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 REPLY TO RECEIVER AND ROTHSTEIN KASS' RESPONSE TO RECEIVER'S MOTION FOR FINAL BAR ORDER, AND BRIEF IN SUPPORT

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A.
Receiver Had the Indispensable Burden to Prove all Three Elements of Standing and he Filed No Admissible Evidence

As the party invoking federal jurisdiction, Receiver had the burden to prove, with competent and admissible evidence, that he had standing to bring State Court Plaintiffs' claims, that he actually brought those claims, and that he had standing to settle those claims. *See generally Reneker v. Offill*, 2009 WL 804134, at *5 (N.D. Tex. March 26, 2009) (Fitzwater, J.). Indeed, proving standing is not merely a pleading requirement, "but rather an *indispensable* part of the plaintiff's case, each element [of standing] must be supported in the same way as any other matter on which the plaintiff has the burden of proof, i.e., with the manner and degree of evidence required at the successive stages of litigation." *See Lujan, Jr. v. Defenders of Wildlife et al.*, 504 U.S. 555, 561 (1992) (Scalia, J.) (emphasis added).

In *Lujan*, Justice Scalia underscored the point that the "constitutional minimum of standing contains three elements," which must be proven with competent evidence:

> *First*, the plaintiff must have suffered an "injury in fact"—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) 'actual or imminent, not 'conjectural' or 'hypothetical.'
>
> *Second*, there must be a causal connection between the injury and the conduct complained of—the injury has to be 'fairly ... trace[able] to the challenged action of the defendant, and not ... th[e] result [of] the independent action of some third party not before the court.'
>
> *Third*, it must be "likely," as opposed to merely "speculative," that the injury will be "redressed by a favorable decision." The party invoking federal jurisdiction bears the burden of establishing these elements. Since they are not mere pleading requirements but rather an indispensable part of the plaintiff's case, each element must be

> supported in the same way as any other matter on which the plaintiff bears the burden of proof, *i.e.,* with the manner and degree of evidence required at the successive stages of the litigation.

Id. (emphasis added) [internal citations omitted].

As set forth in State Court Plaintiffs' opening brief, Receiver has no admissible evidence to prove that he had standing to bring State Court Plaintiffs' claims, that he actually brought those claims, and that he had standing to settle those claims. *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]; *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]; *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).

Because Receiver fails to meet his burden of proof, the Motion for a Bar Order should be denied, the settlement should otherwise be approved, and the stay lifted.

B.
Judge Fitzwater's Opinions in *Taylor* and *Reneker* are Dispositive

It is well settled that Receiver has no standing to bring misrepresentation claims that belong to investors because no receivership entity could prove any traceable injury to the misrepresentations made to those investors. *See, e.g., Fleming v. Lind-Waldcock Co.*, 922 F.2d 20, 25 (1st Cir. 1990) ("The funds allegedly mismanaged by Lind–Waldock in accounts established by Kent belonged entirely to investors, not to USIC.

Hence, Fleming as equity receiver cannot assert these investors' claims."); *see also Liberte Capital Group LLC v. Capwill*, 248 Fed. App'x. 650, 656-67 (6th Cir. 2007) (receiver cannot bring claims for misrepresentations made to investors because the receivership entities could not have been damaged by those misrepresentations); *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1515 (1st Cir. 1987) (equating powers of trustee [in *Caplin*] and receiver; insisting equity receiver lacks standing to bring suit on behalf of investors); *Commodity Futures Trading Comm'n v. Chilcott Portfolio Management, Inc*., 713 F.2d 1477, 1481 (10th Cir. 1983) (warning that receiver can assert claims only for corporate fund, not "damages on the claims for the investors"); *Lank v. New York Stock Exchange*, 548 F.2d 61, 67 (2d Cir. 1977) (insisting receiver "stands in shoes of corporation and can assert only those claims which corporation could have asserted"); *Johnson v. Chilcott*, 590 F. Supp. 204, 207-08 (D. Colo. 1984) (disallowing receiver's standing to assert investors' claims when corporate interests not congruent with investors' interests); *In re Investors Funding Corp. Secur. Litigation*, 523 F. Supp. 533, 540, 544 (S.D. N.Y. 1980) (emphasizing need for "proximate causal connection" or "'but for' chain" between misrepresentations to investors and losses to corporate entity in order for trustee to assert investors' claims).

