UNITED STATES DISTRICT COURT
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 P.A. d/b/a ROTHSTEIN KASS & CO. P.C.; ROTHSTEIN KASS & COMPANY, PLLC and BRIAN MATLOCK, Defendants.	§ § § § § § § § § § §	NO. 3:19-cv-01594-D

THE RECEIVER'S RESPONSE TO DEFENDANT ROTHSTEIN KASS'S MOTION FOR SUMMARY JUDGMENT AND BRIEF IN SUPPORT

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Plaintiff Thomas L. Taylor III, solely in his capacity as temporary Receiver for the Breitling group of companies ("Receiver"), files this response to Defendants Rothstein Kass P.A. d/b/a Rothstein Kass & Co. P.C., ("RK") and Brian Matlock ("Matlock")'s motion for summary judgment and memorandum of law in support [ECF Nos. 94 and 95] and would show the Court the following.

I. PRELIMINARY STATEMENT

RK and RK audit engagement partner Matlock (RK and Matlock sometimes collectively referred to herein as "Defendants") served as the auditors for the principal Breitling entities Breitling Oil and Gas ("BOG"), Breitling Royalties ("BRC") and Breitling Energy Corporation ("BECC")[1] and issued two "clean", unqualified audit opinions for inclusion in SEC filings as part of the reverse merger transaction the entities consummated to create the public company BECC. As part of their audit work, Defendants discovered all the various components of fraudulent and illegal conduct being committed by the Breitling entities - under the control and at the direction of Breitling CEO Chris Faulkner ("Faulkner") - that eventually led the United States Securities & Exchange Committee ("SEC") to file its enforcement action against Breitling and Faulkner *et al* and to appoint the Receiver.[2]

Despite their knowledge of Breitling's fraudulent and illegal conduct, Defendants proceeded to violate various audit standards and their obligations as auditors in order to assist Faulkner to conceal Breitling's misconduct from Breitling's Board and Audit Committee, the SEC and even from RK's own supervisory partners. Defendants then continued their concealment efforts after they had resigned as the auditors for BECC by refusing to turn over any of the work papers or even Breitling's own general ledger financial documentation to BECC's CFO or

[1] BOG, BRC and BECC are sometimes collectively referred to herein as "Breitling".
[2] *SEC v. Faulkner et al*., Case No. 3:16-CV-1735-D (N.D. Tex. 2016) (the "SEC Action").

successor auditor in 2014-2015, thereby making it impossible for the successor auditor or BECC's Board or Audit Committee to verify Defendants' work or discover their misconduct.

As the record evidence cited below demonstrates, Defendants knew that Faulkner was causing Breitling to (1) commit securities fraud by misrepresenting the details of the oil and gas securities offerings and failing to disclose material facts to investors in Breitling's offering materials, and (2) violate securities laws prohibiting the sale of securities by unlicensed sales personnel, and also knew that (3) Faulkner was misappropriating millions of dollars from the Breitling entities through unsubstantiated "expense reimbursements". Nevertheless, Defendants assisted Faulkner by concealing and covering up the fraud and violations of law they discovered and instead issuing 2 clean audit opinions for Breitling which were filed with the SEC. In doing so, Defendants furthered Faulkner's unlawful purpose and contributed to causing catastrophic liabilities to Defendants' clients, the Breitling entities.[3] As a result, the Receiver sues Defendants for participation in breaches of fiduciary duty and for negligence/malpractice. There is substantial evidence from which a jury could find in the Receiver's favor on both issues. At a minimum, the evidence set forth below creates fact issues that must be considered by a jury and precludes summary judgment.

II. FACTS ESTABLISHED BY THE SUMMARY JUDGMENT RECORD

A. RK knew that Faulkner was Breaching his Fiduciary Duties by Causing the Breitling Entities to Engage in Fraud and to Violate Securities Laws

Chris Faulkner was the CEO and Board member of BOG, BRC and BECC.[4] Jeremy Wagers ("Wagers") served as General Counsel of BOG, BRC and BECC and was also a member

[3] The Receiver's expert witness, Saul Solomon of Berkeley Research Group ("Solomon"), has provided an expert opinion on causation and damages in this case, opining that Defendants' conduct resulted in between $25.5 million and $52.4 million in increased liability damages to the Breitling entities and between $12.8 million and $34.1 million in misappropriation damages. Saul Solomon Declaration and Report at ps. 67-68, App. 3591-92.

[4] Jeremy Wagers Depo., at 21:2-22:2, App. 2883-84.

of the Board of BECC,[5] and Rick Hoover ("Hoover") served as the formal CFO of BECC from December 2013 to February 2015, although he had worked part time for Breitling as an accounting consultant since mid-to-late 2013.[6]

As officers and directors of the above Breitling entities, Faulkner, Wagers and Hoover owed fiduciary duties to said entities as a matter of law, which included duties to ensure that the Breitling companies complied with U.S. securities laws and did not engage in fraud.[7] Instead, they caused the Breitling entities to engage in securities fraud and other violations of securities laws, and the Breitling fraud scheme and violations of securities laws inevitably led the SEC to file its enforcement action against the Breitling entities and, *inter alia*, Faulkner, Wagers and Hoover, in June 2016 and to appoint the Receiver on August 14, 2017.[8] In its original and Amended Complaints, the SEC alleged that Faulkner, Wagers and Hoover engaged in or aided and abetted securities fraud and violations of various securities laws.[9] Faulkner was indicted for various criminal acts, and on November 2, 2020 Faulkner reached a Plea Agreement with the government whereby he pled guilty to, *inter alia*, securities fraud.[10] As part of the Factual Resume in support of his Plea Agreement, Faulkner admitted to engaging in a scheme to defraud that involved inflating the drilling and completion costs (the Authorization for Expenditures, or "AFEs") for the

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[5] Wagers Depo., at 147:6-149:24, App. 2809-11.

[6] Hoover Depo., at 34:10-35:9, App. 608; Hoover Depo. at 16:22-17:14, App. 727-728; 38:6-14, App. 749.

[7] It is axiomatic that a corporate director or officer breaches his fiduciary duty by causing the entity to engage in illegal conduct. *Gearhart Indus. v. Smith Int'l,* 741 F.2d 707, 719 (5th Cir. 1984) (holding that a director will be held personally liable for a breach of the duty of obedience if he intentionally directs the corporation to violate positive law); *In re Life Partners Holdings, Inc. S'holder Deriv. Litig*., 2015 U.S. Dist. LEXIS 168198 *32 (W.D. Tex. 2015) (holding that a director is liable for a "knowing violation of law"); *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003) ("[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey.").

[8] *SEC v. Faulkner et al*., Case No. 3:16-CV-1735-D (N.D. Tex. 2016), at ECF No. 1 (Original Complaint) and ECF No. 108 (Order Appointing Temporary Receiver).

[9] *See* First Amended Complaint in the SEC Action, ECF No. 22, at ps. 50-61.

[10] Faulkner 11/2/20 Plea Agreement in *United States v. Christopher A. Faulkner*, Case No. 3:18-CR-500-B, App. 9 - 16. On December 1, 2020 Judge Boyle accepted Faulkner's guilty plea and set his sentencing for April 1, 2021. *Id*., at ECF Nos. 131, 132.

oil and gas wells Breitling offered to investors via its offering prospectuses, causing the Breitling entities to oversell oil and gas interests to investors, failing to maintain investor funds for the different well projects segregated in separate bank accounts and instead commingling investors' funds into Breitling's general operating accounts, and causing the Breitling entities to transfer millions of dollars of investor funds to Faulkner for his own personal use.[11]

1. Breitling Retains RK for public company audits for FY 2011-2012 and 2013

Defendants knew from the inception of their relationship with Breitling that the audit work they were to perform for Breitling was related to a reverse merger transaction to convert BOG and BRC into a publicly traded company that became BECC, and that RK's audit opinions were going to be included in related SEC filings. Indeed, RK's engagement letters with Breitling specifically acknowledge that the purpose of the audits was for the reverse merger and related SEC filings.[12]

Importantly, Defendants' audits of Breitling were also important for the SEC to understand Breitling's operations. Breitling's counsel at Vinson & Elkins ("V&E") John Wander, who at the time was representing Breitling in an SEC investigation related to Breitling's sales practices, testified that when Breitling retained RK to perform the audits for the reverse merger transaction, the SEC was anxious to obtain and review audited financials for Breitling, and the SEC (and V&E) believed it was a "good development" that RK would be auditing Breitling's financials,[13] because having audited financials for Breitling would help Breitling resolve any doubts the SEC had about Breitling at the time.[14]

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[11] Factual Resume in *United States v. Christopher A. Faulkner*, Case No. 3:18-CR-500-B, App. 17 - 27.
[12] PX 95, App. 3728-34 (engagement letter with BOG/BRC for 2011/2012 audit); PX 105, App. 3822-28 (engagement letter with BECC for 2013 audit). Wagers Depo. at 41:7-42:18, App. 2703-04.
[13] John Wander Depo., at 115:2-25, App. 3180.
[14] Wander Depo., at 197:4-25; App. 3262.

2. At the Initiation of the Audit work for Breitling, Defendants Determined that Breitling Employees were Offering and Selling Securities as Unregistered Brokers and that Faulkner was a Fraud Risk for Misappropriation of Cash

When Defendants began their initial audit preparatory work for Breitling they learned that Breitling's internal bookkeeper or "controller" Beth Handkins ("Handkins") would be RK's primary source for Breitling financial documentation, but she had no accounting experience and Defendants didn't consider her to be competent.[15] RK's Bertrand Maimo ("Maimo") created an internal control "walk through" Memo in July 2013 describing how Faulkner and Handkins controlled all payments and expenditures for Breitling.[16]

In its "Planned Audit Scope Memorandum" created at the beginning of its audit field work in October 2013, RK noted that Breitling "***serves as more of a broker-dealer of oil and gas securities***" and had ***non-existent internal controls***.[17] RK described the Breitling audit as "high risk" because RK's audit would be used in public SEC filings, and RK identified fraud risks associated with (i) improper revenue recognition; (ii) ***management override of controls***; and (iii) and significant use of credits cards by Faulkner which, when coupled with a lack of controls over disbursements (processed by Handkins), led RK to conclude that "***there is increased risk of misappropriation of cash due to fraud***".[18] Defendants' early recognition of an increased risk that Faulkner could steal company funds led RK to state in its audit planning Memo that it would perform additional testing on expenses incurred by Faulkner.[19]

Once they began the audit field work in October 2013, Defendants quickly realized that close to 100% of Breitling's revenues came from investors purchasing oil and gas securities

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[15] Nymeyer 8/3/17 Depo at p. 86-87; App. 1843-44; Maimo 12/4/14 Depo. App. 1027.
[16] PX 157; App. 3938-3941. Maimo 12/4/14 Depo. at ps. 16-17, 21; 76, 78-79, 86-88, App. 1001-02,1026, 1027, 1029, App. 1029; Maimo 5/22/19 Depo. at ps. 50, 86, 210-211; App. 1235, 1244, 1275.
[17] PX 96, App. 3735-42.
[18] *Id.* Upon being shown RK's Planned Audit Scope Memorandum (PX 96), which he had never seen before, Wagers testified that no one from RK informed him of RK's concern that Faulkner posed a risk of misappropriation of company funds. Wagers, at 73:19-74:7, App. 2735-36; 77:4-78:23, App. 2739-40.
[19] PX 96. App. 3735-42.

(fractionalized working and royalty interests) from Breitling.[20] RK's Audit Manager for the Breitling audit Michael Nymeyer ("Nymeyer") immediately began experiencing problems obtaining audit support for Faulkner's expense reimbursements, which he communicated to lead RK audit partner Matlock in real time.[21]

In late October/early November 2013, Nymeyer reviewed a large portion of Breitling's offering prospectuses called "Confidential Information Memorandums" ("CIMs"). On November 26, 2013, Matlock e-mailed Breitling's contract accountant (and future BECC CFO) Hoover explaining that RK needed to review the CIMs "***to ensure that Breitling is complying with Texas securities laws***", and Matlock also referenced the "***rules that individuals selling working interests must be registered as securities brokers in Texas***", and his view that Breitling's "***historical litigation…makes the risk of rescission liability substantial***".[22]

3. RK Discovers all the Components of the Breitling Fraud by December 2013

a. Overselling of Securities Fraud

Through his review of the CIMs and Breitling's financial records, by November 2013 RK's Nymeyer discovered that Breitling was likely committing securities fraud via the overselling of fractionalized working interests in oil and gas wells to investors (i.e., BOG was selling more interests in the wells than BOG owned) (the "Overselling Fraud").[23] Nymeyer testified that he and Matlock discussed whether such overselling constituted securities fraud.[24]

As a result of his discoveries, on November 20, 2013 Nymeyer e-mailed Matlock attaching a chart that detailed the Breitling audit issues uncovered to date, including the Overselling Fraud and RK's inability to verify $1.1 million in expense reimbursements to Faulkner

[20] Nymeyer Depo at p. 48; App. 1756.
[21] PX 206, App. 3957-59.
[22] See PX 265, App. 4078-79.
[23] Nymeyer Depo at p. 13-17, 23, App. 2060-62.
[24] Nymeyer Depo at p. 67-68; App. 2017.

for alleged "lead expenses". Nymeyer's chart states that if Breitling could not resolve the issues then RK would not be able to issue an audit opinion.[25]

Matlock recognized the seriousness of the issues facing Breitling under U.S. securities laws, as evidenced by his November 20-21, 2013 e-mails with Hoover and Breitling General Counsel Wagers in which Matlock identified the overselling of working interests as a material audit issue and observed that the sales were "*subject to securities laws*" and cautioned that Breitling would need to make rescission offers to the oversold investors.[26] Wagers recently testified in deposition that Matlock never raised any of those securities law compliance concerns with him, even though Wagers was the General Counsel of Breitling and himself a securities lawyer, and since RK issued the two clean audit opinions and never withdrew from the engagements, Wagers assumed that Matlock's concerns had been resolved.[27]

Nymeyer has admitted that the Overselling Fraud was material to the Breitling financial statements since the sales would have to be reclassified as balance sheet liabilities,[28] because if Breitling didn't remediate the issue then RK would have to make "significant adjustments" due to "significant rescission" exposure in the "millions of dollars".[29] Yet despite a November 22, 2013 internal e-mail between Nymeyer and Matlock discussing the Overselling Fraud and how Breitling would need to record rescission liabilities,[30] Defendants never recommended that Breitling record such liabilities; instead, as discussed below, Matlock's eventual "fix" for the Overselling Fraud

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[25] See PX 206, App. 3957-59.
[26] PX 239, App. 3989-91.
[27] Wagers Depo., at 63:11-64:11, 66:19-67:22, App. 2725-26, 2728-29. Wagers further testified that based on the Nymeyer Memo (discussed *infra*) and other RK documents he was shown in deposition that ***he believes that RK had knowledge and was aware, in real time, of the same securities law violations and securities fraud that the SEC eventually alleged against Breitling and Faulkner***. Wagers Depo., at 99:15-101:6, App. 2761-63.
[28] Nymeyer Depo. at p. 55-56; App. 2070.
[29] Nymeyer Depo. at p. 154-155; 159; 180-181, App. 1878-79, 1881, 1892.
[30] PX 240, App. 3992-93.

from an accounting perspective was to disguise the overselling as "deferred revenue" in Breitling's financial statements.

Faulkner, Wagers and Hoover's more immediate "solution" to the Overselling Fraud was for Breitling to transfer the oversold investors to different wells than the ones they had invested in.[31] Nymeyer testified that as a result of the investor transfers, RK needed "alternative audit evidence" to support the transfer/substitution of wells, which evidence was to consist of sending letters to the "oversold" investors to obtain their approval for the transfers.[32]

Nymeyer testified that at first Matlock seemed to agree that RK needed to obtain evidence of authorizations from the oversold investors but that – after Matlock *"had conversations with individuals at Breitling*" – Matlock pulled Nymeyer aside and told him that neither Breitling nor RK would send the oversold investors any authorizations or confirmations.[33] Nymeyer also testified that he personally requested that Breitling send authorizations to the investors affected by the overselling, but Breitling refused to do so.[34] Despite Nymeyer's warning that RK needed to receive evidence of the "oversold" investor's express authorization for such transfers,[35] RK never received proof that any of the "oversold" investors had authorized (or even been notified of) such transfers,[36] and therefore RK didn't receive the audit evidence it needed to resolve the Overselling

[31] Nymeyer testified he was told by Wagers that the CIMs allowed Breitling to transfer investors from the well in which they originally invested to other wells, but Nymeyer has admitted that RK never asked for any legal opinions on this issue from its own legal counsel and just took Wagers' word for it that the CIMs allowed such substitution [Nymeyer 6/18/19 Depo. at p. 34-35; 43, 53, App. 2065, 2067, 2070] despite the fact that Nymeyer didn't think that the provision in the CIMs cited by Wagers applied to any of the transfers and was therefore concerned and discussed his concerns with Matlock. Nymeyer Depo. at p. 142-145; 150-154; App. 1872-73, 1876-78.

[32] Nymeyer Depo at ps. 30-31, 33-34, 94-95; 97-98, App. 2064-65; 2080-81. On November 22, 2013 Nymeyer sent an e-mail to Matlock stating that RK needed to "*obtain the support and confirm with the working interest owners as needed*". PX 243, App. 3994**.** Nymeyer testified that given the extent of the overselling RK found, notification letters would have to have been ***sent to "hundreds" of investors.*** Nymeyer Depo at p. 198-200; App. 1901-02.

[33] Nymeyer Depo. at p. 189-191, App. 1896-98. Hoover testified that it was Faulkner and Handkins who told Matlock that Breitling didn't need to send any authorization letters to the oversold investors, and that he never saw any letters that were sent to Breitling's oversold investors. Hoover Depo. at 78:15-80:6 App. 789-791.

