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

THOMAS L. TAYLOR, III, in his capacity as Court-appointed receiver for Breitling Energy Corp. et al., *Plaintiff*, v. ROTHSTEIN KASS P.A. d/b/a ROTHSTEIN KASS & CO. P.C., ROTHSTEIN, KASS & COMPANY, PLLC and BRIAN MATLOCK *Defendants*.	§ § § § § § § § § § § § §	Case No. 3:19-cv-01594-D

DEFENDANTS' MOTION TO COMPEL DEPOSITION FROM SECURITIES AND EXCHANGE COMMISSION AND BRIEF IN SUPPORT

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Defendants Rothstein Kass P.A. d/b/a Rothstein Kass & Co. P.C., Rothstein, Kass & Company, PLLC ("Rothstein Kass") and Brian Matlock, through their undersigned counsel, hereby move to compel the deposition of the Securities and Exchange Commission ("SEC") pursuant to Fed. R. Civ. P. 37 and 30(b)(6).

I. INTRODUCTION

Thomas L. Taylor, III, the Court appointed receiver in this case ("Plaintiff" or the "Receiver") has asserted claims for professional negligence and participation in a breach of fiduciary duty against the Defendants relating to audits of Breitling Oil & Gas Corportation ("BOG"), Breitling Royalties Corportation ("BRC") and Breitling Energy Corporation ("BECC") (collectively the "Breitling Entities"). Plaintiff produced the Expert Report of Saul Solomon, dated August 14, 2020 ("Solomon Report") (App. at 10, Ex. A.), in which his theory of damages puts squarely at issue the SEC's investigation of the Breitling Entities. Specifically, Solomon and the Plaintiff assert that damages accrued from:

> December 19, 2013 (the date Defendants were aware of the significant indicia of fraud and illegal acts and misrepresentations made to investors as discussed above and should have withdrawn *and notified the SEC of their findings*) to August 1, 2014 (the "First Analysis Period"), *which I assume is the date by which the SEC had likely obtained sufficient (albeit disputed) evidence via subpoenas the SEC issued to Rothstein to have sought relief to prevent Breitling from selling additional securities to investors*.

Id. at 67-8, ¶ 108 (emphasis added). Underpinning Solomon's analysis is that *but for* the conduct of the Defendants, the SEC would have taken action that would have prevented the damages he outlines in his report.

Under the Plaintiff's theory of damages, it is critically important to determine whether the SEC had obtained "sufficient (albeit disputed) evidence . . . to have sought relief to prevent Breitling from selling additional securities to investors" before, during, or after the audits of the Breitling Entities' financial statements. The party with that information is the SEC.

On June 30, 2020, Defendants issued a deposition subpoena to the SEC that identified six areas to be examined. App. at 109, Ex. B. After numerous conferences between counsel regarding the SEC's objections to the subpoena, in an attempt to compromise, the Defendants agreed to limit the examination of the SEC to a single topic: the Rothstein Kass Audit's role in the SEC Investigation. Despite this limitation, and despite having had months to consider the subpoena, the SEC refuses to go forward with the deposition. The discovery cut-off in this case is November 16, 2020, and the Defendants will suffer prejudice unless the SEC is ordered to appear for deposition.

II. BACKGROUND

The SEC appears to have begun informally investigating Chris Faulkner, BOG, and BRC in January 2011, when SEC staff interviewed Faulkner. App. at 119, Ex. C. The SEC issued a Formal Order for its investigation of the Breitling Entities two years later, on January 30, 2013. App. at 156, Ex. D. The Formal Order stated in relevant part, "The [SEC] has information that tends to show that ***from at least January 2011***" there were possible violations of the anti-fraud provisions of the federal securities laws, and "the Breitling Entities, and their officers [etc] . . . may have been or may be, among other things, making false statements of material fact or failing to disclose material facts concerning, among other things, their business prospects and activities." *Id*. The SEC's formal order of investigation enabled SEC staff to issue subpoenas for documents and testimony under oath.

