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

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
vs.	§	Civil Action No. 3:16-CV-1735-D
	§	
CHRISTOPHER A. FAULKNER, et al.	§	
	§	
Defendants.	§	

STATE COURT PLAINTIFFS' CONSOLIDATED OBJECTIONS TO RECEIVER'S MOTION TO APPROVE ROTHSTEIN KASS SETTLEMENT AND RESPONSE TO RECEIVER AND ROTHSTEIN KASS' MOTIONS TO ENTER PROPOSED FINAL BAR ORDER, AND BRIEF IN SUPPORT

ORAL ARGUMENT REQUESTED

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I.
Summary of Argument

Jinsun, L.L.C., Silver Star Holdings Trust, TPH Holdings, L.L.C., Vertical Holdings, L.L.C., Steven M. Plumb, and J. Leonard Ivins (collectively, "State Court Plaintiffs") have no objection to Receiver and Rothstein Kass settling their dispute for $7,000,000; however, State Court Plaintiffs forcefully object to a condition of the settlement, which would bar State Court Plaintiffs' claims.

First and foremost, the burden is upon Receiver to prove that *all* of State Court Plaintiffs' claims belong to the receivership, that he had standing to bring, that he actually did bring, and that he had ownership rights and title to settle claims otherwise owned by State Court Plaintiffs. On the contrary, Receiver and Rothstein Kass' appendices contain nothing but un-authenticated and unsworn hearsay documents with no sponsoring witness, which are inadmissible. Indeed, in Texas and in the Fifth Circuit, unsworn expert reports are inadmissible hearsay, which the trial court can and should ignore.[1] Furthermore, pleadings and memoranda are not competent evidence—notwithstanding the hearsay objection. *See, e.g., Henson v. Geithner*, 2013 WL 55953, at *2 (N.D. Tex. Jan. 4, 2013) (Fitzwater, J.); *Laidlaw Waste Systems, Inc. v. City of Wilmer*, 904 S.W.2d 656, 660-61 (Tex. 1995).

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[1] *See Delamar v. Fort Worth Mountain Biker's Association*, 2019 WL 311517, at * 9 (Tex. App.—Fort Worth Jan. 24, 2019, no pet.) (holding trial court properly excluded expert report on the grounds that it was inadmissible hearsay); *see also Provident Life and Acc. Ins. Co. v. Goel*, 274 F.3d 984, 1000 (5th Cir. 2001) ("Unsworn expert reports ... do not qualify as affidavits or otherwise admissible evidence for [the] purpose of Rule 56, and may be disregarded by the court when ruling on a motion for summary judgment.") [citations omitted]; *Balfour Beatty Rail, Inc. v. The Kansas City Southern Railway Co.*, 173 F.Supp.3d 363, 413 (N.D. Tex. 2016) (Lindsay, J.) (holding that expert reports are inadmissible hearsay); *Smith v. Palafox*, 728 Fed. Appx. 270, 275 (5th Cir. 2018) (unsworn expert report was inadmissible hearsay, which was properly excluded by the district court).

This Court should sustain State Court Plaintiffs' objections. Because Receiver has no evidence to prove that State Court Plaintiffs' claims belong to the receivership estate, he fails to satisfy his burden of proof. Receiver's Motion for a Bar Order should be denied on this ground alone.

Be that as it may, Receiver cannot bar State Court Plaintiffs' claims because:

(i) Receiver does not own State Court Plaintiffs' direct causes of action against Rothstein Kass nor did he bring those, settle those, and he, therefore, cannot release those claims;

(ii) Assuming *arguendo* that Receiver had brought and settled State Court Plaintiffs' claims (which is forcefully denied), State Court Plaintiffs, accepting Receiver's own argument, would be entitled to their *pro rata* portion of the settlement; however, Receiver admits in his own public filings that State Court Plaintiffs are not beneficiaries of any proposed settlement and shall receive nothing;

(iii) Contrary to the suggestion that receivership assets may be at risk of dissipation, Rothstein Kass has insurance that substantially exceeds the $7,000,000 proposed settlement with Receiver and State Court Plaintiffs' demand of $11,150,000 (these documents are under a Protective Order and State Court Plaintiffs seek leave to file them under seal); and, therefore, there is no threat to receivership assets—*notwithstanding* the fact that Receiver *does not* own State Court Plaintiffs' direct claims; and,

(iv) Shortly after the Breitling audit, Rothstein Kass sold its assets to KPMG; and, according to the distribution sheet from that sale, Rothstein Kass has both cash and indemnity reserves that substantially exceeds the $7,000,000 proposed settlement and State Court Plaintiffs' demand of $11,150,000, which is not being given to Receiver under the proposed settlement agreement

> (these documents are under a Protective Order and State Court Plaintiffs seek leave to file them under seal); consequently, there is cash owned by Rothstein Kass which is *not* even being used to settle Receiver's claims, which could compensate State Court Plaintiffs without posing any threat to the dissipation of Receivership assets—*notwithstanding* the fact that Receiver *does not* own State Court Plaintiffs' direct claims.

Receiver cannot barter State Court Plaintiffs' direct claims in exchange for an artificially inflated value for his own claims by selling Rothstein Kass a release, which he cannot convey because he neither has standing nor ownership rights to State Court Plaintiffs' direct claims. For these reasons, State Court Plaintiffs have no objection to Receiver and Rothstein Kass' $7,000,000 settlement; however, it should *strike* the Bar Order language contained in that proposed settlement, it should deny Receiver's Motion for a Bar Order, and it should grant State Court Plaintiffs' Third Motion to Lift the Stay so that State Court Plaintiffs can have their day in court too.