In *Wuliger v. Manufacturers Life Insurance Co*., 567 F.3d 787 (6th Cir. 2009), the Sixth Circuit illuminated the true fact that a receiver cannot sue third parties for misrepresentations made to investors because the receivership entities could not have been damaged by those misrepresentations:

> The Receiver's standing problem in *Liberte* was that none of the receivership entities—VES, CFL, Capwill or Liberte—would have had standing to sue Liberte's brokers for the misrepresentations the brokers made to Liberte's investors, because none of the entities would have

> been able to claim any tangible injury traceable to the brokers' misrepresentations to the investors. Because the receivership entities all would have lacked standing, and because of the rule that receivers' rights are limited to those of the receivership entities, the Receiver also lacked standing.

Id. at 794 (citing *Liberte Capital Group LLC*, 248 Fed. App'x. at 656-67).

Be that as it may, Judge Fitzwater has already held, *in this very case*, that Receiver may not bring claims against third parties for misrepresentations made to investors. *See Taylor v. Scheef & Stone, LLP*, 2020 WL 4432848, at *10 (N.D. Tex. July 31, 2020) (Fitzwater, J.). Indeed, Receiver previously asserted professional negligence and breach of fiduciary duty claims against the law firm of Scheef & Stone. *Id*. at *1. Receiver's claims against Scheef & Stone were nearly identical to those he asserts against Rothstein Kass. *Id*. In granting, in part, Scheef & Stone's 12(b)(6) Motion to Dismiss, Judge Fitzwater held that Receiver could not bring misrepresentation claims that were allegedly made by Scheef & Stone to investors because Receiver has no standing to assert them.

Judge Fitzwater stated:

> Taylor, as receiver, "stand[s] in the shoes of [the Breitling Entities]," Taylor may only assert a fraud claim against Scheef & Stone predicated on Scheef & Stone's fraudulent conduct directed at the *Breitling Entities*—not investors or regulators. Notably, Taylor fails to allege that the Breitling Entities relied on any specific representation or omission made by Scheef & Stone. Thus even if the court assumes *arguendo* that Taylor alleges with sufficient specificity that Scheef & Stone "engaged in fraudulent conduct with the requisite knowledge and intent," with respect to investors and regulators, Taylor has failed to demonstrate how Scheef & Stone engaged in fraud with respect to the Breitling Entities. For example, materially misleading offering documents disseminated to investors may induce *investors* to rely to their detriment on the fraudulent information therein. Likewise, Taylor's filing a fraudulent Regulation D statement with the SEC may evidence an alleged material misstatement to *regulators* with the intent that *regulators*—not the Breitling Entities—rely on the misleading

> information. Thus although several allegations may suggest that Scheef & Stone acted with intent to defraud others, Taylor has failed to plausibly allege that Scheef & Stone made any misrepresentations to the *Breitling Entities* or otherwise acted with intent to defraud *them*. For this reason, Taylor's "participation in fraud" claim must be dismissed.

Id. at * 10 (Fitzwater, J.) [citations omitted]. Judge Fitzwater's opinions in *Taylor* and in *Reneker* are dispositive. *Compare Taylor*, 2020 WL 4432848, at *10 (Fitzwater, J.), *with*, *Reneker v. Offill*, 2009 WL 804134, at *5 (N.D. Tex. March 26, 2009) (Fitzwater, J.) ("The standing requirement of Article III 'precludes [Reneker], as the designated receiver for [the AmeriFirst Clients], from bringing causes of action that belong to their investors as such, as contrasted with claims that belong directly to [the AmeriFirst Clients] for whom [Reneker] is the appointed representative.' Because Godwin Pappas represented the AmeriFirst Clients, not the investors, if Godwin Pappas was negligent in its legal representation or if it breached its fiduciary duty, such claims would clearly belong to the AmeriFirst Clients, not to investors. In other words, because both the duty of care and the duty of a fiduciary were owed to the AmeriFirst Clients rather than to the investors, if Godwin Pappas breached either duty, it wronged the AmeriFirst Clients, not the investors.") [internal citations omitted].