Beginning on January 31, 2013, the SEC issued a number of subpoenas for documents, including a subpoena to BOG (App. at 160-5, Ex. E) that requested a large volume of documents, including (i) bank accounts, (ii) documents sufficient to identify Breitling's employees, (iii) documents regarding the wells or prospects that Breitling offered to purchasers,

(iv) documents regarding the accreditation of the persons to whom Breitling offered oil-and-gas interests, and (v) documents regarding Breitling's related party transactions.

On February 13, 2013, counsel for BOG and BRC met with SEC staff at the SEC's Fort Worth offices. *See* App. at 193, Ex. F at 53:9-25. At that meeting, the SEC staff were focused on (i) whether securities being sold by Breitling were being sold in an appropriate fashion for unregistered securities, and (ii) whether the costs of the oil and gas interests were being accurately presented to investors. *Id.* at 194, Ex. F at 55:6-17. In particular, the SEC was probing whether the Authorizations for Expenditure ("AFEs") were accurate. *Id.* at 56:9-13. During the meeting, the SEC implied that Breitling was engaged in offering fraud. *Id.* at 195, Ex. F at 59:13-18.

In February and March 2013, the Breitling Entities' counsel produced more than 12,000 pages of documents to the SEC. App. at 263-8, Ex. G. By April 2013, counsel had produced more than 22,000 pages. The documents produced at this early date later formed the gravamen of the SEC's enforcement action against the Breitling Entities, including, for example, Quickbooks records, Confidential Information Memoranda ("CIMs") / investment brochures, draft financial statements for BOG/BRC, Spreadsheets titled "ownership breakdown.xlsx" and "Breitling well status summary," communications with investors, subscription documents, tax returns, bank account records for the prospect-specific accounts, "login information to a third-party website that has all the revenue and statements for . . . [Breitling]," reserve reports, "economic one-liners" and support therefor. *See id.*; App. at 209, Ex. F at 115:8-116:12.

The SEC staff, unlike Rothstein Kass, also had the ability to issue subpoenas to third parties. The SEC issued many such third-party subpoenas and received many documents in response. In March 2013, for example, the SEC subpoenaed BBVA Compass Bank seeking

documents related to 11 accounts. In April 2013, a subpoena was issued to Wells Fargo Business who produced 6,423 pages of records for 19 accounts.

In June 2013, the SEC received 2,873 pages in response to a subpoena issued to Jan Howland, an outside vendor for the Breitling Entities who provided bookkeeping services with regard to payments by Breitling to both working interest and royalty interest investors. The SEC subpoena sought Howland's work papers, "financial statement files, communications with Breitling, and documents regarding errors or irregularities in Breitling's books and records."

In July 2013, the SEC began inquiring about oversold working interests—another subject that would later feature prominently in the SEC's complaint against the Breitling Entities and in the Plaintiff's complaint in this case. By email dated July 29, 2013, the SEC staff attorney asked Vinson & Elkins:

> These individuals/entities submitted subscription agreements to Breitling for the Pumpkin Ridge 2 prospect, they sent checks to Breitling for that prospect, and Breitling appears to have cashed those checks. But these individuals/entities are not listed as investors in the Pumpkin Ridge 2 prospect on the Payment Manager website.

App. at 273, Ex. H.

After receiving thousands of documents from a variety of sources, conducting interviews, and communicating with counsel, on September 9, 2013, the SEC took sworn testimony on the record from Christopher Faulkner, the Chief Executive Officer of BOG and BRC. At this September testimony, it was clear that the SEC thought that the oil well AFEs were overstated. App. at 202, Ex. F at 86:6-9. That is, the costs were grossly inflated, and, therefore misleading to the potential investors—a central issue later alleged by the SEC against the Breitling Entities. In fact, the SEC implied that Breitling was outright falsifying the AFEs it was including in its offering materials. *Id.* at 229, Ex. F at 196:4-10. The SEC also asked questions about cash segregation during Faulkner's testimony. *Id.* at 204-5, Ex. F at 94:1-9, 99:24-100:9.