II.
Procedural History

State Court Plaintiffs incorporate by reference their Third Motion to Lift the Stay as set forth fully herein, which is pending. *See* docket # 587.

Prior to March of 2013, State Court Plaintiffs were shareholders of Bering Exploration, Inc. ("Bering") before it entered into a reverse merger with Christopher Faulkner's two former private companies, Breitling Royalties Corporation and Breitling Oil and Gas Company (collectively, "Breitling").

On February 14, 2014, the reverse merger was ratified, when Rothstein Kass released its audit opinion, which was filed with the Securities & Exchange Commission ("SEC").

On September 25, 2017, this Court entered a Stay Order. *See* docket # 142 (§ VIII, ¶¶ 32-34) (pp. 11-12).

On November 28, 2017, State Court Plaintiffs sued Rothstein Kass under Cause No. CC-17-06249-C in County Court at Law No. 3 for Dallas County ("State Court Lawsuit") for, *inter alia*, misrepresentations made to State Court Plaintiffs by Rothstein Kass.

On August 20, 2018, Rothstein Kass filed a Motion asking this Court to clarify its Stay Order. *See* docket # 301.

On October 24, 2018, this Court granted Rothstein Kass' Motion to Clarify the scope of the Stay Order. *See* docket # 332. This Court ruled that the State Court Lawsuit was stayed pending further order from this Court.

On December 13, 2018, State Court Plaintiffs filed a Motion to Vacate the Court's October 24, 2018 Order. *See* docket # 358.

On March 5, 2019, this Court denied State Court Plaintiffs' Motion to Vacate. *See* docket # 408. This Court held that State Court Plaintiffs' professional negligence claim belonged to the Receiver. *See id.* State Court Plaintiffs dismissed their professional negligence claim and it is no longer pled.

On July 1, 2019, Receiver filed suit under Civil Action No. 3:19-cv-01594-D in the United States District Court for the Northern District of Texas, Dallas Division, against

Rothstein Kass—bringing claims for professional negligence and breach of fiduciary duty.

On October 16, 2019, Rothstein Kass filed another Motion in this Court seeking "additional" clarification, claiming that State Court Plaintiffs' aiding and abetting a breach of fiduciary duty claim was also stayed under the Court's Stay Order. *See* docket # 487.

On February 6, 2020, this Court granted Rothstein Kass' Motion—finding that the State Court Lawsuit remained stayed. *See* docket # 512.

On February 10, 2020, State Court Plaintiffs filed an Emergency Motion to Lift the Stay so that State Court Plaintiffs could proceed to trial in the State Court Lawsuit, which was then scheduled for March 24, 2020—but only on the claims, which were beyond the Court's prior Memorandum Opinions and Orders (claims that were NOT for either professional negligence or breach of fiduciary duty). *See* docket # 516.

To this end, State Court Plaintiffs agreed to dismiss with prejudice their professional negligence and fiduciary duty claims. State Court Plaintiffs further pointed out that one of the State Court Plaintiffs, Leonard Ivins, was elderly, in failing health, and may not live to see a later trial setting.

On February 25, 2020, this Court denied the Motion. *See* docket # 527.

On May 14, 2020, State Court Plaintiffs moved this Court to lift the stay, but only for the narrow purpose of correcting a "misnomer" in one of the spellings of the correct Rothstein Kass entities and for no other purpose. *See* docket # 544.

On July 1, 2020, this Court denied the Motion. *See* docket # 550.

On December 8, 2020, Rothstein Kass moved for summary judgment on all of Receiver's claims filed under Civil Action No. 3:19-CV-01594-D and styled *Thomas Taylor vs. Rothstein Kass et al*.

On February 11, 2021, Receiver and Rothstein Kass mediated their dispute under Civil Action No. 3:19-CV-01594-D and styled *Thomas Taylor vs. Rothstein Kass et al*. with former United States Magistrate Judge Jeff Kaplan at JAMS. *See* docket # 117.

On February 12, 2021, Judge Kaplan filed an ADR Summary under Civil Action No. 3:19-CV-01594-D and styled *Thomas Taylor vs. Rothstein Kass et al*. stating that Receiver and Rothstein Kass have settled their dispute. *Id*. On the same day, this Court entered an Order administratively closing the case, subject to the Court approving the settlement.

On April 7, 2021, given that Receiver and Rothstein Kass had announced a settlement in their prior filing, State Court Plaintiffs filed their Third Motion to Lift Stay, which remains pending. *See* docket # 587.

On April 21, 2021, Receiver filed a Motion to Approve the Settlement with Rothstein Kass. Receiver stated that the Motion was unopposed; however, it is strongly opposed by State Court Plaintiffs to the extent it seeks to bar State Court Plaintiffs' pending claims. *Compare* docket # 591, *with*, docket # 593.

On April 21, 2021, Receiver also filed a Motion to Enter a Bar Order. *See* docket # 594.

On May 12, 2021, Rothstein Kass filed a "Joinder" in the Receiver's Motion for a Bar Order. *See* docket # 603.

State Court Plaintiffs file this Response to Receiver's Motion to Approve the Settlement and his Motion to Enter a Bar Order. *See* docket # 591 and docket # 594. This Brief shall also serve as State Court Plaintiffs' Reply to Receiver's Response to State Court Plaintiffs' Third Motion to Lift Stay. See docket # 587.

For the reasons articulated below, this Court should deny Receiver's Motion to Enter a Bar order and grant State Court Plaintiffs' Third Motion to Lift Stay.

