violation of securities laws and never advised Faulkner to cease such activities - thereby exposing the Breitling entities to "tens of millions of dollars of rescission claims". FAC ¶¶ 42, 54, 72, 85, 121.

- Defendants realized that Faulkner needed to disclose the existence of multiple investor fraud claims against Breitling entities resulting in rescissions of their securities purchases to other investors or risk the Breitling entities losing their purported registration exemption, but Defendants never urged Faulkner to make such disclosures. FAC ¶¶ 8, 79, 91, 126.

- Defendants lied to regulators and acquiesced in Faulkner's lies to and withholding of relevant documents from regulators, including the SEC. FAC ¶¶ 59, 78, footnote 6, 80, 93.

Such allegations are sufficient to state a claim for professional negligence by lawyers who were duty-bound to ensure that their corporate clients were *not* being manipulated by management into violating the law and committing fraud.[25] Unlike the situation presented in *Reneker I*, where the Court found that the receiver had "not pleaded a duty owed to the clients", here the Receiver has clearly pleaded that Defendants owed duties to their clients, the Breitling entities, to ensure that they complied with securities laws, and that the Breitling entities relied on Defendants' legal representation to their detriment and injury. FAC ¶¶ 4, 7, 35, 37, 127-129. Such pleading conforms with this Court's ruling in its 2010 decision denying the renewed motion to dismiss in

[25] *Greenberg Traurig*, 2014 U.S. Dist. LEXIS 190621 at *8-11 (N.D. Tex. 2014) (facts plead were sufficient to state a negligence claim against former general counsel and outside law firm for assisting Stanford to "skirt regulations" that "contributed to the proliferation and success of the underlying scheme"); *Janvey v. Proskauer Rose*, 2015 U.S. Dist. LEXIS 187809 at *11-14 (N.D. Tex. 2015) (allegations that law firm's legal work was "not in the best interest of the [receivership] entities, and perpetuated the fraudulent scheme" held sufficient to state a malpractice claim against law firm).

Reneker v. Offill.[26] Indeed, the Receiver's FAC is a far cry from the complaint this Court deemed deficient in *Reneker I*, which did "little more than allege that [the defendant law firm] never informed [its entity clients] of the illegality of their actions". *Reneker I*, 2009 U.S. Dist. LEXIS 97338 at *16 (N.D. Tex. 2009).

The Receiver also requests that the Court take judicial notice of the Answers filed by some of the Breitling entities and their principals in the SEC Action, specifically the Answers filed on behalf of Crude Energy LLC and Parker Hallam. SEC Action, Doc. 54 (Answer of Crude Energy LLC) and Doc. 55 (Answer of Parker Hallam). Both of those Defendants have asserted "advice of counsel" (presumably from Defendants, but such presumption can be verified through discovery) as an affirmative defense to the SEC's claims against them.[27] SEC Action, Doc. 54, at p. 32, ¶ 8; Doc. 55, at p. 32, ¶ 8. The Receiver should be allowed to substantiate the Breitling entities' and their principals' reliance on Defendants' legal advice through the discovery process.

Defendants also argue that the Receiver fails to plausibly allege that, had Defendants given proper legal advice then "Breitling" would have heeded that advice and ceased its illicit conduct and thereby avoided suffering injury, and that the Receiver also fails to plausibly allege that had Defendants "blown the whistle" "*on Breitling*" (as opposed to on Faulkner), the Breitling entities would have avoided injury. Motion (Brief) at p. 17-18.[28] But these arguments ask the Court to speculate as to causation outside of the confines of the FAC as opposed to focusing on what the

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[26] *Reneker v. Offill*, 2010 U.S. Dist. LEXIS 38526 at *10-11 (N.D. Tex. 2010) (holding that receiver had cured deficiencies in his complaint by alleging, *inter alia*, that the defendant law firm's representation "*was specifically agreed to include"* compliance with securities laws and that the entities had relied on the defendant law firm to assist them in legally offering securities).

[27] The Receiver requests that the Court take judicial notice only of the fact that these defendants in the SEC Action have asserted reliance on advice of counsel as an affirmative defense. *Reneker v. Offill*, 2012 U.S. Dist. LEXIS 83017 at *41-42 (N.D. Tex. 2012) (citing *Taylor v. Charter Med. Corp*., 162 F. 3d 827 (5th Cir. 1998).