Also in September 2013, the SEC subpoenaed documents from Crown Energy, an operator of three well prospects BOG sold working interests in, and obtained sworn, on the record testimony from its general counsel in October 2013. In October 2013, the SEC also subpoenaed EOG Resources and Oasis Petroleum, Inc., each of whom was an operator for a BOG well prospect.

In September 2013, in response to one of its subpoenas, the SEC received more than 119,000 pages of documents from Mire Petroleum Consultants, an oil and gas petroleum engineering consulting business that specializes in reserve reports and reservoir evaluations. App. at 353-4, Ex. N.

The SEC had in its possession virtually all of the foregoing information on or before the date Plaintiff alleges Rothstein Kass *began* its audit of BOG and BRC in September 2013. First Am. Compl. ("FAC") at ¶ 35 (Dkt. 45). Indeed, the SEC had all of this information (and far more information than Rothstein Kass) by the time Rothstein Kass completed its audit of BOG and BRC in February 2014 and of BECC in March 2014, only a few months from the time the audits began.

However, the SEC investigation continued, and in or about September of 2014, Rothstein Kass produced its audit file and work papers to the SEC. *See* App. at 276-7, Ex. I. Contrary to the suggestion of Plaintiff and his damages expert, receiving this information in 2014 from Rothstein Kass did not cause the SEC to immediately seek "relief to prevent Breitling from selling additional securities to investors." App. at 67-8, Ex. A at ¶ 108.

In January 2015, four years after the beginning of the investigation into the Breitling entities, the Staff of the SEC met with counsel for the Breitling Entities. At that presentation, the

Staff of the SEC informed counsel that it intended to recommend that the SEC file an enforcement action alleging:

1. The Breitling Entities and Faulkner violated the anti-fraud provisions of the federal securities laws;
2. Certain Breitling employees aided and abetted Breitling's and Faulkner's fraud;
3. Certain individuals violated broker-dealer registration provisions; and
4. BECC and its Chief Financial Officer violated the antifraud and reporting provisions of the Exchange Act.

See App. at 280, Ex. J. The basis for these claims was that Breitling made misrepresentation in its CIMs including (i) inflating the costs of the AFEs, and (ii) making false statements about segregating cash. During this January 2015 meeting, the SEC laid out facts that they intended to allege in a lawsuit alleging violations of United States securities laws. App. at 217, Ex. F at 149:14-19. To be sure, in its presentation the SEC Staff credits Rothstein Kass for identifying the inflated AFE and cash segregation issues. But, again contrary to the damages theory asserted by Plaintiff and his expert witness, even after having received information from Rothstein Kass, the SEC did not seek "relief to prevent Breitling from selling additional securities to investors." App. at 67-8, Ex. A at ¶ 108.

In June 2016—nearly two years after receiving the Rothstein Kass work papers—the SEC brought an enforcement action against the Breitling entities and Chris Faulkner in *SEC v. Faulkner*, Case No. 3:16-cv-01735-D (N.D.Tex.). In its original complaint and its First Amended Complaint against Faulkner and the Breitling entities, the SEC made allegations relating to issues that were the subject of the SEC investigation well before Rothstein Kass began its audit. For example, the SEC alleged, "the Big Caesar, Pumpkin Ridge, and Bighorn prospects included identical AFEs despite involving prospects with different operators, prospect locations, and proposed drilling depths." *SEC v. Faulkner et al.*, No. 3:16-cv-01735-D (N.D. Tex.) First

Am. Compl. ("SEC FAC") ¶ 53 (Dkt. 22). The Breitling Entities produced the CIMs for Big Caesar and Bighorn to the SEC in February 2013 and the CIM for Pumpkin Ridge in March 2013. *See* App. at 264-5, Ex. G. Importantly, in the SEC's complaint against the Breitling Entities, the SEC explicitly and in detail alleges that the Breitling Entities, BECC and its management "lied to the auditors with an eye toward obtaining a clean audit opinion for BECC." SEC FAC at ¶ 75. Yet Plaintiff in this case alleges that the SEC could have and would have stopped the Breitling Entities' securities fraud if only Rothstein Kass had "withdrawn and notified the SEC of their findings." App. at 67-8, Ex. A at ¶ 108.