III.
Objections to Receiver and Rothstein Kass' Inadmissible Exhibits: All Documents Filed in the Appendices are Unauthenticated, Irrelevant Hearsay with No Sponsoring Witness

Receiver and Rothstein Kass' Motions rely upon Appendices containing various documents, which are unauthenticated, irrelevant hearsay with no sponsoring witness. *See* docket # 595 (Receiver Appendix); *see also* docket # 604 (Rothstein Kass Appendix). There is no declaration authenticating any of the documents Receiver and Rothstein Kass rely upon; and, therefore, Receiver has no evidence to meet his burden of proving that State Court Plaintiffs' claims belong to him.

a. Unsworn Expert Reports are Inadmissible Hearsay

In Texas and in federal court, unsworn expert reports, such as that of Gilbert Herrera offered to prove the truth of the matter asserted in Receiver and Rothstein Kass' appendices,[2] are inadmissible hearsay and cannot be used as evidence. *See Delamar v. Fort Worth Mountain Biker's Association*, 2019 WL 311517, at * 9 (Tex. App.—Fort Worth Jan. 24, 2019, no pet.) (holding trial court properly excluded expert report on the grounds that it was inadmissible hearsay); *see also Provident Life and*

[2] *See* docket # 595 (Appx. pp. 55 et seq.) (filed by Receiver); *see also* docket # 604 (Appx. pp. 61-98) (filed by Rothstein Kass)

Acc. Ins. Co. v. Goel, 274 F.3d 984, 1000 (5th Cir. 2001) ("Unsworn expert reports ... do not qualify as affidavits or otherwise admissible evidence for [the] purpose of Rule 56, and may be disregarded by the court when ruling on a motion for summary judgment.") [citations omitted]; *see also Balfour Beatty Rail, Inc. v. The Kansas City Southern Railway Co*., 173 F. Supp. 3d 363, 413 (N.D. Tex. 2016) (Lindsay, J.) (holding that expert reports are inadmissible hearsay); *Smith v. Palafox*, 728 Fed. Appx. 270, 275 (5th Cir. 2018) (unsworn expert report was inadmissible hearsay, which was properly excluded by the district court).

b. Pleadings and Memoranda are not Competent Evidence

In federal and state court, pleadings are not competent evidence. *See, e.g., Henson v. Geithner*, 2013 WL 55953, at *2 (N.D. Tex. Jan. 4, 2013) (Fitzwater, J.) ("Unsworn pleadings, memoranda, or the like are not competent summary judgment evidence.") [citations omitted]; *Laidlaw Waste Systems, Inc. v. City of Wilmer*, 904 S.W.2d 656, 660-61 (Tex. 1995).

Receiver and Rothstein Kass' appendices contain nothing other than unsworn expert reports, memoranda, and unsworn pleadings. State Court Plaintiffs' authentication, relevance, and hearsay objections should be sustained. Because Receiver has no evidence to prove that State Court Plaintiffs' direct claims belong to the receivership estate, Receiver fails to meet his burden of proof. Receiver's Motion for a Bar Order should be denied on this basis alone and State Court Plaintiffs' Third Motion to Lift Stay should be granted.

IV.
Argument & Authorities

A.
Receiver Cannot Compromise State Court Plaintiffs' Direct Claims against Rothstein Kass

"[R]eceivership courts have no authority to dismiss claims that are unrelated to the receivership estate." *See, e.g., SEC v. Stanford Int'l Bank, Ltd*., 927 F.3d 830, 848 (5th Cir. 2019). As Receiver correctly admits, "the Court may only bar claims that the receiver has standing to assert and compromise, which includes claims that are derivative and non-independent of the receiver's own claims." *See* docket # 594 (¶ 29) (p. 13) (citing *Rotstain v. Mendez*, 986 F.3d 931, 939-40 (5th Cir. 2021)). Indeed, "[i]t is a well-known legal principle that a receiver can bring *only* those claims belonging to the entities it represents and cannot bring claims on behalf of third parties**."** *See, e.g., Reneker v. Offill*, Civil Action No. 3:08-CV-1394, 2009 WL 804134, *5 (N.D. Tex. March 26, 2009) (Fitzwater, J.) (emphasis added) [citations omitted].

As Judge Fitzwater has stated, State Court Plaintiffs' claims could only be a receivership asset, "if the Receiver could have brought the claim *directly* and—due to the claim's *derivative* nature—the *Jinsun* Plaintiffs [State Court Plaintiffs] could *not* have done so." *See* docket # 408 (§ III-A, ¶ 1) (pg. 8) (emphasis added). Judge Fitzwater also ruled that State Court Plaintiffs' non-professional negligence and non-breach of fiduciary duty claims, "*do not appear* to be receivership assets." *See* docket # 408 (§IV, ¶ 1) (pg. 12) (emphasis added). This Court's statement is reproduced below:

In denying the motion to vacate, the court observes that the claims the *Jinsun* Plaintiffs bring *other than* for professional negligence do not appear to be receivership assets. Rothstein Kass and the Receiver do not argue that these other claims—for aiding and abetting a breach of fiduciary duty, aiding and abetting violations of the Texas Securities Act,[10] negligent misrepresentation, common-law fraud and aiding and abetting fraud, fraud by non-disclosure, and statutory fraud—are derivative of a direct claim held by a receivership entity. Rather, these claims appear to allege harms inflicted directly on the *Jinsun* Plaintiffs themselves. *See* 11 William V. Dorsaneo III, *Texas Litigation Guide* § 162.01 (2019) ("When the wrongful acts violate duties owed directly to the injured shareholder rather than to the corporation, the shareholder may prosecute a direct action individually."); *cf. Murphy v. Campbell*, 964 S.W.2d 265, 268 (Tex. 1997) (where tax advisor counseled dissolving corporation *and* its shareholders, and consequences of tax treatment of dissolution fell directly on shareholders, shareholders had direct cause of action against advisor). The Receiver has not yet expressed any intent to pursue similar claims on behalf of the

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[10] *See* Tex. Rev. Civ. Stat. Ann. art. 581-33(F)(2) (West 2010).