[28] Defendants also argue that any duties they had to "blow the whistle" on Faulkner were duties owed to, *inter alia*, Breitling's investors. Brief at p. 18 (citing *Reneker I*). But recent changes to Texas law since *Reneker I* have made clear that lawyers owe no duties - and are not liable - to third party non-clients such as the Breitling investors, even where it can be established that they aided and abetted fraud. *Troice v. Greenberg Traurig*, 921 F. 3d 501 (5th Cir. 2019); *Troice v. Proskauer Rose*, 816 F. 3d 341 (5th Cir. 2016); *Cantey Hanger v. Byrd*, 467 S.W. 3d 477 (Tex. 2015). **Therefore, the only redress for Defendants' conduct is through the Receiver's claims in the instant suit.**

FAC alleges the Defendants *did* and the injury caused to the Breitling entities by their breaches of duty. See FAC ¶ 6 (alleging Defendants' creation of sales bonus program allowed Faulkner to sell over $100 million in illicit securities); ¶ 35 (alleging causation and damages linked to Defendant's breaches of duties); ¶¶ 121, 127, 129 (alleging damages – including exposure to tens of millions of dollars of investor rescission claims – caused by Defendants' negligence).

It is certainly plausible that, had Defendants *not* set up the disguised commission structure that allowed Faulkner to pay sales commissions to his unlicensed securities sales staff, or had Defendants advised Faulkner to cease his Internet-based sales strategy using "general solicitation",[29] then Faulkner would not have been able to sell his fraudulent securities in the volume that he did, such that the damages to the entities would have been lessened. FAC at ¶ 135 (alleging that but for Defendants' negligence, the "scale and duration of the overall fraud scheme…would have been reduced"). *See Greenberg Traurig*, 2014 U.S. Dist. LEXIS 190621 at *8-11 (N.D. Tex. 2014) (holding that allegations that law firm's "assistance in skirting regulation…enabl[ed] the Stanford entities to conduct their business" were sufficient to raise "a reasonable inference that [the law firm's] deficient legal services contributed to the size and scope of the underlying scheme, which ultimately resulted in Stanford's financial ruin").[30]

Moreover, Defendants' proximate cause argument is premature and improperly raised at this stage of the proceedings because under Texas law the issue of proximate causation is a question of fact for the jury to decide. *See e.g., Flock v. Scripto-Tokai Corp.*, 319 F.3d 231, 237 (5th Cir. 2003) ("Under Texas law, causation generally is a question of fact for the jury."); *Texas*

[29] FAC ¶¶ 127, 129. The FAC alleges that in October 2013 Faulkner specifically asked Defendant Little whether Breitling could "build the relationship in this manner", referring to the way in which Breitling's sales staff was soliciting investors, but received no response. FAC ¶ 102.

[30] Importantly, "[mo]re than one action may be the proximate cause of the same injury." *Wilson v. Brister*, 982 S.W.2d 42, 44 (Tex.App.1998, pet.denied). "To proximately cause an injury, an actor need not be the last cause, or act immediately preceding the injury." *J. Wigglesworth Co. v. Peeples*, 985 S.W.2d 659, 663 (Tex.App.1999, pet.denied).

Department of Transportation v. Olson, 980 S.W.2d at 890, 893 (Tex. App.— Fort Worth 1998, no pet.) ("The question of proximate cause is one of fact particularly within the province of a jury, and a jury finding on proximate cause will be set aside only in the most exceptional circumstances").

The Receiver has satisfied his pleading burden on causation at this preliminary stage of the case by pleading how Defendants' negligence caused damages to the Breitling entities, as described above. To the extent that the Court disagrees that the Receiver has adequately plead proximate cause for his negligence claim, then the Receiver requests leave to amend his Complaint. The Receiver incorporates a motion for leave to amend at the end of this Brief.

F. The Receiver's Fraudulent Transfer Claim is not Barred by the Statute of Repose

Defendants argue that the Receiver's fraudulent transfer claim is extinguished pursuant to the repose provisions of the Texas Uniform Fraudulent Transfer Act ("TUFTA"), TEX. BUS. & COMM. CODE section 24.010(a). Defendants' Motion should be denied as to the TUFTA claim for the same reasons as set forth in this Court's decision in *Taylor* and because Defendants misconstrue the TUFTA repose provision.

Defendants argue that pursuant to §24.010(a) the Receiver's TUFTA claim is extinguished four years after the last alleged fraudulent transfer, i.e. April 2018. But Defendants ignore the remainder of the statutory language in §24.010(a)(1), which provides that a fraudulent transfer is extinguished unless the action 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*. (emphasis added).

Thus, by its very terms §24.005(a)(1) incorporates an alternative "one-year from discovery" repose time limit beyond the four-year limit. *See Taylor,* 2020 U.S. Dist. LEXIS 17435

at **26-28; see also, Renate Nixdorf GmbH & Co. KG v. TRA Midland Props.*, LLC, 2019 Tex. App. LEXIS 26 at *22-23 (Tex. App. – Dallas 2019) (TUFTA repose statute includes one year from discovery component for claims brought under §24.005(a)(1)); *Biliouris v. Patman*, 2017 U.S. Dist. LEXIS 40868 at *4-5 (N.D. Tex. 2017) (same).