[34] Nymeyer Depo. at p. 30-31, 33-34; App. 2064-65.

[35] PX 206, App. 3957-59.

[36] See Nymeyer Depo. at p. 129-131; App. 1865-66.

Fraud issue.[37] Nymeyer has admitted that the audit evidence RK had on the Overselling Fraud issue was, as a result, insufficient for RK to issue an audit opinion.[38]

Nymeyer has also testified that the underlying legal basis cited by Wagers for the transfers of oversold investors to substitute wells based on the CIM was flawed because the cited CIM provision only allowed Breitling to transfer investors to comparable wells "*in the event Breitling or the operator obtains additional geological information*", which Nymeyer felt did not permit the transfer of investors when Breitling oversold a well, and Nymeyer testified he wasn't aware of any "additional geological information" that justified or supported any of the transfers, and that he raised his concerns with Matlock that the Overselling Fraud issue constituted potential fraud or illegal acts by Breitling that were left unresolved.[39]

Shockingly, Defendants knew that Breitling's overselling of securities was not just an isolated problem in the past but that Breitling continued to oversell its projects during the time RK was performing its audit fieldwork all the way through December 31, 2013.[40]

b. Commingling of Investor Funds Fraud

Nymeyer testified that he discovered the commingling of investor funds in violation of representations made in the CIMs regarding segregation of investor funds per well project in November-December 2013 when he discovered that Breitling was paying drilling costs out of the Breitling general operating account (the "Commingling Fraud").[41] Nymeyer discussed the issue

[37] Nymeyer Depo. at p. 94-95; 97-98; App. 2080-81.
[38] Nymeyer Depo. at p. 170-171; App. 1887.
[39] Nymeyer Depo at p. 142-145; 150-154, App. 1873-74, 1876-79. Nymeyer Depo. at p. 448-51; App. 2001.
[40] Nymeyer Depo at p. 242-243; App. 2117.
[41] Nymeyer Depo. at p. 338-340, App. 1973-74; Nymeyer Depo at p. 77, App. 2076. The SEC's forensic accountant Rodney Sowards has testified via declaration that Breitling commingled "the vast majority" of investor funds by transferring "substantially all deposits" from the segregated project-specific bank accounts to Breitling's general operating account in violation of the terms of the CIMs. Rodney Sowards Decl., at p. 5, 16, App. 3663, 3674. The Court has previously relied on the data and information provided by Rodney Sowards in the SEC Action. *SEC v. Faulkner*, 2020 WL 2042339 (N.D. Tex. 2020) (order approving Receiver's plan of distribution).

with Matlock and has admitted that Breitling's transfers of investor money from well-specific accounts to Breitling's general operating account constituted commingling of investor funds that violated representations Breitling made in the CIM offering documents.[42]

The way the Commingling Fraud worked was that Breitling would receive cash from investors into a segregated bank account Breitling established for each specific oil and gas well, where, per the terms of the CIMs, the cash was to be used exclusively to fund e.g., drilling expenses for the particular well(s), but as soon as the cash was received into the segregated account Faulkner had Breitling transfer the funds into Breitling's general operating account, which was contrary to the terms of the CIMs.[43] Nymeyer testified that the Breitling general operating account was the same account from which Faulkner took the millions of dollars in "expense reimbursements" he received from Breitling.[44]

Nymeyer testified that when he discovered Breitling was engaged in the Commingling Fraud, ***RK internally discussed whether Breitling was running a Ponzi* scheme**, using investor funds from one well project to pay for development costs for other wells,[45] and admitted that RK had to consider whether the commingling might constitute fraud or an "illegal act" under the audit standards.[46] Despite such discussions, Nymeyer didn't recall RK performing any additional audit procedures to determine whether the Commingling Fraud constituted securities fraud.[47]

c. Inflated AFE Fraud

In mid-December 2013, Nymeyer discovered that Breitling was inflating (and in some

[42] Nymeyer Depo. at p. 76-78, App. 1763-64; Nymeyer Depo. at p. 338-340; App. 1973-74.
[43] Sowards Decl., at p. 5, App. 3663. BECC Board member and Chair of the Audit Committee Chris Williford testified that a company like Breitling could not use working interest investors' money for any purpose other than paying for the drilling costs for the well prospect they invested in. Williford Sept. 30, 2020 Depo. at 30:6-23, App. 3328.
[44] Nymeyer Depo at p. 44, App. 2067. Sowards 8/8/17 Decl., at ps. 11-15, App. 3669-73.
[45] Nymeyer Depo. at p. 65-73; App. 1761-62.
[46] Nymeyer depo at p. 340:17-22, App. 1974 ("they weren't complying with…what they were representing"); ps 352:8-10, App. 1977.
[47] Nymeyer Depo. at p. 76-78; App. 2075-76.

cases duplicating) the AFEs that Breitling represented in the CIMs were the drilling and completion costs applicable to the specific oil and gas well projects (the "AFE Fraud").[48] Nymeyer reached the conclusion that the AFEs were inflated by comparing the actual costs of development (which he got from Breitling's general ledger) with the AFEs represented in the CIMs.[49] Both Nymeyer and Matlock recognized the AFE Fraud as potential securities fraud and cited to a contemporaneous SEC case (*Arcturus*) that involved virtually the exact same fact pattern.[50]

Many of the AFEs were exact duplicates of AFEs from different CIMs for different well projects. On December 18, 2013, Nymeyer sent an e-mail to Wagers questioning why the AFEs described in the CIMs had the *exact same AFE costs* despite the wells having different operators and locations, and also asked Wagers who prepared the AFEs for the CIMs.[51] Nymeyer testified that Hoover told him that Breitling prepared the AFEs internally,[52] but Nymeyer didn't believe Breitling had the personnel necessary to prepare accurate AFEs (because AFEs are usually prepared by well operators and Breitling was not an operator and did not have a reserve engineer on staff) and he never got an answer as to who exactly at Breitling prepared the AFEs.[53] Nymeyer testified that it appeared to him that Breitling just "made up" the AFE numbers and that they were *not* based on "historical costs" of drilling wells,[54] as falsely represented in a footnote in the

[48] Nymeyer testified he discussed the inflated AFE issue with Hoover, but Hoover's explanation didn't satisfy him, and that Breitling **never** provided a satisfactory explanation for why this was happening. Nymeyer 9/30/14 Depo at p. 52-54, App. 1757-58.

[49] Nymeyer Depo at p. 264-268, App. 1936-37. The SEC's forensic accountant Rodney Sowards has testified via declaration the BOG offerings (that Defendants examined) included AFEs totaling $41 million, but that in reality only $12 million was used by Breitling for well-related drilling and other expenses, leaving an excess of close to $30 million for Faulkner to "play" with. Sowards Decl. at ps. 5-6, 15-17, App. 3663-64, 3673-75.

[50] PX 112-114, App. 3928-31; PX 158, App. 3942; PX 218, App. 3967-68. Nymeyer Depo at p. 254-262, App. 1930-34.

[51] PX 269, App. 4080. Nymeyer testified that despite his work on 20 prior oil and gas company audits, he had never seen a situation where the AFEs for different wells were exactly the same. Nymeyer Depo at p. 31-35; App. 1752-53.

[52] Nymeyer Depo at p. 31-35; App. 1753.

[53] Nymeyer Depo at ps. 38-39, 59-60, App. 1754, 1759; Nymeyer Depo. at p. 280-283; App. 1944-45; Nymeyer 8/4/17 Depo at 362:3-10, App. 1979.

[54] Nymeyer Depo. at ps. 89-92; App.1767.

financial statements approved by RK and included in the SEC filings.[55] Nymeyer has also admitted that he became aware of several different Breitling CIMs offering different wells in different counties (even different states) and using different operators that also contained *identical* AFEs, such that the duplication appeared to him to be intentional and Nymeyer agreed that the duplicated AFEs constituted another fraud risk.[56]

After questioning Hoover about the reasons for the inflated AFEs and receiving a less than satisfactory answer, on December 19, 2013 Nymeyer sent an email to Matlock regarding Hoover's response and noted "***would a reasonable person buy…knowing that ½ of his money is being pocketed by Breitling to cover overhead***"?[57] Nymeyer also testified that, because the inflated AFEs were included in Breitling's offering CIM documents, he viewed the CIMs as materially misleading to investors, and has since ***admitted that the AFE Fraud constituted securities fraud as alleged by the SEC in its enforcement action and that he discovered the AFE Fraud in December 2013***.[58] RK's Bertrand Maimo has also admitted that he believed the inflated AFE issue constituted potential fraud on the Breitling investors.[59] Nymeyer has further admitted that neither he nor anyone at RK did any additional work to resolve the concerns surrounding the AFE Fraud because Matlock decided that the AFEs were outside the audit scope and didn't affect the financial statements.[60] So based on Matlock's judgment, RK didn't book any additional contingent

[55] Nymeyer Depo at p. 231-232, 238-244; App. 1919, 1922-25. Nymeyer and Hoover testified that RK prepared the footnotes and other major portions of the Breitling financial statements that were included in the SEC filings. Nymeyer depo at p. 377-390, App. 1983-86; Hoover 9/17/2019 Depo at p. 89, 151-153, 245-247, App. 621, 637, 660-61.
[56] Nymeyer Depo. at p. 313-322; App. 1961-66.
[57] PX 217, App. 3965-66.
[58] Nymeyer Depo. at p. 116-120; App. 2085-86.
[59] Maimo Depo. p. 180-183; App. 1140-41.
[60] Nymeyer Depo at p. 41, 43-48; App. 1755-56. Nymeyer further testified that the AFE issue was never resolved to his satisfaction. Nymeyer 8/4/17 Depo at 355:1-12, App. 1977.

liabilities for the AFE Fraud, and Defendants didn't even ask Wagers for an assessment of the litigation risk related to the AFE Fraud.[61]

d. Other Indications of Fraud

Nymeyer has testified that he was concerned about other misrepresentations he discovered in the Breitling CIMs, including that Faulkner had obtained a PhD from Concordia College, as Breitling represented in the CIMs, and which RK was unable to confirm was true.[62] Nymeyer admitted that such misrepresentations constituted further evidence of fraud or illegal acts that RK discovered in late 2013 *prior* to issuing its first audit opinion for Breitling.[63] Also during December 2013, RK requested and received a background report on Faulkner which disclosed Faulkner's recent arrest for cocaine possession and various lawsuits and judgments against Faulkner arising from the collapse of his prior internet companies.[64]

RK also learned in December 2013 that the SEC had "some kind of" investigation open on Breitling,[65] that there were multiple investor claims and lawsuits pending against Breitling alleging fraud, that the State of Kansas was investigating Breitling, and that the State of Pennsylvania had initiated a securities fraud investigation of Breitling.[66] But there is no evidence RK followed up on or investigated any of those issues as part of its audit work.

e. Faulkner's Theft of Funds from Breitling via Expense Reimbursements

Despite RK's early conclusion in its "Planned Audit Scope Memorandum" that Faulkner posed a risk of fraud for cash misappropriation,[67] Defendants decided not to probe into the millions

[61] *Id.* Nymeyer Depo at 357:11-359:19, App. 1978.
[62] Nymeyer Depo at p. 214-223; 228-229, App. 1909-14, 1917. Nymeyer agreed that Faulkner was a "hack" who never graduated from any college and didn't know anything about geology or petroleum engineering. *Id*., App. 1911.
[63] Nymeyer Depo. at p. 214-223; 228-229; App. 1909-14, 1917.
[64] PX 97-99, App 3742-73.
[65] PX 162, App 3943.
[66] PX 162, App. 3943; Nymeyer Depo. at p. 197-200; App. 2106.
[67] PX 96, App. 3735-42.

of dollars in "expense reimbursements" that Faulkner was paid by Breitling, including in particular Faulkner's use of multiple American Express cards for "business expenses".[68] Nymeyer testified that RK discovered the vast amount of Faulkner expense reimbursements early on in October 2013, and immediately ran into "roadblocks" over it.[69] RK's Maimo testified that he was concerned that as of December 11, 2013 roughly $10 million in "reimbursements" to Faulkner had not been corroborated and further testified that there "was no support" for those reimbursements.[70] A lot of Faulkner's expenses were for purchases of "investor lead lists", but Nymeyer and Maimo testified that RK could never get audit support documentation for the "lead" expenses.[71] Nymeyer testified that RK had little to no audit evidence to support $5.1 million that Faulkner's claimed he spent on advertising in 2012.[72] Maimo admitted that Faulkner was reimbursed for "lead" expenses of $1.2 million in 2011 and $1.3 million in 2012 but that RK received no invoices and no detailed explanation for those expenses and Maimo couldn't explain why RK issued an unqualified audit opinion anyway.[73]

Faulkner was paid $4.5 million by Breitling (from the commingled general operating account) for reimbursement of expenses in 2011 and 2012 *on top of* the direct payment by Breitling of his AMEX credit card charges for "travel" expenses.[74] Nymeyer admitted that RK had no evidence to support what the $4.5 million was for, except for $700,000 allegedly paid to L&J

[68] The SEC's forensic accountant Rodney Sowards has testified via declaration that Faulkner misappropriated *at least* $12 million during the time periods under audit by RK (January 2011 to December 2013). Sowards 8/8/17 Decl., at ps. 19-29, App. 3677-87.
[69] PX 205, App. 3955-56; Nymeyer 6/18/19 Depo. at p. 23, App. 2062. Nymeyer 8/3/17 Depo at p. 123-125, App.1862-63.
[70] PX 213, App. 3954; Maimo 6/8/17 Depo. p. 150-151; App. 1125-26.
[71] Nymeyer 8/3/17 Depo at p. 123-125, App. 1862-63; Nymeyer 8/4/17 Depo at 399:11-18, App. 188. Maimo 6/8/17 Depo. at p. 74-76, 81, App. 1089-92.
[72] Nymeyer 6/18/19 Depo. at ps. 278-281; App. 2126-27.
[73] Maimo 5/22/19 Depo. at pp. 146-147; App. 1259.
[74] Nymeyer 6/18/19 Depo at ps. 249-254; 258-259; App. 2119-21.

Holdings for investor "leads"; otherwise the only evidence RK obtained was a one page confirmation *from Faulkner* that he had incurred those expenses for Breitling's business.[75]

Similarly, Nymeyer admitted that Defendants knew that Faulkner owned two companies, Grand Mesa and Excel Management, that between them received over $4 million from the Breitling general operating account, and testified he knew that Breitling paid Faulkner's company Grand Mesa over $1 million for expense "reimbursements" but that the only audit evidence for the payments and reimbursement was a confirmation from Faulkner.[76]

Despite glaring evidence that Breitling reimbursed Faulkner for AMEX credit card charges that were for purely personal expenses, Nymeyer has admitted that RK just took Breitling management's word for it that those were legitimate business expenses.[77] In fact, on March 23, 2014, Matlock e-mailed Hoover and Wagers regarding $6 million in AMEX charges, asking "*are they just for Faulkner*" and suggesting that RK would just prepare a confirmation for Faulkner to sign.[78] Nymeyer also testified that the only audit evidence that RK received to support $6.9 million in AMEX credit card charges that Faulkner ran up in 2013 was a confirmation from Faulkner.[79]

Hoover testified that he relied on RK to confirm directly with the third-party vendors all the business expenses that Faulkner claimed, and that RK had full access to all of Breitling's AP/vendor files but never asked him any questions about Faulkner's expense reimbursements or requested any support for any of Faulkner's alleged marketing expenses.[80]

B. <u>Nymeyer Repeatedly Urges Matlock to Withdraw RK from the Breitling Audit</u>

Nymeyer testified that he lost faith in the credibility and integrity of Breitling's management by December 2013 and told Matlock on multiple occasions prior to the issuance of

[75] *Id.*
[76] Nymeyer 6/18/19 Depo. at ps. 201-213, App. 2107-10.
[77] Nymeyer 6/18/19 Depo. at ps. 215-223; App. 2110-12.
[78] PX 233, App. 3983-88.
[79] Nymeyer 9/30/14 Depo. at ps. 109-118; App. 1772-74.
[80] Hoover 9/17/19 Depo at 60:22-61:8, 63:1-64:2, 68:9-69:10, 72:15-73:10, App. 614 - 617.