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See docket # 408 (§IV, ¶ 1) (pg. 12) (emphasis added).

It is important to underscore that Receiver "may sue *only to redress injuries* to the *entity* in *receivership*." *See SEC v. Stanford Int'l Bank, Ltd*., 927 F.3d 830, 841 (5th Cir. 2019) (emphasis added) (reversing a district court's bar order and holding that a receiver "may sue *only to redress injuries to the entity in receivership*.") [quotations omitted]. These are the receivership entities:

SECOND AMENDED ORDER APPOINTING RECEIVER

The court finds, based on the record in these proceedings, that the appointment of a temporary receiver in this action is necessary and appropriate for the purposes of marshaling and preserving all assets—in any form or of any kind whatsoever—owned, controlled, managed, or possessed by defendants Christopher A. Faulkner, Breitling Oil & Gas Corporation ("BOG"), Breitling Energy Corporation ("BECC"), Crude Energy, LLC ("Crude Energy") and Patriot Energy, Inc. ("Patriot"), and non-parties Breitling Royalties Corporation ("BRC"), Breitling Ventures Corporation ("BVC"), Breitling Holdings Corporation ("BHC"), Breitling Operating Corporation ("Breitling Ops"), Crude Royalties, LLC ("Crude Royalties"), Inwood Investments, Inc. ("Inwood") and Grand Mesa Investments, Inc. ("Grand Mesa") (collectively, the "Receivership Entities"), directly or indirectly ("Receivership Assets").

See docket #418 (SECOND AMENDED ORDER APPOINTING RECEIVER) (March 26, 2019). Indeed, the receivership entities that Receiver sued Rothstein Kass on behalf of (for professional negligence and breach of fiduciary duty) are these entities: Breitling Oil and Gas Corporation, Breitling Royalties Corporation, Breitling Energy Corporation, Crude Energy, LLC, Crude Royalties, LLC, and Patriot Energy, Inc. *See* docket # 45. (p. 1) (§ I, ¶ I) (Civil Action No. 3:19-cv-10594-D).

Bering, for whom State Court Plaintiffs are former stockholders, is notably absent because it is *not* a receivership entity. Even assuming *arguendo* it was, which is forcefully denied, Receiver cannot sue for investor losses, *even* in receivership entities. *See Scholes v. Schroeder*, 744 F. Supp. 1419, 1422 (N.D. Ill. 1990), *quoted with approval by Judge Fitzwater*, *Reneker*, 2012 WL 2158733, at * 5. This fact alone is dispositive of whether State Court Plaintiffs' claims are all direct.

Be that as it may, State Court Plaintiffs are *not* bringing professional negligence and breach of fiduciary duty claims[3] nor are they suing for damages caused to any receivership entity. Appx. (pp. 76-82). On the contrary, there is *zero overlap* between Receiver and State Court Plaintiffs' claims:

Receiver's Claims:	**State Court Plaintiffs Claims:**
Professional Negligence	Negligent Misrepresentation
Breach of Fiduciary Duty	Violations of the Texas Securities Act
	Fraud

Compare docket # 45 (Civil Action No. 3:19-cv-10594-D), *with*, Appx. (pp. 76-82).

State Court Plaintiffs are suing for the loss of their rescission rights caused by Rothstein Kass *before* Faulkner contaminated the value of their ownership rights in *Bering*, a non-receivership entity, when *Bering* was a stand-alone entity. *See SEC*, 927 F.3d at 841. The loss of these rescission rights prevented State Court Plaintiffs from being returned to the status quo *ante* before Faulkner's criminal enterprise even came along. These direct claims for individualized losses belong solely to State Court Plaintiffs.

B.
State Court Plaintiffs have Direct Claims that they Own, which Cannot be Barred by Receiver

The undercurrent of Receiver's argument is that the only torts Rothstein Kass could have committed were against Breitling for whom it was in contractual privity, but that has nothing to do with whether Rothstein Kass made negligent misrepresentations and breached legal duties that it independently owed to State Court Plaintiffs.

[3] Although State Court Plaintiffs have an aiding and abetting a breach of fiduciary duty claim still in their Ninth Amended Petition, they have already agreed to dismiss this claim if and when the stay is lifted.

1. Third Parties can Sue Auditors for Negligent Misrepresentation

"An accountant's false representation that an audit report was prepared in accordance with generally accepted auditing standards can support a claim for negligent misrepresentation," by third parties. *See Liberty Mut. Ins. Co. v. Padgett Stratemann, & Co., LLP*, 2014 WL 12616137, *2 (S.D. Tex. May 22, 2014) (citing *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873, 880 (Tex. Civ. App.—Fort Worth 1971, writ ref'd n.r.e.)).

Where, as here, Rothstein Kass had an actual awareness that State Court Plaintiffs were relying upon the financial statements it was auditing—it owed, under RESTATEMENT (SECOND) OF TORTS § 552(2)(a), a separate and independent legal duty to make no negligent misrepresentations. *See, e.g., In re Enron Corp. Securities v. Enron Corp*., 762 F.Supp.2d 942, 980 (S.D. Tex. 2010) [citations omitted].