The Receiver's fraudulent transfer claim is clearly brought pursuant to §24.005(a)(1) and therefore subject to the one year discovery provision because in ¶ 144 of the Complaint the Receiver specifically pleads that the transfers at issue were made with "actual intent to hinder, delay, or defraud" creditors of BOG and BECC. Moreover, in ¶¶ 130-132 of the Complaint the Receiver pleads that he did not discover and could not with the exercise of reasonable diligence have discovered until more recently, Defendants' connection to the Breitling fraudulent scheme and the true nature of the injury suffered. The Receiver further pleads that the Defendants' wrongful acts were inherently undiscoverable. *Id.*

Under Texas law, the limitations period for a §24.005(a)(1) claim does not begin to run upon the discovery of the transfer alone; instead the claim accrues only when the claimant discovers or reasonably could have discovered the ***fraudulent nature of the conveyance***. *DSCC,*712 F. 3d at 195 (5th Cir. 2013). "When a plaintiff knew or should have known of an injury is . . . a question of fact" that cannot be determined at the dismissal stage. *Taylor*, 2020 U.S. Dist. LEXIS 17435 at **26-28; Janvey v. Dem. Sen. Campaign Comm.*, 793 F. Supp. 2d 825, 837 (N.D. Tex. 2011), *affirmed*, *DSCC* 712 F.3d 185 (5th Cir. 2013), *Brandau v. Howmedica Osteonics Corp.*, 439 Fed. Appx. 317, 322 (5th Cir. 2011), *USPPS, Ltd. v. Avery Dennison Corp.*, 326 Fed. Appx. 842, 850-51 (5th Cir. 2009). As a result, Defendants' Motion should be denied on the above grounds.

G. <u>The Receiver's Fraudulent Transfer Claim is otherwise Properly Plead</u>

TUFTA sets forth two grounds for recovery: actual fraud and constructive fraud. TEX. BUS. & COMM. CODE ANN. §§ 24.001–.010 (Vernon 2009). Actual fraud – which is what the Receiver has plead in this case - occurs when the debtor/transferor makes a transfer "with actual intent to hinder, delay, or defraud any creditor." *Id.* at § 24.005(a)(1). The transferee's intent is not an element of the plaintiff's case under either ground. *See* TEX. BUS. & COMM. CODE ANN. § 24.005. Indeed, "'the transferees' knowing participation is irrelevant under [UFTA]' for purposes of establishing . . . [even the actual fraud] premise . . . ." *SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295, 301 (5th Cir. 2007) (quoting *Warfield v. Byron*, 436 F.3d 551, 559 (5th Cir. 2006)).

Defendants argue that the Receiver has not sufficiently alleged facts that enable the court to draw a reasonable inference that Faulkner or the Breitling Entities acted *with actual fraudulent intent* when the payments were made to Defendants. But the FAC sufficiently pleads facts supporting the Receiver's claim of fraudulent transfer under that section, specifically alleging that Faulkner caused BOG and BECC to make transfers totaling at least $331,637.48 between December 1, 2013 and April 1, 2014 with actual intent to hinder, delay or defraud creditors of BOG and BECC. Complaint at ¶¶ 143-147.[31] While Defendants cite to the Fifth Circuit's decision in *In re Soza* as mandating the pleading of one or more of the enumerated "badges of fraud", the Fifth Circuit in *Soza* made clear that it only cited to the "**non-exclusive**" list of "badges of fraud" as a useful tool that courts "*may* consider in determining whether a debtor actually intended to defraud creditors under TUFTA". *In re Soza*, 542 F. 3d. 1060, 1067-68 (5th Cir. 2008).

The FAC lays out Faulkner's actual intent to defraud creditors using the Breitling entities

[31] Again, fraudulent transfer claims are subject to Rule 8's requirement of "a short and plain statement of the claim showing that the pleader is entitled to relief", not Rule 9(b)'s pleading requirements. *See U.S. Bank. Nat. Ass'n v. Verizon Comm's Inc*., 2012 WL 3100778, at *11 (N.D. Tex. Jul. 31, 2012); *Janvey v. Alguire*, 846 F.Supp.2d 662, 676 (N.D. Tex. 2011) (there is "no principled reason for applying Rule 9's pleading requirements to [the Plaintiffs'] fraudulent transfer claims."); *GE Capital Comm., Inc. v. Wright & Wright, Inc*., 2009 WL 5173954, at * 10 (N.D. Tex. Dec. 31, 2009).