RK's first audit opinion that RK should withdraw from the Breitling audit due to "reputational risks" to RK ***and the potential for lawsuits against RK***.[81] Nymeyer further testified that he urged Matlock to withdraw because of the Overselling Fraud he uncovered in November 2013 and the AFE Fraud he uncovered in December 2013.[82] Nymeyer testified that he first discussed RK's withdrawal with Matlock in late December 2013 because of the AFE Fraud but Matlock responded that the AFE issue was "outside of the financial statements" and therefore didn't impact the audit.[83]

Nymeyer had more than 3 discussions with Matlock about RK withdrawing,[84] asking Matlock "*why do we want to put ourselves at potential risk to be associated with a client like this?"* which he explained meant **the risk that someone might sue RK or Breitling or both**.[85] Importantly, *Nymeyer has admitted that it was* ***foreseeable*** *to RK that RK could be sued based on its work on the Breitling audits*.[86]

C. Matlock Actively Conceals Breiting's Fraud and Illegal Acts

1. Matlock "Buries" Nymeyer's Audit Summary Memo Outlining the Fraud

After discovering Breitling's Overselling Fraud, the Commingling Fraud, the AFE Fraud, and Faulkner's unsupported "expense reimbursements", Nymeyer wrote a scathing 11-page Summary Review Memorandum ("SRM")[87] (the "Nymeyer Memo"), which he completed in early January 2014, in which he detailed Breitling's fraud, "severely flawed" internal controls, RK's

[81] Nymeyer 6/18/19 Depo at p. 47-48; 102-103; 131; 165, App. 2068, 2082, 2089, 2098; Nymeyer 8/4/17 Depo at p. 364-370; App. 1980-81.
[82] *Id.*
[83] Nymeyer 6/18/19 Depo at p. 156, 160-162, App. 2095-97; Nymeyer 8/4/17 Depo. at p. 364; App. 1980.
[84] Nymeyer 8/4/17 Depo. at p. 366-369; App. 180-81.
[85] *Id.*
[86] Nymeyer 6/18/19 Depo. at p. 190-191, 194-195; App. 2104-05.
[87] At RK, an SRM typically would contain a summary of findings made by an RK audit team that the team felt needed to be highlighted to assist RK's supervisory reviewers. Nymeyer 8/3/17 Depo at p. 68-69, App. 1833-34; Maimo 6/8/17 Depo. at 168, App. 1134 (per Maimo, the SRM is a "standard RK work paper" that should capture all the important accounting/audit issues). Nymeyer testified that RK's supervisory partners would normally review an SRM as part of an audit. Nymeyer 8/3/17 Depo at p. 226-227, App. 1916.

knowledge of investor fraud claims and RK's problems verifying Faulkner's alleged "expenses".[88] But instead of immediately forwarding the Nymeyer Memo to the BECC Board or Audit Committee or directly to the SEC, as required by applicable auditing standards, once he reviewed the Nymeyer Memo Matlock decided to "bury" it by cutting and pasting (and watering down) Nymeyer's findings into a separate memo Matlock called a "CIM Review Memorandum",[89] which Matlock then placed (or, rather, buried) in the audit "permanent file" because he knew that the RK reviewing partners would not look at documents placed in the permanent file.[90]

According to Nymeyer's testimony and RK's work papers, Matlock reviewed Nymeyer's Memo on January 24, 2014, and Matlock then cut and pasted from Nymeyer' Memo to prepare the CIM Review Memo on that same day, January 24, 2014, which is also the same day that Matlock prepared the Critical Accounting and Audit Matters Memo (the "CAAM") for the Breitling audit.[91] Matlock then placed the CIM Review Memo in the audit "permanent file" instead of the audit "completion file".[92]

Also on January 24, 2014, Matlock created the "final", heavily watered down SRM for the Breitling 2011/2012 audit,[93] which at 4 pages was a shell of Nymeyer's original 11-page SRM

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[88] PX 163, App. 3944-54. Nymeyer 8/4/17 Depo at 431:10-433:4, App. 1996-97.

[89] PX 100, App. 3774-78. For detailed discussion of Matlock's "butchering" of the Nymeyer Memo, see Nymeyer 8/4/17 Depo at ps. 432:1-492:1, App. 1997-2012; ps. 501:7-529:1, App. 2014-21.

[90] Nymeyer 8/4/17 Depo. at p. 437:18-442:9, App. 1998-99.

[91] PX 147, App. 3932-33. Matlock placed the CAAM in the completion file as well. Nymeyer 8/4/17 Depo. at 457:1-6, App. 2003. The CAAM prepared by Matlock does ***not*** describe possible fraud and illegal acts at Breitling or otherwise alert the reader that the CIM Review Memo that Matlock buried in the permanent file contained information about fraud or illegal acts. PX 147, App. 3932-33. Nymeyer has testified that Breitling's fraud and illegal acts should have been referenced in the CAAM. Nymeyer 8/4/17 Depo. at p. 463:2-468:7, App. 2004-06. Matlock also appears as the first reviewer of the CAAM, which violates auditing standards because he should not review his own work. Nymeyer 8/4/17 Depo. at p. 455-464, App. 2002-05.

[92] Nymeyer 8/4/17 Depo. at p. 460-462, App. 2004. At RK, the audit "permanent file" would include routine things like corporate documents, and Nymeyer testified that RK supervisory review partners typically would *not* review documents contained in the permanent file, and that he was not surprised that RK's supervisory review partners testified they never saw Matlock's CIM Review Memorandum. Nymeyer 8/3/17 Depo at p. 75-78, App. 1837-39; Nymeyer 8/4/17 Depo at p. 442, App. 1999.

[93] PX 149, App. 3934-37.

Memo. Unlike the CIM Review Memo, which Matlock hid in the permanent file, Matlock placed his "sanitized" final SRM into the audit completion file where it belonged.[94] Nymeyer has testified that his original SRM Memo should have remained intact and should not have been converted into a CIM Review Memo and hidden in the permanent file, and that he felt the various audit issues he had uncovered (inflated AFEs, identical AFEs, oversold wells, commingling, misrepresentations in the CIMs) should have been properly documented.[95]

Nymeyer has further testified that Matlock not only cut and pasted and exported the vast majority of the "ugly" portions of the Nymeyer Memo to create the CIM Review Memo, but that Matlock also revised or deleted a lot of the original language Nymeyer used in his Memo to water it down such that Matlock's CIM Review Memo downplays the magnitude of the fraud Nymeyer originally described in his Memo and "leaves more to interpretation".[96] Nymeyer also testified that his original SRM Memo (and even Matlock's CIM Review Memo) were quite different from the final "sanitized" SRM that Matlock ultimately produced.[97] *Importantly, Matlock also deleted all references to issues concerning Faulkner's expense reimbursements from both the CIM Review Memo and the final watered down SRM*, which Nymeyer testified was "unusual".[98]

2. Matlock Conceals Nymeyer's Fraud Findings from RK's Reviewing Partners

On February 11, 2014, Maimo submitted RK's Quality Control package (including the watered down SRM and CAAM prepared by Matlock) for the Breitling audit to the RK supervisory/quality control reviewers Stuart Smith ("Smith") and Ken Stephens ("Stephens").[99] Matlock followed up with an e-mail to Smith and Stephens in which he told them that the audit

[94] Nymeyer 8/4/17 Depo at p. 440-441, App. 1999; p. 456:16-458:23, App. 2003.
[95] Nymeyer 8/4/17 Depo. at p. 432:1-440:6, App. 1997-99, p. 521, App. 2019.
[96] Nymeyer 8/4/17 Depo at p. 501:7-521;21, App. 2014-19; ps. 534-535; App. 2022.
[97] Nymeyer 8/4/17 Depo at 444:12-445:4, App. 2000;
[98] Nymeyer 8/4/17 Depo. at p. 524:1-529:1, App. 2020-21.
[99] PX 258, App. 4041-74.

would be used in an 8-K/A filing with the SEC for a reverse merger and, incredibly, represented to them that "***there is not a lot there***".[100]

As the RK concurring partner on the Breitling audit, Stephens testified that he never saw the CIM Review Memo because it was put in the permanent file, and as a concurring partner Stephens does not look at the type of "source" documents that are typically maintained in the permanent file.[101] Upon reviewing the CIM Review Memo, Stephens testified that such a document should *not* have been placed into the permanent file.[102]

Stephens also testified that he does not recall anyone on the RK audit team informing him about concerns that Breitling was committing fraud with the CIMs.[103] During his deposition, Stephens reviewed Matlock's final "sanitized" SRM (PX 149, App. 3934-37) and agreed that it did not mention inflated AFEs,[104] and testified that Breitling's AFE Fraud and Commingling Fraud *should have been communicated to Breitling's management or to the BECC Board* ***in writing*** but that RK failed to do that because there is no mention of either issue in the letters RK sent to Breitling's management (for the 2011/2012 audit) or to the Audit Committee (for the 2013 audit).[105]

As RK's quality control reviewer on the Breitling audits, Smith similarly testified he had never seen Matlock's CIM Review Memo and doesn't recall anyone from the RK audit team informing him about the AFE Fraud or the Commingling Fraud or that the Breitling CIMs

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[100] PX 258, App. 4041-74.
[101] Ken Stephens 11/20/14 Depo. at 13-15; 21-26; 30-31; App. 2441, 2443-44, 2445.
[102] Ken Stephens 11/20/14 Depo. at 58-61; 63-64; App. 2452-53, 2453.
[103] Ken Stephens 11/20/14 Depo. at 28-30; App. 2444-45. Nymeyer testified that he did not inform Stephens or Smith of the issues described in the Nymeyer Memo. Nymeyer 8/4/17 Depo. at p. 477:19-479:4, App. 2008.
[104] Stephens 11/20/14 Depo at 37-39, App. 2447.
[105] PX 103, App. 3779-94; PX 108, App. 3831-33. Ken Stephens 11/20/14 Depo. at p. 40-41; App. 2447-48 (discussing RK's audit letter to management, PX 103), 48-51, App. 2449-50 (admitting that RK failed to communicate Breitling's fraud to BECC's Board), 66-67, App. 2454 (discussing RK's 2013 audit letter to Board, PX 108).

contained misrepresentations.[106] He further testified that he would expect major issues like that to have been detailed in the CAAM, but they weren't.[107] Smith further testified that he never saw the CIM Review Memo because the "*policy for QC reviewers was not to look at documents in the permanent file*" even if they were mentioned in the CAAM, and he could tell by the work paper numbering that the CIM Review Memo was from the permanent file.[108] Importantly, Smith further testified that "***one would not put a document that is critical to an audit in the Permanent File***" and "*CAAM work papers would usually not make reference to a Permanent File document*".[109]

3. Matlock Conceals Nymeyer's Findings from the Brietling Board and Audit Committee

Besides concealing Nymeyer's fraud findings from RK's own supervisory review partners, Matlock also made sure that none of Nymeyer's fraud findings were included in the letters RK sent to Breitling's management or the BECC Audit Committee. Neither the RK letter to Breitling's management for the 2011/2012 audit,[110] nor RK's letter to the BECC Audit Committee for the 2013 audit,[111] mention the audit issues Nymeyer had uncovered like the AFE Fraud, the Overselling Fraud, or the Commingling Fraud, or issues with Faulkner's expense reimbursements.[112]

In its February 14, 2014 letter to Breitling's management regarding the 2011/2012 audit, RK represented that it had been unable to obtain support for material expenses, including reimbursements to, and credit card payments for, Faulkner, and as a result RK had to "*satisfy*

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[106] Smith 11/20/14 Depo. at 18-21; 28-29; App. 2421–22, 2423-24.
[107] *Id.*
[108] Smith 11/20/14 Depo. at 30-35; App. 2424-25.
[109] Smith 11/20/14 Depo. at 30-35; App. 2424-25.
[110] PX 103, App. 3779-94.
[111] PX 108, App. 3831-33.
[112] Nymeyer 8/4/17 Depo. at p. 479-480; App. 2008-09 (testifying that he would have expected the RK letters to management and the Audit Committee to have disclosed the fraud issues he had outlined in the Nymeyer Memo, but they do not); Stephens 11/20/14 Depo. at 40-41, App. 2447 - 2448 (discussing RK's audit letter to management, PX 103), 66-67, App. 2454 (discussing RK's 2013 audit letter to Board, PX 108).

ourselves through alternative substantive testing", without disclosing that the "alternative substantive testing" consisted of RK having Faulkner himself sign a confirmation that the expense reimbursements were justified.[113] Similarly, in its April 14, 2014 letter to the BECC Audit Committee regarding the 2013 audit, RK again noted that it had been unable to obtain supporting invoices for material expense balances but that RK had been able to satisfy itself through "alternative substantive testing", *without disclosing to the Audit Committee that the "substantive testing" consisted of merely asking Faulkner himself to vouch for his expenses*.[114]

Nymeyer has testified that it concerned him that RK's letter to the BECC Audit Committee made no mention of the AFE Fraud, the Commingling Fraud or Breitling's liquidity issues.[115] Nymeyer further testified that even though the 2011/2012 CIM Review Memo and the 2013 CIM Review Memo[116] (both of which Matlock created and then buried in the permanent file) state that RK is going to note the AFE Fraud issue in RK's letter to management, ***RK didn't do that***, and as a result the statements in both CIM Review Memos are false and "reflect poorly" on Matlock.[117] Nymeyer further testified that he can't think of a reason why the concerns he raised in his original Memo were not described in RK's letters to management and the BECC Audit Committee.[118]

The Chair of the BECC Audit Committee, Chris Williford ("Williford") has testified that Matlock never mentioned to him, whether on the phone or at a Board meeting, that Breitling was committing fraud or engaged in illegal activity or that the Breitling CIMs were misleading, and

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[113] PX 103, App. 3779-94. Solomon Report at p. 26, App. 3550.
[114] PX 108, App. 3831-33. Solomon Report at p. 26, App. 3550. The Receiver's expert opines that RK's reliance on the confirmations from Faulkner, the "potential fraudster" with identified "integrity issues" was "simply ludicrous". *Id.*, at ps. 39-40, App. 3563-64.
[115] Nymeyer 8/4/17 Depo at ps. 483-487; 530-533; App. 2009-10, 2021-22. Nymeyer also testified he didn't disclose the Commingling Fraud to the Breitling Board or Audit Committee. Nymeyer 8/4/17 Depo at p. 353:9-22, App. 1977.
[116] PX 107, App. 3829-30.
[117] Nymeyer 8/4/17 Depo at p. 483:10-487:25; App. 2009-10; ps. 530-533; App. 2021-22.
[118] Nymeyer 8/4/17 Depo. at p. 491-492; App. 2011-12.

never mentioned to him any problems with the AFEs and neither did anyone else at RK.[119] Williford also testified he was never informed by RK or Breitling management about any mass overselling of well prospects by Breitling.[120]

Williford further testified he does not recall anyone from RK informing him of the commingling of investor monies or that Breitling was using investor funds from one project to pay development costs for another project, or that the Breitling's CIMs were inaccurate.[121] Williford testified that he was only generally aware of issues related to reimbursement of expenses to Faulkner based on RK's letter to the Audit Committee for the 2013 audit, but that he had been satisfied by RK's representations in said letter that they had conducted "*alternative substantive testing*" on the expense reimbursements (without disclosing that the "substantive testing" consisted of just getting confirmations from Faulkner).[122] Williford testified that there were no further discussions or information provided to the Board or Audit Committee by RK concerning the 2013 audit or any issues RK had discovered other than what was contained in RK's letter to the Audit Committee and that, "*conversely*", the representations made by RK in its letter to the Audit Committee gave Williford comfort that everything was fine with RK's audit of BECC, and that at no time during or after the 2013 audit did Matlock or anyone else from RK ever inform Williford of any issues or "red flags" they had encountered that contradicted what RK told the Audit Committee in its March 2014 letter.[123]

Based on his prior experience with audits, Williford testified that he would have expected to see any material accounting or audit issues addressed in RK's letter to the Audit Committee,

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[119] Williford Depo. at p. 40-43, 47, App 4167-4169; Williford 9/30/20 Depo. at 79:18-80:24, App. 3377-3378.
[120] Williford Depo. at p. 57, 60, 69; App. 4172.
[121] Williford Depo. at p. 50-55; App. 4175.
[122] Williford Depo at p. 62-64, 66-68; 73-76, App. 4173,4174,4176.
[123] Williford Depo. at 99:3-100:20, 107:10-20, 114:16-115:2, App. 3397-98, 3405, 3412-13. Williford further testified that he was never informed by RK about Faulkner's prior court judgments and arrest for cocaine possession. Williford 9/30/20 Depo. at. P. 87, App. 3385.

and would have expected RK to have informed him if they had uncovered any potential fraudulent or illegal conduct at Breitling, but that RK never reported any such matters to him.[124] Williford also testified that no one from RK ever told him about potential rescission liabilities from Breitling's overselling of working interests, and that he would have expected RK to disclose to him if they had uncovered that Breitling was engaged in fraud or illegal conduct, particularly prior to their issuing an unqualified audit opinion.[125]

When shown a copy of the Nymeyer Memo, which he had never seen before, Williford testified that he had never been informed by RK of any of the issues contained therein, other than issues surrounding problems with Breitling's internal controls, and that if RK had informed him that RK considered Breitling's CIM's to be fraudulent or that Breitling was commingling investor cash destined for specific well projects it would have caused him concern.[126]

Similarly, Breitling General Counsel Wagers has testified that RK never informed him of the concerns expressed in the Nymeyer Memo, including concerns about *e.g.*, the Commingling Fraud.[127] He further testified that since Defendants didn't inform him of their findings and concerns surrounding Breitling's fraud and violations of law, it prevented him from fulfilling his duties as General Counsel to report that information "up" to the BECC Board or Audit

[124] Williford Depo. at ps. 62-64, 66-68; 73-76, 81-82, App. 4173,4174,4176,4178; Williford Depo. at 120:9-121:12, App. 3418-19. It is clear that Matlock dealt more directly with BECC's management regarding audit issues, instead of reporting directly to the Audit Committee as required. Williford Depo. at 111:4-112:2, App. 3409-10; see also *id.*, at 31:24-32:11, 89:3-6, App. 3329-30, 3387 (RK was supposed to report directly to the Audit Committee and not go through management).

[125] Williford Depo. at p. 71-72; 81-82; App. 4175, 4178.

[126] Williford Depo. at 121:17-125:5, App. 3419-23.

[127] Wagers Depo., at 89:6-90:7, App. 2751-52. While the Receiver takes much of Wagers' testimony with a grain of salt since the Receiver alleges (and will prove at trial) that Wagers breached his fiduciary duties, he cites to Wagers' testimony to, in part, further underscore the breadth of fact questions and credibility determinations that will need to be made by a jury at the trial of this cause.