In *Blue Bell, Inc. v. Peat Marwick Mitchell & Co*., 715 S.W.2d 408 (Tex. App.—Dallas 1986, writ ref'd n.r.e.), the Dallas Court of Appeals applied Section 552 of the RESTATEMENT (SECOND) OF TORTS to extend accounting liability for negligent misrepresentation to third parties, "whom the accountant intends to receive the information, or whom the accountant knows, or should know, will receive the information, or parties who are members of such a class of persons." *Id*. at 413. Thus, in deciding whether the auditors could be held liable for a negligent misrepresentation to a third party, the fact finder would decide whether the auditors knew or should have known that members of such a limited class would receive copies of the audited financial statements it prepared."

In *Ernst & Young, LLP v. Pacific Mut. Life Ins. Co*., 51 S.W.3d 573, 576-578 (Tex. 2001), the Texas Supreme Court stated that, if the accountant's false representation is made with knowledge that it will reach a known third party, those third parties will be permitted to assert a misrepresentation claim. *Id*. at 580; *see also Grant Thornton, LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 918-20 (Tex. 2010) (holding where, as here, the accountants are aware of the third party, who may foreseeably rely upon the accountants' work—a duty in tort is owed.).

The Fifth Circuit in, *Compass Bank v. King, Griffin & Adamson, P.C.*, 388 F.3d 504 (5th Cir. 2004), refused to follow *Blue Bell supra*, holding the test should instead be one of "actual knowledge;" that is, only those third parties "actually known" by the accountant are within the class of persons who can sue for negligent misrepresentation. *Id*. at 505.

2. State Court Plaintiffs Prove Negligent Misrepresentations were made by Rothstein Kass to them Directly

State Court Plaintiffs have, *inter alia*, "direct" negligent misrepresentation claims against Rothstein Kass. Both federal law and Rothstein Kass' own engagement agreement imposes a duty to disclose <u>*any*</u> errors, fraud, or illegal acts that it may find during the course of the audit.[4] *See* 15 U.S.C. § 78j-1(a)-(b)(1) et seq. Rothstein Kass's audit manager on the Breitling engagement, Michael Nymeyer, admitted that Rothstein Kass's duty was to the foreseeable users of the financial statements. Appx. (p. 4) (Nymeyer 57:8-22).

[4] Rothstein Kass' engagement agreement with Breitling was designated as "confidential" under the state court's Protective Order. Accordingly, State Court Plaintiffs seek leave to file this document, which is bates labeled RK-Jinsun 6851-6858 under seal.

a. Rothstein Kass had an "Actual Awareness" that State Court Plaintiffs were relying upon its Audit Opinion *before* the Audit Even Began

Before the audit even began, and on Breitling's behalf, Rothstein Kass was creating red-lined edits to the Asset Purchase Agreement ("APA") that would later be executed between Breitling and Bering.[5] Indeed, the version of the APA that Rothstein Kass red-lined and which ultimately became the final, signed version months later, included Breitling's representation and warranty that State Court Plaintiffs would receive materially accurate financial statements.[6] Those representations and warranties are reproduced herein below:

> *Section 2.4* **Financial Statements**. The financial statements of Breitling listed in Section 2.4 of the Breitling Disclosure Schedule (the "**Breitling Financial Statements**"), a copy of each of which previously has been provided to the Company, are, except as set forth in Section 2.4 of the Breitling Disclosure Schedule, GAAP Prepared. For purposes of this Agreement, "**GAAP Prepared**" means that such financial statements have been prepared from, and are in accordance with, the books and records of the applicable Person to which such
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> financial statements relate, comply in all material respects with applicable accounting requirements and with the applicable published rules and regulations of the Securities and Exchange Commission ("**SEC**") with respect thereto, have been prepared in accordance with generally accepted accounting principles ("**GAAP**") applied on a consistent basis (subject, in the case of interim financial statements, to normal year-end adjustments) and fairly present, in conformity with GAAP applied on a consistent basis (except as may be indicated in the notes thereto), the consolidated financial position of the applicable Person to which such financial statements relate, as of the date thereof and the consolidated results of operations and cash flows (and changes in financial position, if any) of such applicable Person, for the periods presented therein (subject, in the case of any interim financial statements, to normal year-end adjustments).

[5] State Court Plaintiffs seek leave to file these documents, which are bates labeled RK-Jinsun 46791-46793, 42599-42600, 7524-7575 under seal as they have been designated as confidential.

[6] *See* f.n. 4, *supra*.

See Appx. (pp. 16-17) (ASSET PURCHASE AGREEMENT) (Art. II, § 2.4) (emphasis added). Furthermore, State Court Plaintiffs are identified by name in the APA as the very Bering stockholders, who are relying upon those audited financial statements. *See* Appx. (p. 18) (ASSET PURCHASE AGREEMENT) (Schedule 1.8(f)).