III. PROCEDURAL HISTORY

On June 30, 2020, Defendants issued a Subpoena to Testify at a Deposition in a Civil Action to the SEC that identified six areas to be examined. App. at 109, Ex. B.[1]

By correspondence dated July 9, 2020, the SEC objected to the subpoena on a variety of grounds to which Defendants' counsel responded on August 7, 2020. App. at 333-9, Exs. K & L. Among other things, Defendants' counsel agreed to significantly narrow the scope of the subpoena to a single topic: the Rothstein Kass Audit's role in the SEC Investigation. *Id.* at 338. Having received no response from counsel for the SEC for over a month, on September 24, 2020, Defendants' counsel again conferred with SEC counsel by telephone and provided additional information regarding the relevance of the SEC's deposition testimony. App. at 344-6, Ex. M. Most recently, on October 9, 2020, counsel for the SEC indicated that the SEC will not comply with the subpoena. App. at 356-9, Ex. O.

[1] The Defendants have also issued a subpoena *duces tecum* to the SEC seeking production of relevant documents and communications related to the SEC's investigation of Breitling and its management. After significant communications between counsel for the SEC and Defendants, the SEC has indicated that they will try their best to produce responsive documents by the end of October. Should that response be insufficient, the Defendants may move to compel the SEC to produce all non-privileged, responsive documents.

The Defendants seek an order from this Court compelling the SEC to comply with the deposition subpoena.

IV. ARGUMENT

A. The Discovery Sought by Defendants is Relevant

The proper scope of discovery is "any nonprivileged matter that is relevant to any party's claim or defense." Fed.R.Civ.P. 26(b)(1). Information is relevant "if the discovery appears reasonably calculated to lead to discovery of admissible evidence." Fed.R.Civ.P. 26(b)(1). The scope of discovery is broad. *See Gomez v. Martin Marietta Corp.*, 50 F.3d 1511, 1520 (10th Cir.1995). The federal discovery rules reflect the recognition that "[m]utual knowledge of all the relevant facts gathered by both parties is essential to proper litigation." *Hickman v. Taylor*, 329 U.S. 495, 507 (1947). "Relevant information encompasses 'any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case.'" *Merrill v. Waffle House, Inc.*, 227 F.R.D. 467, 470 (N.D. Tex. 2005) (*quoting Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1978)). The SEC cannot meet its burden to show that its testimony is irrelevant to the Plaintiff's claims and the Defendants' defenses. *Id.* at 470-471 (if discovery seems relevant, objecting party bears the burden of establishing lack of relevance).

Plaintiff's damages theory makes plain the relevance of the SEC's deposition testimony. Specifically, Plaintiff has tied his entire damages theory to the point in time when, in his view, Rothstein Kass "should have withdrawn and notified the SEC of their findings" so that the SEC could have "sought relief to prevent Breitling from selling additional securities to investors." App. at 67-8, Ex. A at ¶ 108. Plaintiff's damages expert goes further and speculates that damages stopped accruing once the SEC had "likely obtained sufficient (albeit disputed) evidence via subpoenas the SEC issued to Rothstein" to bring an enforcement action. *Id*. However, Plaintiff's damages expert believes that the SEC could have brought an enforcement

action against the Breitling Entities in August 2014, nearly two years prior to the date on which the SEC actually brought its case in June 2016. *Id*.

While the parties appear to agree that the SEC could have brought its enforcement action much earlier than it did, the timing of the SEC's enforcement action (and the impact of Rothstein Kass's audit on that timing) is central to Plaintiff's damages theory and Defendants' defenses to that theory. As discussed above, by the time Rothstein Kass began the audits of BOG and BRC in September 2013, the SEC had conducted an informal investigation for more than one year, had conducted a formal investigation for at least 9 months, and had been focused on the very issues Plaintiff faults Defendants for not telling the SEC about earlier than they did.