Committee,[128] and that if RK had informed him of the information contained in the Nymeyer Memo he would have reported it to the Board and/or the Audit Committee.[129]

Wagers also testified that as the General Counsel and as a securities lawyer who had worked on multiple occasions with auditors, he would have expected RK to have reported to the Audit Committee, in writing, the type of findings presented in the Nymyer Memo, and that Defendants should have provided the Nymeyer Memo directly to the BECC Board and Audit Committee.[130] Wagers also noted that even though RK's audit letters obliquely reference the overselling of working interests, they do so in regard to "deferred revenues" and don't mention potential securities laws violations or Breitling's potential rescission liabilities to investors, and the letters don't mention the inflated AFE issue at all.[131] He further testified that at no time did Matlock ever inform the BECC Board or Audit Committee that Breitling was engaged in fraud or mention anything to the Board or Audit Committee about the inflated and duplicated AFEs, the massive overselling, the commingling of investor funds or Faulkner's receipt of millions of dollars of unsupported expense reimbursements.[132] He further testified that he found the contents of the Nymeyer Memo "unsettling",[133] but since he never saw it until his deposition and Defendants never informed him about Nymeyer's findings, the fact that RK issued two clean audit opinions for Breitling gave him comfort that Breitling was operating in a legitimate manner.[134]

Similarly, BECC's CFO Hoover testified that he was never informed that RK suspected Breitling was committing fraud or securities law violations.[135] He testified that RK never provided

[128] Wagers Depo., at 104:5-20, App. 2766.
[129] Wagers Depo. at 133:4-136:5, App. 2795-98.
[130] Wagers Depo. at p. 117, App. 2779; p. 129, App. 2791; p. 135:8-137:25, App. 2797-99.
[131] Wagers Depo. at 119:18-123:13, App. 2781-85; 127:22-129:13, App. 2789-91.
[132] Wagers Depo. at 133:4-134:14, App. 2795-96.
[133] Wagers Depo. at 138:2-13; App. 2800.
[134] Wagers Depo. at 138:14-23, App. 2800.
[135] Hoover 9/17/19 Depo at p. 267:22-268:22, App. 666.

him with, and he never saw, Nymeyer's Memo, and that he didn't know that the AFEs were inflated by $12 million, although he admitted that Nymeyer had told him the actual development expenses were significantly less than what was stated in the CIMs.[136] Hoover also testified that no one from RK told him there were $17 million in "oversold" oil and gas interests, and that he had only heard of one or two investors who had been oversold and transferred to other properties.[137] Hoover further testified that Defendants didn't tell him that investor funds were not kept segregated but instead were transferred to the Breitling general operating account,[138] and that if he had known any of this information he would never have signed off on the 8-K/A or the 10-K and would have instead resigned from Breitling because there was "no reality to the financial statements" and it was just "a house of cards".[139] Hoover also testified that he didn't know Faulkner was taking investor money from the Breitling general operating account to reimburse himself for expenses.[140]

4. RK Issues Two Clean Audit Opinions for Breitling Knowing they will be Filed with the SEC

Despite all of the fraud and illegal conduct being committed by Faulkner via the Breitling entities that Defendants uncovered between October 2013 and January 2014, and despite the fact that, at least in Nymeyer's view, RK never received sufficient audit evidence to resolve the AFE Fraud, the Commingling Fraud, or the Overselling Fraud issues,[141] RK proceeded to issue a clean, unqualified audit opinion for Breitling's 2011 and 2012 financial statements on February 14, 2014 that was included in Breitling's 8-K/A filing with the SEC as part of the reverse merger transaction.[142]

Prior to issuing the first 2011/2012 unqualified audit opinion, RK considered including a

[136] Hoover 9/17/19 Depo at 110:15-112:10, App. 627.
[137] Hoover 9/17/19 Depo at 113:3-115:20, App. 627-28; 185:3-22, App. 645.
[138] Hoover 9/17/19 Depo at 119:10-121:10, App. 629.
[139] Hoover 9/17/19 Depo at ps. 118:15-122:15, App.629-30 .
[140] Hoover 9/17/19 Depo at p. 129, App. 631.
[141] Nymeyer 8/4/17 Depo at ps. 448:16-451:6, App. 2001.
[142] PX 104, App. 3795-3821 (RK's 2011/2012 audit opinion); PX 270, App. 4081-4126 (Breitling's 8-K/A filing).

liquidity footnote as part of a "going concern" opinion. On January 7, 2014, Nymeyer sent an email to Hoover, approved by Matlock, informing Hoover that RK had "noted" that a liquidity footnote might be appropriate for Breitling.[143] But Faulkner managed to "persuade" Matlock - in a private conversation - to delete the liquidity footnote and to instead issue a clean audit opinion.[144] This all occurred the day before the 8-K/A was to be filed with the SEC. Nymeyer testified he analyzed the liquidity issue, and compared all the cash Breitling had in its bank accounts against its outstanding development liabilities per the (inflated) AFEs, and discovered that there was a $700,000 shortfall, and Nymeyer concluded the only way Breitling could make up that shortfall was to keep selling working interests to investors (which is characteristic of a Ponzi scheme).[145] But Matlock instructed Nymeyer to delete the liquidity footnote from the Breitling financial statements the day before they were to be filed with the SEC as part of the 8-K/A.[146]

As for the Overselling Fraud, Matlock determined that the way to "resolve" (in reality, to disguise) it and Breitling's unauthorized transfer of oversold investors to different well prospects was to classify the overselling as "deferred revenues" instead of as contingent rescission liabilities based on fraud.[147] Hoover testified that Matlock came up with the "deferred revenue" idea and that it occurred during a weekend discussion between Faulkner, Matlock and Hoover about whether RK would issue a clean or qualified "going concern" opinion.[148] Matlock's "deferred revenue" concept assumed that when Breitling oversold a well project, it transferred the "oversold" investors

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[143] PX 254, App. 4037-74. Nymeyer testified that Breitling's financials didn't show proper liquidity because there was a lack of cash for operations (because Faulkner was stealing all the cash), and Nymeyer agreed that it was "unusual" that Breitling didn't have sufficient cash to fund operations given the inflated AFEs, but he never resolved that conflict because Matlock handled the liquidity issue. Nymeyer 8/4/17 depo at p. 393-395; App. 1987.

[144] Hoover 9/17/19 Depo. at 96:22-103:8, App. 623-25.

[145] Nymeyer 8/4/17 Depo at p. 434-437, App. 1997-98. Nymeyer 9/30/14 Depo at ps. 65-72, App. 1761-62.

[146] Nymeyer 8/4/17 Depo at p. 408-409, App. 1991; PX 259; App. 4075-77.

[147] PX 163, App. 3944-54; Hoover Nov. 6, 2020 Depo. at 157:8-158:6, 184:4-7, App. 686-69. Hoover testified that RK never explained to him that RK had addressed Breitling's overselling issues by classifying them as "deferred revenues". Hoover Nov. 6, 2020 Depo. at 158:2-6, App. 869.

[148] Hoover 9/18/19 Depo at 90-93; App. 622.

to a new well that had not yet been drilled, so Breitling couldn't recognize any revenues until the new well was completed (per the "milestone" method) and started producing sales.[149] Hence the oversold investors' funds were accounted for as "deferred revenue" instead of as liabilities, and the overselling "problem" was never identified (or even mentioned) in the audited financial statements that were filed with the SEC.[150]

BECC's 8-K/A with RK's clean, unqualified audit opinion was filed with the SEC on February 14, 2014.[151] RK then issued its second audit opinion for Breitling's 2013 financial statements in March 2014, which audit opinion was included in BECC's first 10-K filed with the SEC.[152] As part of finalizing the BECC 2013 financial statements and RK's audit opinion, RK and BECC's management once again discussed whether RK needed to include a "going concern" opinion for BECC for inclusion in its 10-K filing.[153] In the end, and after obtaining assurances from Faulkner as to his financial wherewithal to fund Breitling as needed, RK issued another "clean" audit opinion for Breitling.[154] Williford testified he didn't know what work RK performed to verify Faulkner's ability to finance BECC's continued operations, and that he relied on RK to ensure that statements made by BECC in the 10-K concerning Faulkner's financial wherewithal were sufficient to address BECC's liquidity issues.[155]

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[149] *Id.*

[150] Hoover Nov. 6, 2020 Depo. at 150:14-151:18, App. 861-62. BECC's outside accounting consultant Steve Plumb, who was retained in May 2015 to prepare BECC's 2014 financial statements and who was forced to recreate RK's audit work for 2013 after RK refused to cooperate or provide its audit support documentation to BECC, testified that he concluded by **November 2015** that RK's classification of the overselling as "deferred revenues" was improper and resulted in the recording of millions of dollars in revenues that did not exist. Plumb Depo., at 129:13-132:22, App. 2310-13. Plumb concluded that Breitling had overstated revenues by tens of millions of dollars going back to 2012, and that Breitling did not have sufficient assets to offset the overselling such that ***all*** of the oversold interests should have been classified as liabilities in Breitling's financials. Plumb Depo., at 151:5-21, App. 2332;

[151] PX 270, App. 4081-4126.

[152] PX 109, App. 3834-3927; Williford Depo. at 75:13-19, App. 3373.

[153] Williford Depo. at 67:9-70:19, App. 3365-68.

[154] Williford Depo. at 76:12-78:9, App. 3374-76.

[155] Williford Depo. at 85:3-90:3, App. 3383-90.

5. Defendants Continue to Conceal RK's Knowledge of and Involvement in Breitling's Fraud throughout 2015

After RK withdrew as the auditor for BECC following its merger with KPMG in the summer of 2014, on June 30, 2014 BECC retained a successor auditor, MaloneBailey, to audit and issue an opinion on BECC's 2014 financial statements for inclusion in BECC's 2014 10-K.[156] In order to assist with the transition in auditors from RK to MaloneBailey, Hoover contacted Defendants to request RK's work papers and/or, at a minimum, request that RK return to BECC the financial information it had relied on in preparing its audit opinions; but RK refused to produce anything to Breitling – not even BECC's own journal entries.[157]

Steve Plumb, whose consulting firm was retained by BECC in May 2015 to help gather and prepare BECC's 2014 financial information for MaloneBailey to audit, testified he also made an attempt to obtain Breitling financial documentation from RK in 2015 so that MaloneBailey could complete its audit, but that RK refused to allow its prior work to be used and wouldn't turn over any of its work papers or Breitling's own financial information, which forced Plumb to have to reconstruct BECC's 2013 financial statements so that MaloneBailey could issue a new opinion for 2013.[158] He also testified that when he contacted RK in May 2015 to attempt to obtain RK's prior audit documentation, he was referred to RK's lawyer, Nick Morgan (RK's current counsel in this case), who informed Plumb that RK would not produce any of its Breitling files to Breitling, ***not even any of the supporting journal entries or general ledgers that by statute (Texas Administrative Code) belong to Breitling***.[159]

Trenton Thornock, Chair of the BECC Audit Committee at that time in 2015, also testified

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[156] Leah Gonzales Depo., at 40:19-41:7; App. 67 - 68.
[157] Gonzales Depo at 179:18-187:8; App. 206-14.
[158] Plumb Depo., 62:11-22, App. 2243; 65:15-67:9, App. 2246-48.
[159] Plumb Depo., at 202:9-209:18, 221:5-230:6, App. 2383-90, 2402-11. Plumb described Mr. Morgan's response to the request by Breitling for RK's prior audit documentation as "***Not no, Hell no***". *Id.*, at 206:12-19, App. 2387.

that RK refused to cooperate or provide any information concerning its prior audits to BECC or to RK's successor auditors at MaloneBailey.[160] Thornock further testified that in his 20 years working in the finance departments of public and private companies and interfacing with external auditors, he had never witnessed an auditor refuse to reissue its audit opinion or refuse to communicate with a successor auditor like RK did with BECC.[161]

D. ***Defendants' Knew that Faulkner Created the Crude Entities to Continue the same (Fraudulent) Business Practices as BOG and BRC and Knew that the Crude Entities' Financials were Consolidated with BECC's Financials.***

Defendants became aware in December 2013 that Faulkner had formed the Crude entities to continue the "*legacy*" business of BOG and BRC in offering and selling oil and gas securities.[162] Nymeyer testified that he discovered an Administrative Services Agreement ("ASA") between BECC and Crude in BECC's December 9, 2013 8-K filing,[163] and that it raised questions about whether or not Crude was a Variable Interest Entity ("VIE") to BECC and consequently whether Crude's financials needed to be consolidated with BECC for both the 2011/2012 and 2013 audits.[164] Nymeyer further testified that in January 2014 Wagers explicitly told he and Matlock that the BOG/BRC oil and gas securities sales business would be transferred to the new Crude entities but that BECC would still be involved identifying properties to sell to Crude; basically that the ***"old business" "would be Crude's problem" going forward***.[165]

As evidenced by an e-mail exchange between RK's Maimo, Matlock and Nymeyer in

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[160] Thornock Depo. at 151:22-153:25; App. 2621-23.
[161] Thornock Depo. at 63:20-66:15; App. 2533-36.
[162] See December 9, 2013 e-mail chain between Maimo, Nymeyer and Matlock referencing that Crude Energy will ***"carry on the legacy business" of BOG and BRC"***. PX 211, App. 3960-63. Breitling General Counsel Wagers testified that the Crude entities were formed because the new public company BECC could not be involved in selling unregistered Reg D securities to investors. Wagers Depo., at 25:11-27:2, App. 2687-89; 107:2-15, App. 2769.
[163] PX 276, App. 4128-41 (BECC's December 9, 2013 8-k filing). The ASA was the mechanism through which BECC could extract "revenues" from the Crude entities. Wagers Depo., at 108:5-109:11, App. 2770-71.
[164] Nymeyer 8/4/17 Depo. at p. 375-376, App. 1982-83. See also PX 248, App. 3995-97, PX 249, App. 3998-4006 (Nymeyer emails to Hoover and Wagers regarding BECC ASA with Crude and noting that under GAAP Crude may be a VIE to BECC and so would need to be consolidated with BECC for financial reporting).
[165] Nymeyer 9/30/14 Depo. at p. 97-99, App. 1769.

December 2013, RK also learned that Faulkner's right hand and Controller for Breitling who handled all of Breitling's bank accounts, Beth Handkins, had been transferred from BOG/BRC to the Crude entities with a new title of Chief Operations Officer, along with all other former BOG/BRC employees (including the unregistered securities sales staff) and that the only former BOG/BRC employees who transitioned to BECC (and not Crude) were Faulkner and Wagers.[166] The fact that all of BOG/BRC's employees had been transferred to Crude caused Maimo to continue to raise the issue of whether the Crude entities needed to be consolidated with BECC right up to the time that RK issued its second audit opinion in March 2014.[167]

Also in March of 2014, as Defendants were completing their field work on BECC's 2013 audit, Matlock e-mailed Hoover that he had discovered that BECC's general ledger for 2013 included "Crude activities" (apparently Crude profits and losses), despite Crude purportedly having been "spun off", and that Crude's numbers needed to be removed from the trial balance because "*we are walking a very tight rope on the VIE and any inclusion of Crude P&L amounts could seal the deal*".[168] Matlock has since testified to the SEC that from his perspective Crude and Breitling were "***one and the same***" and that even though Crude was "papered" as a separate company, he knew that Breitling (Faulkner) was still going to control Crude and that the entities were eventually going to need to be consolidated.[169] Yet RK signed off on the 2013 audit opinion for BECC in that same month despite knowing that Breitling had not disclosed the consolidation of the Crude entities with BECC in its SEC filings.

The SEC's forensic accountant Sowards has testified via declaration that BECC consolidated the results of operations and other accounting activities for Crude in its general ledger

[166] PX 211, App. 3960-63; Wagers Depo. at 110:15-114:8, App. 2772-76. Hallam Depo., at 106:25-107:4, App. 422-423; 134:7-135:5, App. 450-51.
[167] See PX 224, App. 3969-72 (RK e-mail chain re: "*possible VIE consolidation*"); PX 226, App. 3973-82.
[168] PX 319, App. 4142-43; Wagers Depo. at 115:17-116:24; App. 2777-78.
[169] Matlock 8/17/17 Depo., at 560:11-563:24, App. 1385 - 1387.

but failed to disclose this consolidation in its SEC filings.[170] And when MaloneBailey succeeded RK as the auditors for BECC, MaloneBailey realized that the interrelationships between Crude and BECC required Crude to be consolidated with BECC.[171] Similarly, the BECC Board eventually realized in November 2015 that the Crude entities and Patriot needed to be consolidated with BECC.[172]

E. *Faulkner used the Crude and Patriot Entities to continue to Fraudulently Raise Money from Investors and then Diverted the Investor Funds from Crude and Patriot to BECC so that Faulkner could Steal the Funds*

Once the two Crude entities were established in conjunction with the creation of BECC, Faulkner used those entities to solicit investor cash using the same fraudulent and illegal securities sales tactics he had employed at BOG and BRC.[173] In fact, besides the transfer of the former BOG and BRC personnel over to Crude, Crude also took over the old offices of BOG and BRC so that in practice nothing changed except the name on the door.[174] Faulkner installed Hallam as the President of the Crude entities, but in reality Faulkner controlled and dictated all of Crude's activities and Hallam was just Crude's "figurehead" president in name only,[175] because Faulkner functioned effectively as the CEO of Crude, which Hallam has testified was in reality a ***"sham" entity***.[176] In fact Faulkner controlled Crude to such an extent that he even had the authority to override Hallam with respect to the hiring and firing of Crude employees.[177] Similarly, Hoover

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[170] Sowards 8/8/17 Decl. at 7, App. 3665.
[171] Gonzales Depo. At 198:3-201:7; 205:24-207:20, App. 225 – 228, 232 - 234; PX 329-330, App. 4144-47.
[172] Mourglia 11/12/20 Depo at 79:12-81:9, App. 1731-33.
[173] Hallam Depo. at 151:5-152:14, App. 467-68.
[174] Hallam Depo. at 155:19-157:3, App. 471-72; 162:2-22, App. 478 (testifying that Crude and BECC were all interconnected after the reverse merger, and that the operations continued to be the same). Wagers Depo. at 113:19-114:8, App. 2775-76.
[175] Hallam Depo. at 153:24-155:18, App. 469-71.
[176] Hallam Depo. at 225:24-226:20, App. 541-42.
[177] Hallam Depo. at 184:23-185:24, App. 500-501. Faulkner even prepared and mandated the use of all of the CIM offering materials (with inflated AFEs) for the oil and gas projects offered by both Crude and Patriot despite having no official title or role with either entity [Miller Depo. at 160:10-161:18, App. 1629 – 1630; (Crude); 164:5-19, App. 1633 (Patriot)], and otherwise dictated to Crude and its securities sales force which oil and gas projects to offer and sell to investors. Hallam Depo. at 183:24-184:22, App. 499-500.