Rothstein Kass knew State Court Plaintiffs were the end-users of the financial statements; and, furthermore, State Court Plaintiffs testified that they were relying upon Rothstein Kass's audit opinion in effectuating the transaction. *See* Appx. (pp. 20-23) (Plumb depo: 87:21-88:14; 91:14-92:1; 252:8-18); Appx. (pp. 26-27) (Casey depo: 251:7-18; 262:24-263:12). Accordingly, Rothstein Kass knew: (i) Breitling was representing that State Court Plaintiffs would receive materially accurate financial statements, which it was responsible for auditing; and (ii) it knew who State Court Plaintiffs were because they are identified in Schedule 1.8(f) to the APA—and it was Rothstein Kass who was doing the red-lined edits to the transactional documents. Thus, State Court Plaintiffs are in the narrow class of third parties, who may assert a negligent misrepresentation claim against the auditors.

b. Rothstein Kass Discovered the Fraud before the Audit Opinion was Released and Failed to Disclose it to State Court Plaintiffs as it was Required to do by Statute and Common Law

During the audit, Rothstein Kass discovered Breitling's fraud and it prepared a highly detailed eleven (11) page "Summary Review Memorandum" (SRM), which documents Faulkner's scam at length (Appx. (pp. 29-39)); however, Rothstein Kass did not disclose it to State Court Plaintiffs, which Rothstein Kass was required to do. *See, e.g.*, 15 U.S.C. § 78j(b) (requiring auditors to disclose fraud); *In re Cascade Int'l Securities Litigation*, 894 F.Supp. 437, 443 (S.D. Fla. 1995); *accord Fischer v. Kletz*,

266 F.Supp. 180, 188 (S.D. N.Y. 1967), *cited with approval*, *IIT, An International Inv. Trust v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980), *abrogated on unrelated grounds*, 130 S. Ct. 2869 (2010). The attorney advising State Court Plaintiffs during the reverse merger transaction, Tom Pritchard, testified that, had Rothstein Kass disclosed the contents of the SRM, he would have made sure that State Court Plaintiffs did not go forward with the closing on the reverse merger transaction. *See* Appx. (pp. 41-42) (Pritchard depo: 60:23-61:13; 62:4-25).

Nymeyer repeatedly told Rothstein Kass' senior audit partner, Brian Matlock, that Rothstein Kass should withdraw from the audit. *See* Appx. (pp. 5-10) (Nymeyer depo: 114:10-116:24; 120:16-21; 127:1-128:16; 159:13-22; 186:1-188:12). Nymeyer admitted that, if it did not withdraw knowing what it knew, it would tarnish Rothstein Kass' reputation. *See* Appx. (pp. 12) (Nymeyer depo: 289:22-291:1). Nymeyer also admitted that Rothstein Kass should not have issued a "clean" audit opinion. *See* Appx. (pp. 8-11) (Nymeyer depo: 142:9-143:13; 213:25-214:6). Had Rothstein Kass withdrawn as Breitling's auditor, the reverse merger would not have been consummated. Indeed, an unqualified audit opinion is required by federal law in a reverse merger. *See* SEC Rule § 12220.2(2); 17 C.F.R. § 229.1010(a)(1) et seq.

The Dallas Court of Appeals decision in, *Tara Capital Partners I, L.P. v. Deloitte & Touche, LLP*, No. 05-03-00746-CV, 2004 WL 1119947, at *3 (Tex. App.—Dallas May 20, 2004, pet denied), can be analogized to the case at bar. There, the Dallas Court of Appeals affirmed a summary judgment in favor of the auditors in a negligent misrepresentation case, where shareholders sued the auditors for issuing a misleading opinion. In *Tara*, the appellate court affirmed the summary judgment because the

shareholders purchased their shares in the company being audited *after* the release of the audit opinion (*Id*. at *3); whereas, in contrast to *Tara*, in the present case, this fact pattern presents the opposite scenario.

Unlike *Tara*, in the case at bar, State Court Plaintiffs owned shares in Bering *before* the audit opinion was released. *Compare*, Appx. (pp. 14, 18) (Asset Purchase Agreement of December 9, 2013), *with*, Appx. (p. 44) (Audit Opinion of February 14, 2014). Had State Court Plaintiffs known that, in violation of the representations and warranties set forth in Article 2.4 of the APA, they would not receive accurate financial statements, or had Roshtein Kass withdrawn as the auditor, or had Rothstein Kass disclosed the fraud set forth in its own SRM, State Court Plaintiffs would have exercised their rescission rights, Breitling would never have become public, and State Court Plaintiffs would still own their Bering shares, which would have remained uncontaminated by Faulkner's criminal enterprise. Appx. (pp. 46-48) (Wagers depo: 75:18-25; 81:14-24; 82:9-18); Appx. (pp. 41-42) (Pritchard depo: 60:23-61:13; 62:4-25).

These facts demonstrate that Receiver does not own State Court Plaintiffs' claims, he did not bring these claims, and he did not settle these claims. Receiver did not even file negligent misrepresentation claims.

c. Rothstein Kass' conduct was so egregious that its Senior Partner on the audit, Brian Matlock, was found to have covered up the fraud, he had his accounting license to practice before the SEC suspended, and a cease and desist order was issued

In a nine (9) page single-spaced order, the SEC found that Rothstein Kass' senior audit partner, Brian Matlock, participated and covered up the fraud, he had his accounting license to practice before the SEC suspended, and a cease-and-desist order

was issued against him in a public filing. Appx. (pp. 50-58). This Court can take judicial notice of these violations and the SEC's order. *Id*.

d. Under federal law, the Reverse Merger was not consummated until the Audit Opinion was released; and, therefore, State Court Plaintiffs have individualized damages for the loss of their Rescission Rights

Under federal law and by SEC Rule, the reverse merger was not consummated until the audit opinion was released (February 14, 2014). *See* SEC Rule § 12220.2(2); 17 C.F.R. § 229.1010(a)(1); Appx (p. 44). As noted above, a representation and warranty set forth in the APA was the requirement that State Court Plaintiffs receive materially accurate financial statements in accordance with Generally Accepted Accounting Principles, which State Court Plaintiffs did not receive. *See* Appx. (pp. 14-17) (ASSET PURCHASE AGREEMENT) (Art. II, § 2.4). Accordingly, State Court Plaintiffs had rescission rights all the way through February 14, 2014. Appx. (p. 44).