Testimony from the SEC will demonstrate the presence or absence of information in the Staff's possession before, during, and after the Rothstein Kass audits. The SEC's testimony is essential to this line of inquiry. The SEC's communications with third-parties, for instance, will demonstrate the sources of information—other than Rothstein Kass—that the SEC had access to and the breadth of the SEC's knowledge of the Breitling Entities' activities. Defendants will be improperly prejudiced if the SEC is permitted to withhold information about its investigation and enforcement action against the Breitling Entities while the Plaintiff is permitted to press his assertion that the SEC's delay of more than five years in bringing an enforcement action against the Breitling Entities and Faulkner is somehow attributable to the timing of information provided to the SEC by Rothstein Kass.

As narrowed, the single deposition topic now at issue falls well within what is permitted under the Federal Rules of Civil Procedure. *See, SEC v. Kramer*, 778 F. Supp.2d 1320, 1326-8 (M.D. Fla. 2011) (overruling as clearly erroneous magistrate judge's order denying defendant's motion to compel deposition testimony from the SEC under FRCP 30(b)(6) regarding "The

specific facts, information, documents, and/or other evidence specifically relied upon by the [Commission], which support a specific cause of action and claim(s) for relief asserted by the [Commission]"); *see also SEC v. Merkin*, 283 F.R.D. 689 (S.D. Fla. 2012), *SEC objections overruled*, 283 F.R.D. 699 (S.D. Fla. 2012) (upholding magistrate judge's ruling that the SEC was not exempt from a 15 topic Rule 30(b)(6) deposition).

B. The Defendants are Entitled to Depose the SEC

Federal Rule of Civil Procedure 30(b)(6) permits a party to notice the deposition of "a governmental agency." Fed. R. Civ. P. 30(b)(6). In pertinent part, Rule 30(b)(6) provides that "a party may name as the deponent a public or private corporation, a partnership, an association, ***a governmental agency***, or other entity. . ." *Id.* (emphasis added). Thus, there is no express or implied exception to Rule 30(b)(6) for government agencies. In fact, the Advisory Committee Notes to Rule 30(b)(6) indicate that in 1970 the Rule was revised specifically to allow for the deposition of a governmental agency. *See* Fed. R. Civ. P. 30(b)(6) advisory committee's note to 1970 amendment.

Upon receiving a subpoena, the agency must "designate one or more officers, directors, or managing agents, or designate other persons to testify on its behalf; and it may set out the matters on which each person designated will testify. . . The persons designated must testify about information known or reasonably available to the organization." Fed. R. Civ. P. 30(b)(6). Further, the "Rule 30(b)(6) deponent must make a 'conscientious good-faith endeavor to designate the persons having knowledge of the matters sought' and to prepare those persons so they can 'answer fully, completely, unevasively, the questions posed ... as to the relevant subject matters.'" *F.T.C. v. CyberSpy Software, LLC*, No. 6:08-cv-1872-Orl-31GJK, 2009 WL 2386137, *1 (M.D. Fla. July 31, 2009) (*quoting S.E.C. v. Morelli*, 143 F.R.D. 42, 45 (S.D.N.Y.1992)).

C. Defendants are Not Seeking Privileged Material

To the extent that the SEC opposes this motion by arguing that the Defendants are seeking information protected by the attorney client privilege, the deliberative process privilege, or the attorney work product protection doctrine, that contention is without merit. The Defendants are seeking the facts about how the audits of the Breitling Entities impacted the SEC's investigation.

Specifically, Defendants are seeking factual information about the investigation, not the mental processes or decision making of the SEC. No privileges apply to such purely factual information. *In re Sealed Case*, 121 F.3d 729, 737 (D.C. Cir. 1997) (per curiam) ("The deliberative process privilege does not … protect material that is purely factual, unless the material is so inextricably intertwined with the deliberative sections of documents that its disclosure would inevitably reveal the government's deliberations"). The deliberative process privilege protects information Defendants are *not* seeking: "advisory opinions, recommendations and deliberations comprising part of a process by which governmental decisions and policies are formulated." *Department of Interior v. Klamath Water Users Protective Ass'n*, 532 U.S. 1, 8 (2001) (*quoting National Labor Relations Board v. Sears, Roebuck & Co.*, 421 U.S. 132, 150 (1975) (internal quotation marks omitted)). Even if the SEC were able to establish a claim of deliberative process privilege, such a privilege is not absolute and may "be defeated by a showing of evidentiary need" by a party that "outweighs the harm that disclosure of such information may cause." *Alaska v. United States*, 16 Cl. Ct. 5, 11 (1988). The government may waive the privilege by using the material in other litigation or placing a portion of the material at issue while self-servingly retaining the rest. *Rupert v. United States*, 225 F.R.D. 154, 156 (M.D. Pa. 2004). The fact that the SEC staff has filed a complaint against the Breitling Entities, provided its investigative file to Plaintiff, and (prior to filing its lawsuit)