testified that the Crude entities were established to be the "sales arm" for Breitling but that they would "have no real revenue other than being reimbursed for the salesmen they were paying".[178]

In order to maintain his control over the cash raised by Crude from investors, Faulkner installed former BOG/BRC controller Handkins to serve the same function at Crude (and later Patriot).[179] Handkins thereafter controlled all of Crude's (and later Patriot's) bank accounts and money transfers between bank accounts at the direction of Faulkner.[180] Faulkner immediately began to suck cash from the Crude entities (and later Patriot) through BECC by instructing Hallam and Miller to transfer millions of dollars from the Crude and Patriot entities to BECC,[181] where Faulkner could then misuse and misappropriate the funds – including using the funds to pay his AMEX expense charges.[182]

Once the BECC-Crude-Patriot scheme was established, Faulkner caused Crude to continue the "legacy" business model of BOG and BRC (including commingling investor funds together into their general operating accounts).[183] Crude raised over $40 million from investors, and Patriot raised another $14.5 million,[184] and Faulkner caused Crude and Patriot to collectively transfer more than **$39 million** of the money they raised over to BECC.[185] Sowards has testified that the transfers of investor money from Crude and Patriot accounted for roughly 93% of total cash

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[178] Hoover Nov. 6, 2020 Depo. at 98:3-8, App. 809.
[179] Miller Depo., at 147:12-148:9, App. 1616 - 1617; Hallam Depo., at 106:25-107:4, App. 422-23; 134:7-135:5, App. 450-51.
[180] Hallam Depo. at ps. 194:15-196:10, App. 510-512; ps. 218:23-219:12, App. 534-35 (Faulkner and Handkins controlled all the money).
[181] Hallam Depo. at 156:17-157:3, App. 472-73.
[182] Miller Depo., at 150:21-153:8, 165:21-166:9, App. 1619-22, 1634-35. Faulkner even had BECC take over distribution of oil and gas revenues for BOG and BRC investors and also to assume responsibility for the Crude projects. Miller at 154:24-155:22, App. 1623-24. Hallam Depo. at 144:23-25, App. 460 (Faulkner was stealing money anywhere he could).
[183] Sowards 8/8/17 Decl. at p. 7, 36-37, App. 3665, 3694-95.
[184] Sowards 8/8/17 Decl. at p. 7, 33-36, App. 3655, 3691-94.
[185] Sowards 8/8/17 Decl. at p. 7, APP 3665, 37-39, App 3695-97. BECC also directly received an additional roughly $13 million of investor money that was tied to Crude or Patriot working interest or royalty interest offerings. Sowards 8/8/17 Decl., at p. 38, Table K, App. 3696.

receipts deposited into BECC's bank accounts during the period December 2013 to February 2016, such that BECC was funded almost entirely by investor money raised by Crude and Patriot.[186] Once the investor funds arrived at BECC, Faulkner misappropriated for his own personal benefit – either directly or through his various wholly owned companies and whether in cash or via credit card payments for his benefit - approximately **$18 million**.[187]

Both Hallam and Miller testified that whenever they questioned or raised objections about Faulkner's constant requests for transfers of millions of dollars from the Crude entities and, later, Patriot to BECC, Faulkner, Wagers and Hoover assured them that such transfers were legitimate because all of the Breitling entities (including BECC, Crude and Patriot) were consolidated together and in reality comprised one single business entity.[188]

F. Defendants' Conduct Violated Auditing Standards and Securities Laws and the SEC Bans Matlock from Auditing Public Companies

The Receiver's expert witness, Saul Solomon ("Solomon") issued an expert report and declaration in this case in which he opines that Defendants were negligent in their audits of Breitling and violated multiple accounting standards as well as violated the section of U.S. securities laws governing auditors of public companies. Specifically, Solomon has opined that Defendants (i) inappropriately issued unqualified audit opinions for Breitling; (ii) were aware of facts that provided Defendants with a strong indication that Breitling was engaged in fraud and illegal acts; (iii) failed to comply with GAAS in both investigating and communicating Breitling's fraud and illegal acts to appropriate governance officials (and to the SEC); (iv) should have notified the SEC of their findings of fraud and illegal acts occurring at Breitling; (v) should have withdrawn

[186] Sowards 8/8/17 Decl. at p. 7-8, App. 3665-66; 39 App. 3697.
[187] Sowards 8/8/17 Decl. at ps. 39-46, App. 3697-3704. ***BECC paid $17.3 million in AMEX credit card expenses alone.*** *Id*. at p. 41, footnote 27, App. 3699.
[188] Hallam Depo., at 198:18-199:13, App. 514-515. Miller Depo. at 65:12-23, App. 1534; 78:20-79:10, App. 154 - 1548; 152:11-153:8, App. 1621-22; 166:13-23, App. 1635; 169:5-18, App. 1638; 171:2-16, App. 1640.

from the audit engagements; and that (vi) ***RK's actions and inactions "enabled the continuation of the fraud and illegal acts".***[189]

Solomon opines that Defendants' conduct "departed significantly from the level of due professional care" in their audits of Breitling.[190] For example, Solomon opines that Defendants' acceptance of confirmations from Faulkner as support for the millions of dollars in expense reimbursements paid to Faulkner was "a wholly inadequate and improper alternative source of audit evidence…particularly given the fraud risks that [RK] had identified with respect to Faulkner," and that RK ignored and failed to adequately address Breitling's related party transactions with Faulkner's personal companies, Breitling's rampant overselling of interests and related fraud and violations of securities laws and exposure to rescission liabilities, the inflated AFE issue - which facilitated Faulkner's misuse of the excess amounts – and related fraud and violations of securities laws and Breitling's exposure to rescission liabilities created thereby, and that RK's misconduct enabled Faulkner to continue the fraud.

Solomon opines that during their audits of Breitling, Defendants violated the following specific Auditing Standards: (1) AU Section 316 (Consideration of Fraud in a Financial Statement); (2) AU Section 317 (Illegal Acts by Clients); (3) AU Section 380 (Communication with Those Charged with Governance); Auditing Standard No. 3; Auditing Standard Nos. 12 and 13; Auditing Standard No. 14; Auditing Standard No. 15; AU Section 230; AU Section No. 333; and AU Section 508.[191]

Solomon also opines that Defendants violated Section 10A(b) of the Securities Exchange

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[189] Solomon Report at p. 2, App. 3526. Solomon opines that RK's reliance on the confirmations from Faulkner, the "potential fraudster" with identified "integrity issues" was "simply ludicrous". *Id.*, at ps. 39-40, App. 3563-64.

[190] Indeed, Solomon describes Defendants' conduct as an "***extreme departure*** from the requirements set out in the professional and auditing standards." Solomon Report at ps. 46-47, App. 3570-71.

[191] Solomon Report at ps. 41-56, App. 3565-80. Solomon also opines that Breitling and Defendants did not adequately disclose BECC's relationship with Crude in BECC's 10-K, specifically that Crude was consolidated into BECC's financial statements as a VIE. Solomon Report at p. 16, footnote 96, App. 3540.

Act because Defendants failed to report their findings (as detailed in the Nymeyer Memo) to the BECC Board or Audit Committee or to the SEC and also failed to resign from the audit as Nymeyer repeatedly urged.[192] Solomon opines that, based on the breadth and scale of the fraud and illegal acts/violations of securities laws uncovered by Defendants, Defendants were obligated to withdraw from the Breitling engagement and to notify the SEC of the reasons for their withdrawal, including reporting Breitling's fraud and illegal acts to the SEC, and that had Defendants taken such required actions it would have prevented the completion of the SEC filings for the reverse merger (and concomitant creation of BECC) and would have provided the SEC with compelling evidence to have shut down the Breitling fraud at an earlier time.[193]

The SEC agrees that Defendants violated various auditing standards as well as Section 10A(b) of the Securities Exchange Act with respect to the work they performed on the Breitling audits. On August 13, 2020, the SEC issued its Order in the administrative proceeding it had initiated against Matlock in which the ***SEC found that Matlock and RK violated various accounting standards and also violated Section 10A of the Securities Exchange Act***.[194] Specifically, the SEC found that Defendants violated Section 10A(b)(1)(A)(i) of the Exchange Act and Regulation S-X Rule 2-02(b)(1), and found that "*RK and Matlock…engaged in improper professional conduct, and RK violated…Section 10A(b)(1)(A)(i) of the Exchange Act, by failing to take appropriate steps in relation to potential illegal activity on the part of Breitling and its*

[192] Solomon Report at ps. 42-44, App. 3566-68. Section 10A(b) of the Exchange Act requires public company auditors who become "*aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred*" to report their findings to management or the Board or Audit Committee of a client, and if the Board and/or Audit Committee refuses to take any remedial action, to report their findings directly to the SEC. 15 U.S.C. § 78j-1(b)(3). See, e.g., *In re Cendant Corp. Sec. Litig*., 139 F. Supp. 2d. 585, 607 (D.N.J. 2001); *SEC v. KPMG LLP*, 412 F. Supp. 2d. 349, 376, 388-390 (S.D.N.Y. 2006).
[193] Solomon Report at ps. 40-41, App. 3564-65.
[194] SEC August 13, 2020 Order in the Matlock Proceeding, PX 346, App. 4148-56.

management",[195] and that "*Matlock caused RK's violations of Section 10A(b)(1)(A)(i)",* and *"Matlock caused RK to violate Regulation S-X Rule 2-02(b)(1) when RK issued the Breitling audit report stating that it conducted the audit in accordance with PCAOB standards when, in fact, it had not*".[196] As a consequence of Matlock's conduct, the SEC has permanently barred him from auditing public companies.[197]

Defendants were fully aware of the above described audit standards when they performed the Breitling audits. Nymeyer has admitted that under the applicable auditing standards RK was required to consider the potential for fraud and to plan the Breitling audit accordingly.[198] Nymeyer also admitted that he was aware of the audit standard AU 317 (Illegal Acts by Clients) when he worked on the Breitling audits and understood that under that standard the "illegal acts" do not have to relate to the financial statements.[199] Nymeyer also testified that he was familiar with Section 10A(b) of the Exchange Act and understood that there are separate auditing standards for fraud that includes "both financials and other acts outside the financials",[200] and he agreed that auditors have obligations to take concerns about fraud or illegal acts directly to the Board *whether or not* they impact the financial statements.[201]

III. ARGUMENT AND AUTHORITIES

A. The Receiver's Negligence Claim is Not Barred by Limitations

[195] *See* SEC Order, at p. 2-3, PX 346, App. 4149-50. The SEC also found that Defendants knew that Breitling was misrepresenting its business model to investors, that Breitling was commingling investor funds, inflating the AFEs, overselling the wells, and that investor funds were not being safeguarded, and that Matlock "became aware of this misconduct, and was therefore aware that illegal acts may have occurred", but that he failed to determine whether illegal acts had, in fact, occurred. *Id.*, at ps. 2-3, 6, App. 4149-50, 4153.
[196] SEC Order, p. 7, App. 4154.
[197] *Id.*
[198] Nymeyer 8/3/17 Depo at p. 35; App. 1816.
[199] Nymeyer 8/3/17 Depo at p. 42-45; App. 1820-22.
[200] Nymeyer 8/3/17 Depo at p. 46-48; App. 1822-23.
[201] Nymeyer 8/3/17 Depo at ps. 46-53; App. 1822-24. .

As preliminary matter, under Texas law, limitations is an affirmative defense.[202] Thus, to prevail on summary judgment, Defendants must conclusively establish the date on which limitations commenced to run.[203] The only date(s) offered by Defendants are the dates they issued their audit opinions, **February 14, 2014** and **March 31, 2014**. *See* Defendants' Memorandum [ECF 95] at p. 20. But those dates make no sense for accrual purposes because Defendants issued *clean* audit opinions which by their nature failed to provide notice to anyone of Defendants' misconduct. By failing to establish the date on which the Receiver's' claims accrued, Defendants have not met their burden and are not entitled to summary judgment on their limitations defense.[204]

1. The Court Can and Did Toll the Applicable Statute of Limitations

Defendants' argument that the tolling provisions contained in the Court's Receivership Orders[205] are ineffective to toll limitations for the Receiver's negligence claim is as meritless as it is offensive, because it implies that this Court blindly signed various orders that include provisions that are void, without legal effect and therefore meaningless. A federal court's orders are presumed to be valid and to have the legal effects ascribed to them. And this Court recognized that legal effect by specifically extended the tolling provision included in the Receivership Orders by an

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[202] *Elmo v. Oak Farms Dairy*, 2008 WL 2200265, at *1 (N.D. Tex. May 14, 2008).

[203] *Plumber-Williams v. Alta Health & Life Ins. Co*., 2008 WL 11393152, at *4 (S.D. Tex. Jun. 12, 2008) (citing *Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 221 (Tex. 2003)); *see also Janvey v. Alguire*, 2013 WL 2451738, at *11 (N.D. Tex. Jan. 22, 2013) (citing *Janvey v. Dem. Sen. Camp. Comm*., 69 F.3d 848, 854 (5th Cir. 2012)).

[204] *See Tolbert v. RBC Capital Markets Corp*., 2016 WL 3034497, at *13 (S.D. Tex. May 26, 2016) ("Since RBC does not establish a specific date as to when the six-year limitations period began or expired…the Court cannot grant summary judgment on this issue.").

[205] SEC Action, ECF No. 108 at ¶22; ECF No. 142 at ¶34; ECF No. 320 at ¶34; ECF No. 418 at ¶34. Contrary to Defendants' arguments, by its Memorandum Opinion and Order this Court explicitly included BRC and "***all other entities controlled by Faulkner***" in its September 17, 2017 Receivership Order, ECF No. 142. *SEC v. Faulkner*, 2017 U.S. Dist. LEXIS 155832 at *11 (N.D. Tex. 2017). Based on the evidence of Faulkner's control cited herein, this would also include the Crude and Patriot entities. See *supra* at notes 170 to 189 and accompanying text, and *infra* notes 241 to 246 and accompanying text.

additional 60 days when it entered its March 13, 2019 Order Granting the Receiver's Motion for Leave to Commence Ancillary Litigation against Defendants.[206]

Defendants argue that the Court had no statutory authority to toll limitations but ignore the Court's broad powers in equity receiverships "to determine the appropriate relief" and "to shape equitable remedies necessary to protect the estate".[207] Defendants also ignore the fact that the tolling provision contained in the Receivership Orders was requested by the SEC, *not* the Receiver, and therefore evinces the policy of the SEC to grant an equity receiver "breathing room" to get his or her bearings and arms around a complex receivership case without having to worry about the running of limitations on potential claims against third parties, which policy is entirely consistent with the position of the Fifth Circuit with respect to federal equity receivers. See *Janvey v. Democratic Sen. Campaign Comm., Inc.*, 712 F.3d 185, 196-198 (5th Cir. 2013) ("*DSCC*") (describing, in a limitations context, the difficulties and the length of time it took for the Stanford Receiver to unravel the fraud).

Finally, if the Court finds that it did not have the authority to toll limitations via its Receivership Orders, the Court should nevertheless toll limitations for the Receiver's negligence claim based on the doctrine of equitable tolling because the Receiver relied on the tolling provisions contained in the Court's Receivership Orders in making decisions about issues and priorities within the Receivership and his deadline to file suit against Defendants.[208]

2. Faulkner, Wagers and Hoover acted Adversely to the Breitling Entities and Faulkner Adversely Dominated the Breitling Entities and the Innocent Members

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[206] SEC Action, ECF No. 410. The Receiver and Defendants subsequently entered into a Tolling Agreement on May 7, 2019 that further tolled limitations until July 5, 2019. See Tolling Agreement attached as Exhibit 1 to Taylor Declaration, App. 4159-4162. The Receiver filed the instant case on July 1, 2019 prior to the expiration of that tolling period.

[207] *SEC v. Stanford Int'l Bank Ltd*., 927 F. 3d 830, 840 (5th Cir. 2019).

[208] Taylor Declaration at p.2; App. 4158.

of BECC's Board did not Discover Defendants' Negligence until at the Earliest September 1, 2015 - less than Two Years before the Receiver's Appointment

The Receiver has plead the discovery rule in this case, and it is obvious that the Receiver could not have discovered his claims against Defendants until sometime after he was appointed as the Receiver by this Court's Order on August 14, 2017. *See* generally, *DSCC*, 712 F.3d 185 (5th Cir. 2013). Based on *DSCC*,[209] and the plethora of evidence cited herein of Faulkner's egregious, adverse misconduct towards the Breitling entities (including his rampant looting of the entities), the Receiver believes that the limitations inquiry ends here because the record evidence in this case is no different than the facts established in *Scholes* and *DSCC*.[210]

But Defendants argue that the Court must decide whether limitations had already run on the Breitling entities' negligence claim(s) prior to the appointment of the Receiver, i.e., whether the Breitling entities had discovered their negligence claim against Defendants *before* **August 14, 2015** - two year prior to the Receiver's appointment - based on the imputation of knowledge of *other* control persons of the Breitling entities, specifically Wagers, Hoover and certain members of the BECC Board and Audit Committee. But Defendants' arguments are contradictory and ignore the clear evidence that Faulkner (aided and abetted by Wagers and Hoover) exercised absolute control over the Breitling entities and that the "innocent" independent directors of

[209] As the Fifth Circuit has held, receivership entities themselves are innocent of wrongdoing and cannot have intended to violate the law or deceive investors. *DSCC*, 712 F.3d 185, 190-92 (5th Cir. 2013) (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); *Jones v. Wells Fargo Bank*, 666 F. 3d 955, 965- 967 (5th Cir. 2012) (corporation is entity separate from its individual bad actors). In *DSCC*, 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 fraudsters' knowledge to the 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.