Consequently, "but for" Rothstein Kass' negligent misrepresentations in sponsoring materially misleading financial statements, which were riddled with fraud—State Court Plaintiffs lost their rescission rights and their ability to unwind the deal, which would have returned State Court Plaintiffs to the status *quo ante*. These are direct claims with direct damages.

C.
Receiver is Estopped from Claiming he Owns State Court Plaintiffs' Claims because State Court Plaintiffs are Not Beneficiaries of the Proposed Settlement

The purpose behind the doctrine of judicial estoppel "is to prevent the use of intentional self-contradiction as a means of obtaining unfair advantage." *See, e.g., Davis v. Bills*, 444 S.W.3d 752, 759 (Tex. App.—El Paso 2014, no pet.) [citations omitted]. If Receiver owned State Court Plaintiffs' claims (which is forcefully denied),

and assuming *arguendo* he had settled those claims, State Court Plaintiffs would be entitled to a *pro rata* share of the settlement. However, State Court Plaintiffs are not beneficiaries of the settlement proceeds. Appx. (p. 2) (¶¶ 4-5).

Receiver suggests that State Court Plaintiffs could have made a claim by filling out a "form" on a website somewhere; however, Receiver has known what State Court Plaintiffs were alleging, even before Receiver sued Rothstein Kass and that has never been mentioned to them. *See* docket #301; Appx. (p. 2) (¶¶ 4-5). The fact that State Court Plaintiffs are entitled to no *pro rata* distribution of any settlement funds is irreconcilable with the argument that Receiver brought, settled, and, therefore, has the right to release State Court Plaintiffs' direct claims. *See, e.g., SEC*, 927 F.3d at 845-46 (reversing a district court that entered a bar order, where claimants were foreclosed from receiving a distribution of the settlement). Receiver is estopped.

D.
Rothstein Kass is Estopped from Claiming that State Court Plaintiffs Do Not Have Direct Claims against it

On December 8, 2020, Rothstein Kass filed a Motion for Summary Judgment ("MSJ") on Receiver's claims. *See* docket # 95 (Civil Action No. 3:19-CV-01594-D) (§ VI-C) (filed Dec. 8, 2020). Duly quoting this Court's opinion in *Reneker v. Offill*, 2009 WL 804134, *5 (N.D. Tex. March 26, 2009) (Fitzwater, J.), Rothstein Kass correctly states that Receiver cannot bring claims on behalf of investors who lost money in the receivership entities. *See* docket # 95 (Civil Action No. 3:19-CV-01594-D) (§ VI-C) (p. 47) (filed Dec. 8, 2020). This is an exact reproduction of Rothstein Kass' very statement to this Court in its MSJ:

> Although Plaintiff has filed claims "to recover damages sustained by the" Receiver Entities, Dkt. No. 45, ¶ 1, Plaintiff's claims improperly seek damages on behalf of the *investors* in working interests or royalty interests offered by certain Receiver Entities. This Court faced an identical issue in *Reneker v. Offill*. In *Reneker*, as is the case here, the receiver sought damages for a professional negligence claim based on the entities "causing or increasing liabilities to third parties." 2012 WL 2158733, at *6. The defendant, however, argued the receiver was actually seeking "nothing more than investor losses." *Id.* The Court concluded that the receiver entities' "liability to investors and investor losses are mathematically equivalent," which showed that the "liabilities are not distinct from investor losses." *Id.* Therefore, the Court dismissed the claim "for lack of standing to the extent it is based on liabilities incurred to defrauded investors or the increased amount of such liabilities." *Id.* The Court should do the same here.

See docket # 95 (Civil Action No. 3:19-CV-01594-D) (§ VI-C) (p. 47) (filed Dec. 8, 2020).

This is absolutely correct, but in this case State Court Plaintiffs *are not even investors suing for losses in a receivership entity*. On the contrary, Bering is *not* a receivership entity. *SEC*, 927 F.3d at 841. Rothstein Kass is estopped from now taking the very opposite position, which is to claim that State Court Plaintiffs' direct claims are allegedly owned by Receiver.

E.
Rothstein Kass has Insurance that Substantially Exceeds Receiver's Settlement and State Court Plaintiffs' Settlement Demand

Rothstein Kass has insurance that substantially exceeds Receiver's $7,000,000 settlement and State Court Plaintiffs' previous demand of $11,150,000. State Court Plaintiffs seek leave to file under seal the amount of insurance, which insures Rothstein

Kass on these claims—and the testimony of Stephens' confirming those amounts.[7] As these documents reflect, Rothstein Kass' insurance is substantially in excess of *both* Receiver and State Court Plaintiffs' claims combined.

Receiver's (proposed settlement)		$7,000,000
State Court Plaintiffs' last demand	+	$11,150,000
Combined Total Claims		$18,150,000
Rothstein Kass Total Insurance		$ UNDER SEAL
Remaining Insurance		$ UNDER SEAL

Although the insurance policies may allow Rothstein Kass to be reimbursed for attorney's fees, and even assuming *arguendo* there is a substantial budget for defense costs, there is still *more* than enough insurance to satisfy Receiver and State Court Plaintiffs' claims *combined*. There is no evidence showing that any available insurance has been depleted or by what amounts, if any. If leave is granted to file the aforementioned documents under seal, it will show there is substantially more insurance than the *consolidated* claims, which establishes that there is no threat that receivership assets will be dissipated—notwithstanding the fact that these are direct claims.