in great detail,[32] and describes how Faulkner used Defendants' assistance to effectuate said fraud. *See, e.g.*, FAC at ¶ 144 (alleging that Faulkner engaged Defendants "to continue, and expand upon, his fraudulent scheme"). Faulkner's payments to Defendants (using Breitling entity funds) were part and parcel of the overall fraud scheme. FAC ¶ 118 (alleging that Defendant Little was more concerned about ensuring that his firm's legal bills were paid than making sure he wasn't assisting a fraudulent securities scam). And the Complaint specifically alleges at least three of the enumerated "badges of fraud", including (1) suits or threats of suits against the Breitling entities by defrauded investors;[33] (2) Faulkner's looting of the Breitling entities; and (3) the insolvency of the Breitling entities resulting in the present receivership.[34]

Finally, actual intent to defraud creditors ordinarily is a fact question.[35] Facts and circumstances that may be considered in determining intent include the non-exclusive list of badges of fraud prescribed by the legislature in section 24.005(b). *Ho. v. MacArthur, LLC*, 395 S. W. 3d 325, 328-29 (Tex. App-Dallas 2013, no pet.) A transferor's intent to hinder, delay, or defraud is not an appropriate issue for summary judgment (let alone a 12(b)(6) motion) except in limited circumstances because intent, like knowledge, is a question of fact generally reserved for the jury. *Wohlstein v. Aliezer*, 321 S. W. 3d 765, 777(Tex. App.-Houston [14th Dist.] 2010, no pet.).

The Receiver's detailed pleading of the Breitling fraud scheme, which specifically alleges Faulkner's intent to defraud the Breitling entities' creditors (and loot the Breitling entities in the process) satisfy the Rule 8 and Rule 9 requirements, and Defendants' Motion on this claim should

[32] See FAC at ¶¶ 14-35, 42-44, 52, footnote 4, 57-58, footnote 5, 59, 61, 62-65, 68, 70-74, 76-80, 82-83, 85, 87-88, 91-98, 102-104, 106, 109-110, 112-114, 116-126, 128.

[33] FAC ¶¶ 52, 53, 57, 61, 62, 69-71, 77, 87-89, 91, 95, 100, 103, 104, 106, 110, 112, 113.

[34] See, e.g., FAC ¶ 35, 127-129; *See also*, FAC ¶ 116 (Defendant Little asking Faulkner *"[a]re ya'll insolvent*?).

[35] *Walker v. Anderson*, 232 S.W.3d 899, 914 (Tex. App.—Dallas 2007, no pet.). Circumstantial proof may be used to prove fraudulent intent because direct proof is often unavailable. *See Doyle v. Kontemporary Builders, Inc*., 370 S.W.3d 448, 454 (Tex. App.—Dallas 2012, pet. denied).

be denied. To the extent that the Court disagrees that the Receiver has adequately plead his TUFTA claim, then the Receiver requests leave to amend his Complaint to so plead. The Receiver incorporates a motion for leave to amend at the end of this Brief.

III. MOTION FOR LEAVE TO AMEND COMPLAINT

In the alternative, if the Court is inclined to grant Defendants' Motion in whole or in part, the Receiver respectfully requests leave to amend the Complaint under Rule 15(a) of the Federal Rules of Civil Procedure, so that the Receiver can correct any pleading defects, including any issues specifically identified in the Motion or this Response. When a court is considering a motion to dismiss a complaint for failure to state a claim, granting leave to amend is especially appropriate. See *Great Plains Trust Co., et al v. Morgan Stanley Dean Witter & Co*., 313 F.3d 305, 329 (5th Cir. 2002) ("[O]ur cases support the premise that 'granting leave to amend is especially appropriate . . . when the trial court has dismissed the complaint for failure to state a claim.") (citing *Griggs v. Hinds Junior College*, 563 F.2d 179, 180 (5th Cir. 1977) (per curiam) (addressing Rule 12(b)(6) dismissal)). Rule 15(a) applies where a plaintiff expressly requests to amend even though the request is "not contained in a properly captioned motion paper." *Willard v. Humana Health Plan of Texas, Inc.*, 336 F.3d 375, 387 (5th Cir. 2003) (quoting *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 701 (5th Cir. 1988). A formal motion is not required as long as the requesting party has set forth with particularity the grounds for the amendment and the relief sought. *Id.*.

While the Receiver believes that he has adequately pled facts sufficient to survive dismissal, he nevertheless requests leave to amend the Complaint if necessary, and to the extent relevant to the Court's determination of this Motion, to address the allegedly deficient allegations that are the subject of Defendant's asserted grounds for dismissal.

IV. PRAYER

For the foregoing reasons, the Receiver respectfully requests that the Court enter an order denying Defendants' Motion to Dismiss in its entirety and grant the Receiver such other and further relief the Court deems just and proper.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing instrument was served on this 1st day of May, 2020 on all counsel of record via CM/ECF, and/or email, pursuant to the Federal Rules of Procedure 5(b)(2).

/s/ Edward C. Snyder
Edward C. Snyder