[210] *Taylor v. Rothstein Kass & Co*., PLLC, 2020 U.S. Dist. LEXIS 17435 at *6-10 (N.D. Tex. 2020). *See also 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 (2nd Cir. 2000) (debtor's management acted in their own interest and not in company's interest, barring application of the imputation doctrine); *FDIC v. Nathan*, 804 F. Supp. 888 (S.D. Tex. 1992) (imputation not applicable where directors milked company and pushed it into insolvency).

Breitling did not gain knowledge of Breitling's fraud, let alone Defendants' role in aiding and concealing the fraud, until later in 2015 (if at all).

As an initial matter, Texas law is clear that the imputation doctrine is designed to benefit and protect innocent third parties and does not protect those (like Defendants) who collude with the agent to defraud the principal.[211] For example, where a plaintiff alleges that a law firm defendant colluded with insiders to defraud a company, then the insider's knowledge will not be imputed to the company.[212]

Texas courts have applied the same principal to auditors.[213] In *Sunpoint*, a case that is most directly on point, the court analyzed the law of imputation with respect to auditors and concluded that the imputation doctrine should only be invoked where it would "*serve the objectives of tort liability – to compensate the victims of wrongdoing and to deter future wrongdoing*".[214] The court concluded that the imputation doctrine should not apply in favor of the defendant auditors in that case because the plaintiff Trustee (like the Receiver here) was suing to recover funds for the victims of the Sunpoint fraud, and to permit the imputation doctrine to protect the auditors in that case would "*exonerate these auditors from all liability for their miserable failure to perform their audits according to the applicable standards of their profession*" and "*whose adherence to the*

[211] *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").

[212] *Shrader & York*, 991 F.2d at 226. See also *Janvey v. Thompson & Knight LLP*, 2003 U.S. Dist. LEXIS 29778 at *17-19 (N.D. Tex. 2003).

[213] *SIPC v. Cheshier & Fuller LLP (In re Sunpoint Secs., Inc.)*, 377 B.R. 513, 563-568 (Bankr. E.D. Tex. 2007) ("*Sunpoint*").

[214] *Sunpoint*, 377 B.R. at 566-567 (analyzing *Cenco Inc. v. Seidman & Seidman*, 686 F. 2d 449 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982) and *Schacht v. Brown*, 711 F. 2d. 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983)).

appropriate standard of professional care would have significantly impacted the capability of the corrupt officers to engage in the misappropriation of customer funds". [215]

In the present case, the Receiver has presented more than sufficient evidence that Defendants knowingly assisted Faulkner, Wagers and Hoover to conceal the fraud and illegal acts, and in doing so participated in breaches of fiduciary duty, and therefore Defendants are not the "innocent third party" the imputation doctrine is designed to protect and said doctrine cannot be used as shield to protect the Defendants from their own "miserable failures" and gross negligence.

Even if the Court were to permit the application of the imputation doctrine, Defendants' arguments are specious because they are premised on evidence that Wagers and Hoover *knew* about the AFE Fraud, the Commingling Fraud, the Overselling Fraud and Faulkner's misappropriation of cash through his expense reimbursement scam,[216] all of which means that, since Wagers and Hoover took no action as officers (and in the case of Wagers, a director) of BOG, BRC and BECC to stop Faulkner's fraud and violations of law, then they breached their fiduciary duties owed to said entities and were complicit with Faulkner in his fraud and looting of the entities and therefore acted adversely to the Breitling entities such that their knowledge likewise cannot be imputed to the Breitling entities as a matter of law.[217]

Moreover, the question of what Wagers and Hoover knew and when they knew it is riddled with fact issues because the testimony of both Wagers and Hoover conflicts with the documentary evidence,[218] thereby raising credibility issues for a jury to decide. If a jury is to believe Wagers'

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[215] *Sunpoint*, 377 B.R. at 567.

[216] See Memorandum in Support of Motion for Summary Judgment, ECF No. 95, at ps. 24-26 and accompanying footnote citations to record evidence attached to Defendants' Appendix.

[217] *Sunpoint*, 377 B.R. at 565 (applying adverse interest exception to two insider participants in the lead fraudsters' defalcation of corporate funds despite evidence that they were in a subordinate role and "obtained little financial reward for their activities").

[218] Memorandum in Support of Motion for Summary Judgment, ECF No. 95, at ps. 24-26 and accompanying footnote citations to record evidence attached to Defendants' Appendix. *See also*, Defendants' counsel's cross examination of Wagers at his August 12, 2020 deposition at ps. 165-225, App. 2824-87.

and Hoover's testimony described above that they did *not* know about the fraud and securities law violations being committed at Breitling, or Defendants' knowledge and concealment of same, then imputing their (lack of) knowledge to the entities does not help Defendants' arguments.[219] On the other hand, if a jury were to find that Wagers and Hoover *did* know of, and were complicit in, the fraud and securities law violations at Breitling and breached their fiduciary duties to prevent such misconduct, then Wagers' and Hoover's knowledge cannot be imputed to the entities as a matter of law. These fact issues and credibility determinations will need to be sorted out by a jury at trial.

Defendants argue, based solely on testimony by Nymeyer, that Matlock informed BECC Audit Chair Williford of the various fraud issues RK encountered at Breitling during their first teleconference on February 19, 2014. But Matlock himself testified that Nyemeyer was not even on that call,[220] which is consistent with Williford's testimony,[221] and Williford has denied that anyone from RK (or anyone else) ever informed him about the Commingling Fraud and does not recall anyone from RK disclosing the AFE Fraud or the Overselling Fraud or any concerns or issues surrounding Faulkner's expense reimbursements to him at any time.[222] Matlock has even admitted that during his call with Williford he "strictly" followed the RK letter to the Audit Committee as a "roadmap" for the discussion and therefore likely didn't discuss the inflated AFEs since they aren't mentioned in the letter.[223]

Defendants also mischaracterize evidence concerning whether BECC was contemplating suing RK in 2015. The evidence cited by Defendants at footnote 13 of their Memorandum consists of a 2015 e-mail between representatives of CFO Suites which describes Faulkner being "effing

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[219] See, e.g., *supra* notes 128 to 141 and accompanying text.
[220] See Defendants' Appendix, ECF 96-6, at App. 1413.
[221] Williford Depo. at 138:16-139:19, App. 3436-37.
[222] Williford Depo. at 150:21-151:10, 162:12-19, 176:17-177:3, 188:12-22, 200:15-19, 209:13-18, App. 3448-49, 3460, 3474-75, 3486, 3498, 3507.
[223] Matlock 8/17/17 Depo. at 559:8-560:4, App. 1385. See PX 108, App. 3831-33.

pissed" if the 2014 10-K filing is late and Wagers threatening to sue people involved in the 2014 audit underway at that time – *not RK*.[224] Thornock, who joined the BECC Board in November 2014 and became the Chair of the Audit Committee in December 2014,[225] testified that he doesn't recall any consideration or discussion by the BECC Board of ever suing RK.[226]

Defendants point to some conflicting evidence that BECC's successor auditors and accounting contractors hired to assist the successor auditors may have had some suspicions that RK's audit opinion for the 2013 BECC financials was problematic, but Defendants themselves elicited testimony from those same witnesses that the successor auditors and accounting contractors were ***not*** aware of any errors in the 2013 BECC financial statements *as of August 2015*.[227] And one of the accounting contractors retained by BECC testified that he never had any communications at all with the BECC Board.[228]

In fact, there is no evidence that any of the "innocent" members of the Breitling Board or Audit Committee knew or suspected any misconduct by Defendants until, at the earliest, **September 1, 2015**, which is right before BECC filed its 8-K to notify the public that its prior financial statements from 2012 and 2013 (audited by RK) could not be relied upon.[229] The independent members of BECC's Board didn't even learn about the detail or scope of *Faulkner's* fraud until December 2015, following the report provided to the Board by outside accounting

[224] See Defendants' Appendix, ECF No. 96-4, at App. 1185.
[225] Thornock Depo. at 21:12-22:12, 23:4-7, App. 3491-92, 93.
[226] Thornock Depo. at 67:2-7, App. 2537.
[227] Gonzales Depo at 141:15-142:12, App. 168-69.
[228] Brett Lawson Depo., at 29:18-30:16, App. 932-33. While during the course of their accounting work for BECC between March and May 2015 some of the subcontractors working for CFO Suites began to suspect fraud was being perpetrated at Breitling, including that Breitling was possibly operating a Ponzi scheme, CFO Suites never reported that fraud to BECC's Board or even to MaloneBailey, and only threatened to report its findings when CFO Suites didn't receive payment for its work. Lawson Depo., at 55:12-58:12, 58:24-60:14, 76:14-24, 96:3-100:2, App. 958-61, 961-63, 797, 999-1003.
[229] Gonzales Depo at 175:14-177:7, App. 202-04.

consultant Steve Plumb ("Plumb") at the December 2, 2015 Board meeting,[230] let alone discover any facts that RK was complicit with Faulkner in concealing the fraud. At that December 2, 2015 Board meeting, Plumb disclosed his findings from his audit prep work, including Breitling's massive overselling of interests (some projects oversold by as much as 80%) and payments to AMEX over a two year period totaling over $14 million - none of which payments Plumb could find support for.[231] Based on the Plumb report in December 2015, the BECC Audit Committee retained New York law firm Davis Polk to perform an independent investigation, and as a result, and based on advice of counsel, all the independent Board members resigned that same month.[232]

Thornock had no reason to suspect anything was wrong with RK's prior work on the Breitling audits until, at the earliest **September 1, 2015**, when BECC's new CFO David Kovacs and MaloneBailey audit partner Jay Norris determined that BECC needed to file an 8-K with the SEC advising that BECC's 2012 and 2013 audited financial statements could no longer be relied upon.[233] Plumb also confirms that it was on **September 1, 2015** that he reached his conclusions and reported to the Audit Committee the errors in the 2013 audited financial statements that he had uncovered and recommended BECC file the 8-K, but even by that time no one at BECC had concluded that RK had committed malpractice or engaged in any misconduct.[234] Thornock

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[230] Thornock Depo. at 73:24-74:5, 83:17-89:25, App. 2553-59; 93:15-22, App. 2563; 104:19-105:14, App. 2574-2575.

[231] Plumb Depo., at 158:23-165:25, App. 2339-46; 170:10-172:6, App. 2351-53; 176:6-177:18, App. 2357-58. Plumb testified that it wasn't until December 2015 that he, acting as an accounting consultant for BECC, had put all the pieces together and determined that Breitling was overselling oil and gas securities in violation of securities laws and Faulkner had been misappropriating millions of dollars in funds from Breitling through AMEX reimbursements. Plumb Depo., at 58:2-61:25, App. 2239-41. This was shortly after Plumb concluded in November 2015 that RK's classification of Breitling's "overselling" of securities as deferred revenue was improper and resulted in the recording of millions of dollars in revenues that did not exist. Plumb Depo., at 129:13-132:22, App. 2310-13. During his investigation, Plumb discovered that **Breitling was wiring <u>approximately $90,000 per day</u> to pay AMEX charges**. Wagers 8/12/20 Depo. at 298:23-299:23, App. 2960-61.

[232] Thornock Depo. at 137:2-138:5, App. 2607-08.

[233] Thornock Depo. at 114:12-116:18, App. 2584-86. Plumb testified that he was the one that prepared the 8-K and pushed for it to be filed in September 2015 after concluding that the 2013 financial statements were so full of that they needed to be restated. Plumb Depo., at 148:5-152:25, App. 2229-33;

[234] Plumb Depo., at 151:9-158:8, App. 2332-39; 181:4-9, App. 2362.

testified that he personally had no reason to believe that RK's audited financial statements were not accurate until around the time of the September 4, 2015 filing of the 8-K.[235]

Michael Miller and Parker Hallam, who were the other original 1/3 shareholders with Faulkner in BOG and BRC likewise lacked knowledge of RK's wrongful conduct and lacked the ability to take any action given Faulkner's absolute control over the entities. Hallam testified that he had no idea that RK had discovered Breitling's fraud and illegal conduct during their audit work in 2013-2014, [236] and testified he had never seen the Nymeyer Memo prior to his receiving it in conjunction with his July 29, 2020 deposition,[237] and that no one from RK ever told him while he was the COO of BOG and BRC that RK had uncovered fraud and illegal conduct at Breitling.[238]

Finally, the common law doctrine of adverse domination should apply under the unique facts of this case because the evidence is undisputed that ***all*** of the Breitling entities were dominated and controlled by Faulkner,[239] and that BECC's independent and "innocent" Board members were (*with Defendants' assistance*) kept in the dark about what was transpiring at Breitling.[240] Hallam and Miller have testified that Faulkner dominated and controlled all of the Breitling entities; indeed Miller referred to Faulkner's control over the entities as "***ironclad***".[241] Despite the fact that Miller and Hallam were the purported sole owners and officers of the Crude

[235] Thornock Depo. at 177:22-178:17, App. 2647-48.
[236] Hallam Depo. at 165:21-166:12, App. 481-82.
[237] Hallam Depo. at 167:4-8, App. 483.
[238] Hallam Depo. at 169:5-17, App. 485.
[239] Thornock Depo. at 54:6-19, App. 2524; 138:16-139:9, App. 2608-09 (testifying that he discovered in late 2015 that even though Faulkner did not own Crude and Patriot, he effectively controlled those entities).
[240] While historically the adverse domination doctrine has been reserved for suits by entities against their former officers and directors, given the unique facts of this case - wherein Defendants committed intentional torts to assist the dominant directors and control persons conceal their fraud from the innocent directors (and others) - there is no logical reason not to apply the doctrine here. *Cf FDIC v. Shrader & York*, 991 F. 2d 216, 227 (5th Cir. 1993) (refusing to apply adverse domination doctrine to suit against outside law firm, in part, *because the FDIC had not alleged that the law firm had committed intentional torts*).
[241] Miller Depo., at 50:16-51:18, 64:17-20, App. 1519-1520, 1533; 123:2-11, App. 1592 (it was common knowledge that Faulkner made all the decisions for the entities and his control was "ironclad"); 146:10-17, App. 1615. Hallam Depo. at 135:19-136:3, App. 451-452.

Entities and Patriot, the evidence is clear that in reality Faulkner dominated and controlled those entities as well.[242] Williford and Thornock, both of whom at different times chaired the BECC Audit Committee, as well as fellow Board member Richard Mourglia, testified that the Board really had no authority or control over Faulkner because Faulkner was BECC's primary shareholder and could terminate the Board if the Board tried to fire him as CEO.[243] While the BECC Board was ostensibly composed of three "independent" directors (along with fraud "insiders" Faulkner and Wagers), the reality was that only 2 of the Board members were truly "independent" at any given time, because the third purportedly "independent" Board member, Jonathan Huberman, was a close personal friend of Faulkner who Thornock testified was "in" on the fraud and concealed it from the other independent Board members.[244] Thus the Board was dominated by the fraud insiders and the evidence is overwhelming that Defendants helped the insiders conceal the fraud from the "independent" minority directors and in doing so committed intentional torts; therefore the rationale for the distinction previously drawn by the courts with regard to the adverse domination doctrine does not apply under the facts presented here since the Defendants' conduct was directed at the same goal of preventing the "innocent" directors from discovering and pursuing claims against the principal wrongdoer, Faulkner.[245]

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[242] Miller Depo., at 146:20-147:8, 154:6-23, 163:4-24, App. 1615 - 1616, 1623, 1632.

[243] Thornock Depo. at 47:21-48:13, 144:7-147:5, App. 2517-2815, 2614-17 (testifying that Faulkner exercised "absolute control" over BECC because of his shareholder position). Mourglia 11/12/20 Depo., at 32:2-17, App. 1684 (the BECC Board had no real authority over Faulkner because as the primary shareholder Faulkner controlled what the directors could do); 70:3-8, 71:19-23, App. 1722-23 (noting that there was nothing the Board could do, and that the Board tried to investigate an understand things but "could never get to the bottom of anything"); 81:25-82:19, App. 1733-34.

[244] Thornock Depo. at 15:23-16:19, 47:7-20, 52:16-23, App. 2485-86, 2517, 2522 (**testifying that he and Mr. Mourglia were the only truly "independent" directors at BECC**).

[245] See, e.g., *Warfield v. Carnie*, 2007 U.S. Dist. LEXIS 27610 at *46-48 (N.D. Tex. 2007) (surveying federal case law including for the proposition that entities are "incapacitated" and "paralyzed" while under the control of the wrongdoers, which "results in the concealment of any causes of action from those who otherwise might be able to protect the corporation"); *FDIC v. Dawson*, 4 F. 3d 1303, 1310 (5th Cir. 1993) ("While they retain control [the majority board members] can dominate the non-culpable directors and control the most likely sources of information and funding necessary to pursue the rights" of the entity).

3. Defendants' Fraudulent Concealment Tolled Limitations

The doctrine of fraudulent concealment should estop Defendants from relying on a limitations defense given the extent of their concealment of Breitling's fraud and continuing concealment of their findings and withholding of information from Breitling, their client, from 2014 through 2015. As a direct result of Defendants' concealment of the Breitling fraud as described herein, BECC's independent directors did not discover the details or scope of the fraud and therefore were not in a position to take any action to stop the fraud until November-December 2015, when the Audit Committee was informed of the scope of Faulkner's fraud (and by which time the vast majority of the damage was already done).