F.
Rothstein Kass Has Cash and Indemnity Reserves that Substantially Exceed Receiver's Settlement and State Court Plaintiffs' Settlement Demand

In the proposed Settlement Agreement, it states that the settlement funds are coming solely from Rothstein Kass' insurance companies (as opposed to Rothstein Kass' own cash). The proposed settlement states in pertinent part as follows:

[7] The documents confirming the amount of insurance are as follows: Deposition of Kenneth Stephens (pp. 7-8, 11-12, 151) and those documents bates labeled KPMG 2837, 2844-2845, 2848-2849, 17, 1253, and 1258; Appx. (pp. 59) (letter from Counsel for excess carriers in New York).

> **1. Payment to the Receiver.**
>
> Rothstein Kass's insurance carrier(s), on behalf of Rothstein Kass, agree to pay the Receiver a sum of SEVEN MILLION AND NO/100 DOLLARS ($7,000,000.00) (the "Settlement Payment") within 35 days after the Receivership Court approves the terms of settlement set forth in this Agreement and enters the Bar Order described herein.

See docket # 592 (App. 00005) (¶ 1).

This is significant because Rothstein Kass has its own cash and indemnity reserves available, which remain untouched by the proposed settlement agreement.

In an enormous transaction, Rothstein Kass' assets were purchased by KPMG. Rothstein Kass is ostensibly a defunct company. The distribution statement showing the money Rothstein Kass received is subject to a Protective Order. If leave is granted to file these documents under seal, it will show the "net amount of cash" [8] Rothstein Kass received and the "indemnity" reserves set aside to pay claims.[9] Rothstein Kass has cash and indemnity reserves that substantially exceed the *consolidated* amount of Receiver and State Court Plaintiffs' claims. Because Rothstein Kass' cash and indemnity reserves exceed Receiver and State Court Plaintiffs' claims without even using the insurance proceeds, this Court should deny Receiver's Motion for a Bar Order and grant State Court Plaintiffs' Third Motion to Lift the Stay.

G.
Rothstein Kass Values State Court Plaintiffs' Claims at Zero Underscoring the Point that a Bar Order is Unnecessary

State Court Plaintiffs' most recent demand to Rothstein Kass of $11,150,000 was a negotiating starting point. Rejecting the offer in its entirety, Rothstein Kass made it

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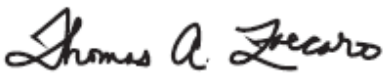
[8] The documents that will prove State Court Plaintiffs' assertions are as follows: KPMG 2862-2864.

[9] *See* f.n. 9, *supra*.

forcefully clear that State Court Plaintiffs' claims are worthless. Rothstein Kass' attorney's response to State Court Plaintiffs' demand illuminates the point:

> At this point, given this record, Rothstein Kass would not pay anything to settle this case, let alone $11.15 million.
>
> Sincerely yours,
>
> 
>
> Thomas A. Zaccaro
> PAUL HASTINGS LLP

Because "Rothstein Kass would not pay anything to settle this [State Court Plaintiffs'] case," there is no reason to bar claims that the settling parties believe are worthless.

H.
The Receiver Accepted the Benefits of State Court Plaintiffs' Prosecution of Rothstein Kass and Should Be Estopped

Receiver saved a substantial sum of money and attorney's fees at State Court Plaintiffs' expense. Receiver did not have to depose any of Rothstein Kass' employees, who performed the audit, which include: Brian Matlock, Michael Nymeyer, Bertrand Maimo, and Kenneth Stephens, respectively.

The reason is State Court Plaintiffs had already deposed these witnesses and Receiver was allowed to use those depositions in his own case without incurring any expense. *See* docket #'s 46-47, & 55 (Civil Action No. 3:19-cv-01594) (stipulations). Those four depositions amass over 1,100 pages of testimony, the exhibits were extracted from the production of over 450,000 pages of documents, and State Court Plaintiffs incurred 100% of the costs. State Court Plaintiffs spent hundreds of hours in attorney and expert witness time preparing for those depositions.

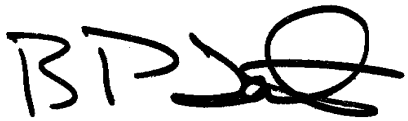
Receiver's procurement of a $7,000,000 settlement without even incurring the expense of deposing Rothstein Kass' auditors did not happen solely at the expense of his outside counsel. Because Receiver benefitted from State Court Plaintiffs' prosecution of Rothstein Kass, and because State Court Plaintiffs shall receive nothing, Receiver is estopped from using State Court Plaintiffs' claims, which he does not own, as a negotiating tool to artificially inflate the true value of Receiver's claims. Principles of estoppel should foreclose such a result.

V.
Conclusion

In conclusion, this Court should approve the $7,000,000 settlement, but deny Receiver's Motion for a Bar Order, and grant State Court Plaintiffs' Third Motion to Lift the Stay so that State Court Plaintiffs can have their day in Court too.

Respectfully Submitted,

BRIAN LAUTEN, P.C.



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CERTIFICATE OF SERVICE

In accordance with Rule 5b of the Federal Rules of Civil Procedure, the undersigned certifies that a true and correct copy of the foregoing instrument has been served upon all counsel of record via the ECF case manager system on this the 19th day of May 2021.

/s/ Brian P. Lauten

BRIAN P. LAUTEN