communicated extensively and in writing with the Breitling Entities (including providing the detailed presentation discussed above outlining the basis for the SEC's proposed claims against the Breitling Entities), suggests there is very little about the SEC's pre-decisional deliberations that remains privileged.

In any event, should the Defendants' deposition of the SEC "stray[] into truly privileged or irrelevant areas, the court [can be] confident that the SEC's counsel is familiar with the appropriate procedure for objecting at a deposition, and, if required, involving the court." *See SEC v. McCabe*, No. 2:13-CV-00161-TS-PMW, 2015 WL 2452937, at *4 (D. Utah May 22, 2015). Thus, to the extent Defendants' examination seeks "either the work product or mental impressions of Commission counsel, the Commission's designated deponent retain[s] the right to refuse to answer on the basis of privilege." *SEC v. Kramer*, 778 F. Supp. 2d 1320, 1328 (M.D. Fla. 2011). Permitting the Commission in this instance to assert a blanket claim of privilege in response to a Rule 30(b)(6) subpoena creates an unworkable circumstance in which a defendant loses a "primary means of discovery without a meaningful review of his opponent's claim of privilege." *Id*.

D. *Touhy* Does Not Preclude a Deposition of the SEC

In its October 9, 2020, letter, the SEC appears to take the position that it has no obligation to respond to a federal court deposition subpoena, inviting Defendants to "appeal" its decision. App. at 356-9, Ex. O. To the extent the SEC seeks to avoid a deposition on the basis of 5 U.S.C. § 301, the Administrative Procedure Act (the "APA"), *United States ex. Rel Touhy v. Ragen*, 340 U.S. 462 (1951), or the SEC's *Touhy* regulations, such avoidance is misplaced. Nothing about the APA or *Touhy* "create[s] an independent privilege to withhold government information or shield federal employees from valid subpoenas. *Exxon Shipping Co. v. U.S. Dep't of Interior*, 34 F. 3d 774, 780 (9th Cir. 1994). Rather, "An agency's *Touhy* regulations are relevant for

internal housekeeping and determining who within the agency must decide how to respond to a federal court subpoena." *Watts v. SEC*, 482 F.3d 501, 508-509 (D.C. Cir. 2007 (Kavanaugh, C.J.)). Federal Rule of Civil Procedure 45 "gives the district courts authority to issue subpoenas and instructs the courts how to address disputes over subpoenas." *Id*. The *Touhy* regulations are only applicable when the deposing party seeks to depose a particular member of the Staff such as the trial team litigating the SEC Action, and "[u]ltimately, it is up to the SEC to designate someone who is not conflicted either by status or privileged issues." *McCabe*, 2015 WL 2452937, at *4 (D. Utah May 22, 2015).

V. CONCLUSION

For the foregoing reasons, the Court should order the SEC to comply with the subpoena issued by the Defendants seeking deposition discovery about the role that Rothstein Kass's audits served in the SEC investigation.

Dated: October 14, 2020

Respectfully submitted,

/s/ Nicolas Morgan

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Certificate of Conference

The SEC opposes this motion. Counsel for Defendants and Juanita C. Hernández, counsel for the SEC, have conferred via telephonic conference on September 24, 2020, during which there was a substantive discussion of every item presented to the Court in this motion and, despite best efforts, the counsel have not been able to resolve those matters presented.

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 and to the SEC in accordance with the Federal Rules of Civil Procedure on October 14, 2020 via ECF notification and by e-mail.

/s/ Nicolas Morgan
Nicolas Morgan