First, the record evidence described above clearly establishes that RK concealed its findings of fraud and violations of law occurring at Breitling, such as the findings detailed in the Nymeyer Memo, during the course of its audit work in 2013 and 2014 from the BECC Board and Audit Committee, RK's own supervising partners, and the SEC. And none of the independent directors of BECC were ever provided a copy of Nymeyer's Memo, despite the audit standards and SEC regulations that required RK to have provided such information to the Board.[246]

Second, RK continued to actively conceal its involvement in Breitling's fraud by refusing to turn over Breitling's own financial records to BECC and its agents *as required by Texas law*. Despite Breitling's officers (Hoover) and agents (Plumb) specifically requesting that RK reissue its 2013 opinion or provide to BECC the documentary support for its 2013 opinion, RK refused to produce anything. When Plumb came on board in May 2015, he specifically asked RK for, at the very least, Breitling's own accounting information supporting the 2013 financials as required by

[246] See *SEC v. KPMG LLP*, 412 F. Supp. 2d. 349, 376, 388-390 (S.D.N.Y. 2006); *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d. 585, 597-598, 607 (D.N.J. 2001).

the Texas Administrative Code,[247] but RK's counsel Nick Morgan told Plumb "*not no, but Hell no*", and refused to provide anything.[248] As a result, Plumb thereafter had to dig in and investigate to recreate the 2013 financials, which took him from May until **September 1, 2015**, which is the only firm date established in the record by which time Plumb determined and reported to the Audit Committee that the 2013 financials needed to be restated, which led to the September 4, 2015 public filing of the 8-K disclaiming reliance on the prior RK-audited financials. As a result, Defendants' continued concealment had the effect of forestalling BECC's Audit Committee from learning the truth, thereby tolling limitations under the doctrine of fraudulent concealment.[249]

Thornock testified that if he had had access in late 2014 or at any time in 2015 to the Nymeyer Memo and other documents revealing what RK knew about the Breitling fraud during the years it performed is audits, he would never have agreed to join the BECC Board or would have immediately resigned.[250] And Thornock testified that it wasn't until the day before his November 11, 2020 deposition, when he reviewed the binder of documents provided by the Receiver's counsel for his deposition (including the Nymeyer Memo),[251] that he discovered RK's work product and wrongful conduct, and he lamented on the record the waste of a year of his life

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[247] Rule 501.76 (a) of the Texas Administrative Code, Rules of Professional Conduct of the Texas State Board of Public Accountancy, requires that accountants shall return original client records to a client or former client within a reasonable time (promptly, not to exceed 10 business days) after the client or former client has made a request for those records. Original client records are those records the client provided to the accountant. Original records also include those documents obtained by the accountant on behalf of the client in order to provide accounting services.

[248] Plumb Depo., at 202:9-209:18, 221:5-230:6, App. 2383-90, 2402-11.

[249] Under Texas law, fraudulent concealment is an equitable doctrine that tolls the statute of limitations. A defendant who has a duty to make a disclosure cannot avoid liability by concealing wrongdoing until the statute of limitations has run. *Borderlon v. Peck*, 661 S.W.2d 907, 908 (Tex. 1983). Fraudulent concealment's estoppel effect "ends when a party learns of facts, conditions, or circumstances which would cause a reasonably prudent person to make inquiry, which, if pursued, would lead to discovery of the concealed cause of action. Knowledge of such facts is in law equivalent to knowledge of the cause of action." *Casey v. Methodist Hosp.*, 907 S.W.2d 898, 904 (Tex. App. 1995). To show entitlement to the estoppel effect, the plaintiff must show: (1) the defendant had actual knowledge of the wrong, (2) a duty to disclose the wrong, and (3) a fixed purpose to conceal the wrong. *Id. at 903* (quotation marks omitted).

[250] Thornock Depo. at 154:3-25, App. 2624; 168:5-8, App. 2638.

[251] Thornock Depo. at 184:16-20, App. 2654; 185:6-19, App. 2655; 187:7-188:21, App. 2657-58.

serving on the BECC Board and his continuing expenditures on legal fees "***because of Rothstein Kass' failure to communicate anything around what they had found***."[252]

B. Fact Issues Related to Defendants' Knowledge and Proximate Cause Preclude Summary Judgment on the Receiver's Negligence Claim

1. Defendants' Privity Argument regarding Matlock is a Red Herring

Defendants' argument that a lack of direct contractual privity between Matlock, individually, and the Breitling entities eliminates the Receiver's ability to sue Matlock for negligence is a red herring unsupported by any caselaw. The privity cases Defendants cite all involve ***non-clients*** suing accounting firms, and surely Defendants do not contend (and have not cited evidence to support) that Matlock, as the RK engagement partner who was in charge of the Breitling audits and who Defendants concede signed RK's engagement letters with Breitling,[253] didn't consider Breitling to be his client.[254] Furthermore, the cases Defendants cite in support of their position acknowledge that a contract to perform accounting services can be express or *implied*, and clearly there was, at a minimum, an implied agreement between Breitling and Matlock to let Matlock lead the audit of Breitling's financial statements.[255]

Moreover, applicable audit standards would not permit Matlock to escape liability based on the lack of a separate contract with his client, as federal courts have routinely held individual audit partners – particularly audit engagement partners who have the "ultimate authority to

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[252] Thornock Depo. at 155:24-157:7, App. 2625-27.

[253] Defendants' Memorandum in Support of Motion for Summary Judgment, ECF No. 95 at footnote 126.

[254] See, e.g., *First Nat'l Bank v. Trans Terra Corp. Int'*l, 142 F. 3d 802, 806-807 (5th Cir. 1998) (noting that "Texas law is clear that a legal malpractice claim requires proof of an attorney-client relationship between the plaintiff and the defendant attorney"). Here it cannot be seriously disputed that there was an accountant-client relationship between Matlock and Breitling.

[255] *W. Houston Airport, Inc. v. Millennium Ins. Agency, Inc*., 349 S. W. 3d 748, 752 (Tex. App. – Hous. [14th Dis.] 2011) (for purposes of professional negligence privity can be formed by express or **implied** contracts) phasis added); *SC&E Admin. Services v. Deloitte*, 2006 U.S. Dist. LEXIS 94032 at *47-48 (W.D. Tex. 2006) (citing to Texas pattern Jury Charges – Malpractice, Premises and Products §61.3 (2003) for the proposition that an "accountant-client relationship exists only if the accountant has agreed, expressly or *impliedly*, to render accounting services…to the person claiming such relationship") (emphasis in the original);

determine whether an audit opinion should be issued" – directly liable for, *e.g.*, securities fraud. See e.g., *SEC v. KPMG LLP*, 412 F. Supp. 2d. 349, 376 (S.D.N.Y. 2006). In that case the court noted that certain GAAS standards make individual auditors liable for violations of Section 10A of the Exchange Act - which is the same provision the Receiver's expert witness has opined Defendants violated - because they impose duties on individual auditors with respect to uncovering and reporting fraud and/or withdrawing from audit engagements. *Id*., at 388-390. It would be absurd to insulate Matlock against negligence liability for his violations of Section 10A of the Exchange Act when said provision of law specifically makes Matlock *personally responsible* for such violations.

As for whether there was privity between Defendants and Crude, as demonstrated by the record evidence cited above, Defendants were well aware of Crude and its relationship with Breitling.[256] Furthermore, Matlock testified to the SEC that from his perspective Crude and Breitling were "***one and the same***" and that even though Crude was "papered" as a separate company, he knew that Breitling (Faulkner) was still going to control Crude.[257]

2. Defendants' Negligence is Supported by the Record Evidence

Defendants' sole argument they were not negligent is because they allegedly informed the Audit Committee (via RK's 2014 letter to the Audit Committee discussed in detail above) and Audit Committee Chair Williford (via telephone) about the fraud and illegal acts occurring at Breitling. The Receiver has already addressed above the undisputed fact that RK's 2014 letter to the Audit Committee doesn't mention anything about the findings contained in the Nymeyer Memo.[258] And the phone conversation with Williford that Nymeyer says he participated in is

[256] See *supra* at footnotes 163 to 160 and accompanying text
[257] Matlock 8/17/17 depo., at 560:11-20, App. 1386; 562:21-563:24, App. 1387.
[258] See *supra* at footnotes 106, 111 to 124 and accompanying text.

disputed not only by Williford himself,[259] but also by Matlock, who denied that Nymeyer was even on that phone call with Williford and also denied he discussed the AFE Fraud or the Commingling Fraud with Williford on the call and testified that the call was more introductory in nature,[260] which is consistent with the e-mail Matlock sent to Wagers and Hoover immediately following the Williford call, which Matlock described as a "wonderful call" - hardly the language an auditor would use after telling a Board member his company is rife with fraud.[261]

Defendants have attempted to distance themselves from the Breitling fraud by pointing to Breitling's Management Representation letters that Defendants contend they relied on in issuing each of the audit opinions,[262] but Hoover testified that Defendants prepared the Management Representation letters and sent them for him to sign in PDF form just hours before the 8-K/A and 10-K were due to be filed with the SEC,[263] and that he only signed the letters (as well as the Sarbanes Oxley certification included in BECC's 10-K filing with the SEC) based on his reliance on RK's work in the preparation of the financial statements and footnotes.[264]

3. The Record Evidence Supports Reliance and Proximate Causation and Defendants are Liable for all Damages that were Foreseeable

Defendants argue that the Receiver cannot establish that anyone relied on their Breitling audits or that their negligence proximately caused any damages. As a preliminary matter, causation is typically a question of fact for the jury.[265] Moreover, direct evidence of causation is

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[259] See *supra* at footnotes 121 to 127 and accompanying text.
[260] *Compare* Nymeyer's testimony cited by Defendants in footnote 104 of their Memorandum in Support of Summary Judgment [ECF No. 95] citing to Defendants' Appendix [ECF No. 96-5] at App. 1379, with Matlock's testimony cited by Defendants in the same footnote 104 of their Memorandum, citing to the same Appendix at App. 1413.
[261] PX 273, App. 4127.
[262] Defendants' Memorandum, ECF No. 95, at p. 11.
[263] Hoover Nov. 6, 2020 Depo., at 41:6-42:42:7, 128:4-130:17, App. 752-53, 839-41.
[264] Hoover Nov. 6, 2020 Depo at 47:17-23, 131:18-132:5, 166:19-168:6, App. 758, 842-43, 877-79. Defendants cannot rely on the statements contained in the Breitling Management Representation letters because they knew that the letters (which they drafted) contained misstatements. *Sunpoint*, 377 B.R. 513, at 546 (Bankr. E.D. Tex. 2007).
[265] *Flock v. Scripto-Tokai Corp*., 319 F.3d 231, 237 (5th Cir. 2003); *Tex. Dept. of Trans. v. Olson*, 980 S.W.2d 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").

not necessary; "circumstantial evidence and reasonable inferences therefrom are a sufficient basis for a finding of causation."[266] In Texas, "[t]he two elements of proximate cause are cause in fact (or substantial factor) and foreseeability."[267] "Cause in fact is established when the act or omission was a substantial factor in bringing about the injuries, and without it, the harm would not have occurred."[268] "Foreseeability" means that the actor, as a person of ordinary intelligence, should have anticipated the dangers that his negligent act created for others.[269] Establishing causation requires facts sufficient for a jury to reasonably infer that the defendant[s'] acts were a substantial factor in bringing about the injury." *Flock*, 319 F.3d at 237.[270]

The Receiver has presented ample evidence to demonstrate a causal link between Defendants' negligence and the damages incurred by the Breitling Receivership Entities. First, Defendants wholly ignore and fail to address the causation opinions given by the Receiver's expert witness Mr. Solomon. Mr. Solomon has opined that Defendants had a duty under Section 10A of the Exchange Act to report Nymeyer's findings of fraud and illegal acts directly to Breitling's management and/or to the BECC Board and Audit Committee, and if management or the Board failed to act, then Defendants were required to report their findings to the SEC.[271] As the record evidence demonstrates, Defendants not only violated their duties under Section 10A of the

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[266] *Tompkins v. Cyr*, 202 F.3d 770, 782 (5th Cir. 2000).
[267] *D. Houston, Inc. v. Love*, 92 S.W.3d 450, 454 (Tex. 2002).
[268] *IHS Cedars Treatment Center of Desoto, Tex., Inc. v. Mason*, 143 S.W.3d 794, 799 (Tex. 2004).
[269] *Travis v. City of Mesquite*, 830 S.W.2d 94, 98 (Tex. 1992).
[270] 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). There can be more than one proximate cause of an injury, i.e., a concurrent proximate cause, and all persons whose negligent conduct contributes to the injury are liable. *Travis v. City of Mesquite*, 830 S.W.2d 94, 98 (Tex. 1992). "[A] concurring cause 'concurs with the continuing and cooperating original negligence in working the injury,' leaving the causal connection between the defendant's negligence and the plaintiff's harm intact." *Stanfield v. Neubaum*, 494 S.W.3d 90, 98 (Tex. 2016) . *See also Davis v. Dallas County, Texas*, 541 F. Supp. 2d 844, 854-855 (N.D. Tex. 2008) ("[a]ll persons who contributed to the injury are liable").
[271] Solomon Report, at 42-44, App. 3566-68. *See SEC v. KPMG LLP*, 412 F. Supp. 2d. 349, 376, 388-390 (S.D.N.Y. 2006); *In re Cendant Corp. Sec. Litig*., 139 F. Supp. 2d. 585, 597-598, 607 (D.N.J. 2001) .

Exchange Act, they instead actively helped Breitling's corrupt management conceal the fraud and securities law violations from the BECC Board and Audit Committee, from the SEC, and even from RK's own supervisory partners.[272]

Specifically, Solomon has opined that Defendants' conduct enabled Faulkner to continue the fraud,[273]and that the damages he calculated for the Breitling entities "are the result of [Defendants'] audit failures, professional negligence and violations of audit standards."[274] Solomon further opines that (as Nymeyer urged) Defendants were obligated to withdraw from the Breitling engagement and to notify the SEC of the reasons for their withdrawal, including reporting Breitling's fraud and illegal acts to the SEC, and that had Defendants taken such required actions it would have prevented the completion of the SEC filings for the reverse merger (and concomitant creation of BECC) and would have provided the SEC with compelling evidence to have shut down the Breitling fraud by the end of December 2013, thereby avoiding all of the damages to the Breitling entities (including the Crude and Patriot entities) that were incurred thereafter.[275] Solomon also opines that Defendants' failures to inform the Board and Audit Committee of their findings contained in the Nymeyer Memo also caused damages to the Breitling entities.[276] At a minimum, this evidence raises genuine issues of material fact on causation and damages.[277]

As for foreseeability,[278] Nymeyer testified that one of the principal reasons he urged Matlock to withdraw from the Breitling audit was because it was foreseeable to him that RK could

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[272] See *supra* at footnotes 88 to 162 and accompanying text.
[273] Solomon Report at 36-37, App. 3560-61.
[274] Solomon Report at 67-68, App. 3591-92.
[275] Solomon Report at ps. 40-41, App. 3564-65.
[276] Solomon Supplemental Report, at ps. 1-5, App. 3624-28.
[277] *Garcia v. Wheelabrator Group, Inc.*, 2011 WL 13232701, at *5 (N.D. Tex. Nov. 3, 2011) (direct and circumstantial evidence of causation creates question of fact for jury); *Elizondo v. Krist*, 415 S.W.3d 259, 272 (Tex. 2013)(evidence from which a reasonable juror could infer plaintiff sustained damages precludes summary judgment).
[278] Foreseeability means that the actor, as a person of ordinary intelligence, should have anticipated the dangers that his negligent act created for others. *Travis v. City of Mesquite*, 830 S.W.2d 94, 98 (Tex. 1992) (citing *Nixon v. Mr.*

be sued by Breitling investors (logically for damages they suffered connected to RK's audits of Breitling).[279] It was therefore admittedly foreseeable to Defendants that their involvement with the Breitling audits and issuance of clean audit opinions for Breitling could "enable Faulkner to continue the fraud",[280] and cause massive fraud liabilities to the Breitling entities.

Defendants argue that they cannot be held liable for damages incurred by the Crude entities or Patriot. But the evidence is clear that most of the funds raised by the Crude and Patriot entities were illicitly transferred to Defendants' audit client BECC and misappropriated by Faulkner, which misappropriation was entirely foreseeable to Defendants since the very beginning of their audit work.[281] Moreover, Defendants knew about Faulkner's creation and utilization of the Crude entities to continue the fraudulent "legacy" oil and gas securities offering business, and Matlock testified that from his perspective Crude and Breitling were "***one and the same***" and that even though Crude was "papered" as a separate company, he knew that Breitling (Faulkner) was still going to control Crude and that Crude was going to continue the same the oil and gas offerings.[282] Therefore it was entirely foreseeable to Defendants that their conduct would contribute to downstream harm incurred by the related Crude entities.[283]

Property Management Co., 690 S.W.2d 546, 549–50 (Tex. 1985)). Significantly, "[f]oreseeability does not require that a person anticipate the precise manner in which injury will occur once he has created a dangerous situation through his negligence." *Id.* (citing *Brown v. Edwards Transfer Co.*, 764 S.W.2d 220, 222 (Tex. 1988); *El Chico Corp. v. Poole*, 732 S.W.2d 306, 313 (Tex. 1987)). "All that is required is that the injury be of such a general character as might reasonably have been anticipated, and the injury should be so situated with relation to the wrongful act that the injury to him or to one similarly situated might reasonably have been foreseen." *Univ. Preparatory School v. Huitt,* 941 S.W.2d 177, 180 (Tex. App.-Corpus Christi 1996, writ denied) .

[279] See *supra* at footnotes 82 to 87 and accompanying text.

[280] Solomon Report at 36-37, App. 3560-61.

[281] PX 96, App. 3735-42 (October 2013 RK's Audit Scope Memorandum in which RK identified fraud risks associated with ***management override of controls*** and significant use of credits cards by Faulkner which, when coupled with a lack of controls over disbursements (processed by Handkins), led RK to conclude that "***there is increased risk of misappropriation of cash due to fraud***").

[282] Matlock 8/17/17 depo., at 560:11-563:24, App. 1385–87.

[283] As for Patriot, should the Court determine that damages incurred by Patriot directly and/or through Faulkner's misappropriation of Patriot funds through BECC are not causally linked to Defendants' misconduct, such determination would only serve to limit the Receiver's recoverable damages at trial, and Solomon calculated his damages models based on different points in time such that Patriot-related damages could easily be excluded for trial. Solomon Report at ps. 67-68, App. 3591-92.

The above evidence certainly raises a fact issue and reasonable inference that Defendants' deficient audit services contributed to the size and scope of the underlying scheme, which ultimately resulted in the financial ruin of the Breitling entities.[284]

But beyond Mr. Solomon's expert opinion, there is direct evidence from Breitling Chief Operating Officer and President of Crude Hallam that he took great comfort in the fact that RK issued clean audit opinions for Breitling because he had begun to identify some "red flags" with respect to Faulkner prior to the issuance of the RK audit opinion but his concerns were assuaged by RK's clean audits.[285] Like the independent directors who were also kept in the dark about what RK knew, Hallam likewise had no idea that RK had discovered (but concealed) Breitling's fraud and illegal conduct during their audit work in 2013-2014.[286] Hallam testified he had never seen the Nymeyer Memo prior to his receiving it in conjunction with his July 29, 2020 deposition,[287] and that no one from RK ever told him while he was the COO of BOG and BRC that RK had uncovered fraud and illegal conduct occurring at Breitling.[288]

After reading the Nymeyer Memo for the first time, Hallam testified that if he had had access to the Nymeyer Memo when he was still an officer of Breitling it "***would have definitely changed the outcome of everything***" because "**things would not have progressed any further**" because Hallam "***would have done the right thing***" and "***confronted it in one way or another***".[289]

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[284] See *Off'l Stanf. Inv. Comm. v. Greenberg Traurig, LLP*, 2014 WL 12572881, at *6 (N.D. Tex. Dec. 17, 2014). *See also, Waste Mgmt. of La., LLC v. River Birch, Inc.*, 920 F.3d 958, 973 (5th Cir. 2019) (reversing summary judgment because circumstantial evidence of a chain of events, if accepted by the jury, would support an inference of causation sufficient to go to the jury).

[285] Hallam Depo. at 164:11-165:20, App. 480-81. Hallam testified that the "red flags" that concerned him about Faulkner were related to Faulkner's spending habits, but that he didn't know about Faulkner's cocaine possession charge or the liens and judgments against him, or that Faulkner's educational had been fabricated (all things that RK knew but never disclosed). Hallam Depo. at 173:24-177:11, App. 489-93.

[286] Hallam Depo. at 165:21-166:12, App. 481-82.

[287] Hallam Depo. at 167:4-8, App. 483.

[288] Hallam Depo. at 169:5-17, App. 485.

[289] Hallam Depo. at 181:14-182:12, App. 497-98.

He also testified that if he had known the information contained in the Nymeyer Memo at or around the time it was prepared in late 2013, he believes that **all of the investor losses thereafter could have been avoided**,[290] and that he never would have agreed to continue on with Breitling or to be named as the President of the Crude entities.[291]

Finally, there is plenty of evidence of reliance not only on Defendants' issuance of two clean audit opinions but also on their shoddy audit field work in general and, most importantly, Defendants' concealment of their findings as set forth in the Nymeyer Memo.[292] As described herein, Williford, Thornock, Hoover, Wagers and Hallam have all testified that they relied on Defendants' issuance of the clean audit opinions and Defendants' failure to disclose the fraud findings and other illegal acts contained in the Nymer Memo in determining that Breitling was a legitimate operation,[293] in signing off on the 8-K/A and 10-K SEC filings,[294] and in deciding to continue to serve as officers and directors of the Breitling entities.[295] There is even evidence that Defendants' audit opinions forestalled more immediate action by the SEC against Faulkner and Breitling.[296]

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[290] Hallam Depo. at 227:2-228:18, App. 543-544.

[291] Hallam Depo. at 182:13-20, App. 498. Hallam's suspicions of Faulkner and his use of investor funds transferred from Crude to BECC eventually led to a confrontation at the end of March 2015 when Hallam decided he needed to take control of Crude funds that were supposed to be used for Crude's drilling operations instead of allowing Faulkner to siphon the money through BECC, which led to Hallam taking a Fedex box of Crude investor checks from BECC's offices and then changing the locks and barricading himself in Crude's offices until Faulkner called the Dallas police and had the building management escort Hallam from the premises. Hallam Depo. at ps. 186:12-191:14, App. 502-507; ps. 202:18-205:13, App. 518-521.

[292] In *Sunpoint*, the court held that "*reliance on the competent performance of any audit is sufficient to prove causation, even if nobody actually relied, or justifiably could have relied, on any specific misstatement contained therein*." *Sunpoint*, 377 B.R. at 557 (Bankr. E.D. Tex. 2007).

[293] Wagers Depo. at p. 104:5-20, App. 2766; p. 138:14-23, App. 2800.

[294] Hoover 9/17/19 Depo at ps. 110:15-122:15, App. 627-630.

[295] Williford Depo at p. 62-64, 66-68; 73-76, App. 4173-74, 4176.Williford Depo. at 99:3-100:20, 107:10-20, 114:16-115:2, App. 3397-98, 3405, 3412-13. Thornock Depo. at 154:3-157:7, App. 2624-27. Hoover 9/17/19 Depo at ps. 110:15-122:15, App. 627-630. Hallam Depo. at 182:13-20, App. 498.

[296] Wander Depo., at p. 115:2-25, App. 3180; p. 197:4-25, App. 3262. Solomon Report at ps. 40-41, App. 3564-3565.

C. Fact Issues Related to Defendants' Knowledge Preclude Summary Judgment on the Receiver's Participation in Breach of Fiduciary Duty Claim

Defendants argue that the Receiver has no evidence that Defendants (i) knew that Faulkner was breaching his fiduciary duties owed to the Breitling entities or (ii) that they knowingly participated in Faulkner's breaches of fiduciary duty.[297] The question of whether Defendants knowingly participated in Faulkner (and Wagers' and Hoover's) breaches of fiduciary duty is properly decided by the jury at trial,[298] as is the question of Defendants' knowledge, which can be inferred (where necessary) from circumstantial evidence.[299]

But in this case, and given the overwhelming nature of direct evidence detailed above, including the Nymeyer Memo and Nymeyer's testimony (which establishes knowledge of fiduciary breaches) as well as Matlock's egregious conduct in butchering and burying the Nymeyer Memo and concealing Nymeyer's findings from the SEC (in violation of his duties under Section 10A of the Exchange Act), BECC's Audit Committee, and even RK's own supervisory review partners and instead issuing 2 clean audit opinions for Breitling (which establishes participation in fiduciary breaches), there is more than enough evidence to support this claim being submitted to the jury.[300] Indeed, Jeremy Wagers testified that he believes that Faulkner and Hoover breached

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[297] Under Texas law, a claim for participation in breach of fiduciary duty has only three elements: (1) the existence of a fiduciary relationship; (2) that the third party knew of the fiduciary relationship; and (3) that the third party was aware that it was participating in the breach of that fiduciary relationship. *Meadows v. Hartford Life Ins. Co.*, 492 F.3d 634, 639 (5th Cir. 2007).

[298] *Azar v. Bryant*, 2019 U.S. Dist. LEXIS 147393 at *11 (E.D. Tex. 2019)(citing *CBIF Ltd. P'ship v. TGI Friday's Inc.*, 2017 WL 1455407 at *16-17 (Tex. App.—Dallas Apr. 21, 2017, pet. denied)).

[299] *Azar*, 2019 U.S. Dist. LEXIS 147393 at *12-13. See also *United States v. Kuhrt*, 788 F.3d 403, 416 (5th Cir. 2016) (jury can infer actual knowledge from circumstantial evidence);*CBIF Ltd. P'ship v. TGI Friday's Inc.,* 2017 WL 1455407, *42-64 (Tex. App.—Dallas Apr. 21, 2017, pet. denied)(affirming jury verdict finding participation in breach of fiduciary duty).

[300] *Darocy v. Abildtrup*, 345 S.W.3d 129, 137-138 (Tex. App.—Dallas 2011, no pet.)(affirming trial court judgment against participant in managing partner's breach of fiduciary duty based on his overall "role and involvement" and "knowledge of problems"); Defendants' Memorandum in Support of Motion for Summary Judgment, ECF No. 95 at p. 41 (arguing that "*Nymeyer was not an attorney and therefore lacked the knowledge necessary to make a legal determination regarding fiduciary duties*"). But such a position is absurd and has no basis under Texas law. See *CBIF Ltd. P'ship v. TGI Friday's Inc.,* 2017 WL 1455407, *42-64(Tex. App.—Dallas Apr. 21, 2017, pet. denied)(affirming jury verdict finding participation in breach of fiduciary duty).

their fiduciary duties owed to the Breitling entities,[301] and further testified that if a jury in this case finds Faulkner and Hoover breached their fiduciary duties then Defendants participated in those breaches and are also responsible for what happened at Breitling.[302]

Defendants argue that they did not know about Faulkner's fiduciary involvement with Crude or Patriot and therefore cannot be held liable for participating in any breaches of fiduciary duty owed to said entities, but that is belied by the record evidence, at least with respect to Crude, because RK knew that Crude was consolidated with BECC and Matlock testified that from his perspective Crude and Breitling were "***one and the same***" and that he knew that Breitling (Faulkner) was ***still going to control Crude*** and that Crude was going to continue the same oil and gas offerings.[303] Evidence of Defendants' knowledge of Faulkner's control over Crude is sufficient to raise a fact question on the issue of Faulkner's fiduciary duties owed to Crude for the jury to decide.[304]

More importantly, it is undisputed that Faulkner, Wagers and Hoover all owed fiduciary duties to BECC, and the plethora of evidence cited herein is certainly sufficient for a rational juror to conclude, at a minimum, that Defendants (1) knew of Faulkner's breaches of fiduciary duty owed to BECC and (2) participated in them, including helping Faulkner cover up his utilization of the Breitling entities to commit securities fraud to raise investor funds and Faulkner's rampant looting of the funds from the Breitling entities.

Texas law is clear that if a jury finds that Defendants knowingly participated in Faulkner's breaches of fiduciary duty, Defendants are jointly and severally liable for all the damages caused

[301] Wagers 8/12/20 Depo. at ps. 76-77, App. 2738-39 Faulkner) and s. 292:10-18, App. 2954 (Hoover);
[302] Wagers Depo., at 138:24-140:3, App. 2800-2802.
[303] Matlock Depo., at 560:11-563:24, App. 1385 – 1387.
[304] See *McBeth v. Carpenter*, 565 F. 3d 171, 177-179 (5th Cir. 2009)(evidence of active control over an entity sufficient to create fiduciary duties where they would not otherwise exist).

by those breaches of fiduciary duty.[305] Thus proximate cause is not an element of the Receiver's knowing participation claim — the causation and damages run from the fiduciary breach by Faulkner (and/or Wagers and Hooover). *Meadows*, 492 F.3d at 639. The relevant inquiry is whether the breaches of fiduciary duty caused damages, *not* whether the participant caused damages.[306] Thus, if a jury finds that Defendants participated in Faulkner's breaches of fiduciary duty owed to BECC and the Crude entities, they are jointly and severally liable for all the damages Faulkner caused to BECC and Crude.

D. The Receiver has Standing to Pursue Increased Liabilities Damages

Courts in this District, as well as the Fifth Circuit Court of Appeals, have repeatedly held in SEC receivership cases that increased liabilities to investors that result from a defendant's misconduct are a proper measure of harm to the receivership entities, not the investors, and thus a valid measure of damages suffered by the entities.[307]

The Fifth Circuit has recognized the validity of the increased liability measure of damages in two opinions in the Stanford receivership cases. First, in *Janvey v. Alguire*, the court stated that "[e]xpanding the number of defrauded investors in the Bank . . . *expanded the Bank's ultimate liabilities and increased the injury to the Bank* . . . ." *Janvey v. Alguire*, 847 F.3d 231, 243 (5th Cir. 2017) (emphasis added). More recently, the Fifth Circuit acknowledged that an SEC receiver

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[305] *Meadows v. Hartford Life Ins. Co.*, 492 F.3d 634, 639 (5th Cir. 2007);*City of Fort Worth v. Pippen*, 439 S.W.2d 660, 665 (Tex. 1969); *Kinzbach Tool Co. v. Corbett Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942). *See also 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); *CBIF Ltd. P'ship v. TGI Fridays Inc.,* No. 05-15-00157-CV, 2017 WL 1455407 *42-45 (Tex. App.—Dallas, April 21, 2017, pet. denied); *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.).

[306] *See, e.g., Heat Shrink Innovs., LLC v. Medical Extrusion Tech.-Texas, Inc.*, 2014 WL 5307191, at *8, 12 (Tex. App.—Fort Worth, Oct. 16, 2014, pet. denied)(defendant who knowingly participates in a breach of fiduciary duty is jointly and severally liable for damages *caused by the breach* because "the knowing participant has not committed a separate tort but has participated in the underlying tort; he is a joint tortfeasor and steps into the shoes of the one who committed the tort"). .

[307] *See Janvey v. Hamric*, 2015 WL 11120301, at *5 (N.D. Tex. Nov. 5, 2015)("Winter's breach of his fiduciary duty injured SIBL by causing SIBL to incur increased liabilities.");*Janvey v. Maldonado*,3:14-CV-2826-N, 2015 WL 1428612, at *3 (N.D. Tex. Feb. 19, 2015).

may sue third parties for "increased liabilities" incurred by the receivership entities that were used as part of a fraud scheme, stating:

> There is no dispute that the receiver and Investors' Committee had standing to bring their claims against the Willis Defendants and BMB. **They bring only the claims of the Stanford entities—not of their creditors—alleging injuries only to the Stanford entities, including from the increase in their unsustainable liabilities resulting from the Ponzi scheme.** The receiver and Investors' Committee "allege that Defendants' participation in a fraudulent marketing scheme increased the sale of Stanford's CDs, ultimately resulting in greater liability for the Receivership Estate," and that defendants' "harmed the Stanford Entities' ability to repay their creditor investors." The receiver and Investors' Committee sought to recover for the Stanford entities' Ponzi-scheme harms, monies the receiver will distribute to investor-claimants.
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> *Zacarias v. Stanford Int'l Bank, Ltd*., 945 F. 3d 883, 899 (5th Cir. 2019).[308]

The Fifth Circuit went on to explicitly reject the argument that the Stanford Receiver could not sue third party aiders for investor liability damages, holding to the contrary that any such investor claims were "***derivative of and dependent on the receiver's claims***". *Zacarias*, 945 F. 3d at 900.[309] Numerous other courts have reached the same conclusion.[310]

Furthermore, "[i]n the Fifth Circuit, damages related to a director's breach of fiduciary duty are defined broadly to include '*any loss*' suffered by the corporation as a result of the

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[308] On December 14, 2020 the United States Supreme Court denied two Petitions for Writ of Certiorari filed by two groups of Stanford investors challenging the Fifth Circuit's decision in *Zacarias*.

[309] To the extent that Defendants might argue that the Fifth Circuit's discussion of increased liabilities in *Zacarias* is *dicta*, the Receiver would point out that the fact that the Stanford Receiver in *Zacarias* was suing for harm to the Stanford receivership entities in the form of increased liabilities to investors served as the basis for the Court's subject matter jurisdiction over the claims and therefore was central to Judge Higginbotham's holding that the Court had jurisdiction to bar the investors' claims.

[310] *See Thabault v. Chait*, 541 F.3d 512,523-25 (3d Cir. 2008)("Today we hold that an increase in liabilities *is a harm to the company* and the law provides a remedy when a plaintiff proves a negligence cause of action . . .When a plaintiff brings an action for professional negligence and proves that the defendant's negligent conduct was the proximate cause of a corporation's increased liabilities . ., the plaintiff may recover damages in accordance with state law.") (emphasis added); *In re Le-Nature's Inc.*, 2009 WL 3571331, at *8 (W.D. Pa. Sep. 16, 2009)(recognizing increased liabilities as a valid measure of damages distinct from deepening insolvency). *In re Brooke Corp*., 467 B.R. 467, 511-12 (Bankr. D. Kan. 2012)(recognizing increased liabilities as a damage model where there is "proof of specific itemized damages, such as increased liabilities, . .proximately caused by a breach of a legally recognized duty."); *Kirschner v. K & L Gates LLP*, 46 A.3d 737, 753 (Pa. Super. 2012)(characterizing "increased liabilities" as "traditional tort damages" and holding that a claim for increased liabilities of an insolvent corporation is distinct from a claim for deepening insolvency); *Collins & Aikman Corp. v. Stockman*, 2009 WL 3153633, at *3 (D. Del. Sept. 30, 2009) (finding plaintiff "satisfactorily alleged . . . harm" in the form of increased liabilities).

director's wrongful conduct." *Floyd v. Hefner*, 556 F.Supp.2d 617, 652 (S.D. Tex. 2008)(quoting *Meyers v. Moody*, 693 F.2d 1196, 1214 (5th Cir. 1982)). And the Fifth Circuit has held that "in breach of fiduciary duty cases, 'litigants and courts must be flexible and imaginative in calculating the proper measure of damages.'" *Id.* (quoting *Taylor Publ'g Co. v. Jostens, Inc.,* 216 F.3d 465, 487 (5th Cir. 2000).

IV. CONCLUSION

Defendants have failed to establish their entitlement to a judgment as a matter of law. There is ample evidence that Defendants knowingly and substantially facilitated breaches of fiduciary duty, and committed malpractice causing damages to the Receivership estate. At a minimum, there are genuine issues of material fact for the jury to decide. Defendants' motion must be denied.

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Respectfully submitted,

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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 January 12, 2020 via ECF notification.

/s/ Edward C. Snyder
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