Receiver has inserted new lyrics into old tunes. Receiver is doing exactly that which this Court said he could not do in *Taylor* and that which receiver was precluded from doing in *Reneker*. This Court can take judicial notice that Receiver did not even bring claims for either negligent misrepresentation or for violations of the Texas Securities Act—not even on behalf of the receivership entities. Rothstein Kass had a "continuing duty" to disclose the fraud upon which it was well aware to State Court Plaintiffs and it failed to do so. As articulated by, *In re Cascade International Securities*

Litigation, 894 F. Supp. 437 (S.D. Fla. 1995), this is an obligation auditors owe to third party-investors, regardless of whether there is any contractual privity:

> The concept of a duty to disclose appears to stem from the extent of reliance on the accountant's work made by [*sic* to] the public and the expectations of the public. Clearly, in a situation in which the accountant "gives an opinion or certifies statements" about a company—statements which the accountant later discovers may not have been accurate based on false information provided by the company—then the accountant has a duty to disclose the fraud to the public. The accountant's previous statements were relied upon by the public, and the accountant's opinion is seen to be unbiased and honest. If the accountant later learns that its statements are being misused, it is understandable that the securities laws can impose upon it a duty to prevent the misrepresentations from continuing.

Id. at 443. To this end, Receiver cannot assert claims for the lost value of State Court Plaintiffs' stock in Bering as a result of misrepresentations (both affirmatively in the audit opinion and by omission) made to them by Rothstein Kass. State Court Plaintiffs purchased that stock—and they did so long before they ever interfaced with Chris Faulkner. State Court Plaintiffs acknowledged that the claims they previously attempted to assert for professional negligence and breach of fiduciary duty belonged to Receiver; however, Receiver and Rothstein Kass' attempt to go a step further by seeking to confiscate State Court Plaintiffs' negligent misrepresentation and Texas Securities Act claims is an example of overreaching, which is disallowed by this Court's precedent. *See Taylor*, 2020 WL 4432848, at *10 (Fitzwater, J.); *Reneker*, 2009 WL 804134, at *5 (Fitzwater, J.).

C.
The "Greater Good" Argument has been Rejected by the Fifth Circuit

Rothstein Kass argues that, without the bar order, there is no settlement, ostensibly implying that the bar order should be entered "for the sake of the greater

good." These arguments were made and rejected by the Fifth Circuit in February of this year. *See, e.g., Securities and Exchange Commission v. Stanford International Bank, Limited*, 927 F.3d 830, 846 (5th Cir. 2021) ("**The district court and receiver lacked authority to dispossess claimants of their legal rights to share in receivership assets 'for the sake of the greater good**'.") (emphasis added).

Reversing the district court's entry of a bar order, the Fifth Circuit in *Stanford* held that a bar order is a "death knell intended to extinguish claims, which are a property interest," regardless of the alleged value of those claims:

> …Receiver lacked standing to settle independent, non-derivative, non-contractual claims of these Appellants against the Underwriters. Of course, the Receiver and Underwriters were, as Appellants' counsel colorfully described, all too happy to compromise at the expense of Appellants' rights. The court purported to justify this result by claiming that 'the bar orders are not settling claims, they are enjoining them.' No matter the euphemism, a permanent bar order is a death knell intended to extinguish the claims, which are a property interest, however valued, of the Appellants.

Id. at 847-48 [internal citations omitted].

D.
Rothstein Kass' Insurance and Cash Position
Has Become a Foundational Issue

Rothstein Kass and Receiver now argue that Rothstein Kass' liability insurance and cash indemnity reserves are no longer relevant to this Court's analysis. However, on multiple occasions, Receiver and Rothstein Kass left the impression with this Court that there were scarce resources to pay claims; and, furthermore, it was represented that State Court Plaintiffs were engaging in an improper "race to recover the value of the assets" and to thereby capture these allegedly limited resources for themselves at the expense of the receivership entities. *See* docket #521 (Rothstein Kass' opposition to

Emergency Motion to Lift Stay) (filed Feb. 14, 2020) (p. 3) (¶ 2) ("the *Jinsun* Plaintiffs are **rushing to the courthouse to beat the Receiver in a race to recover the value of the assets that belong to the Receiver** based on claims the Receiver has also brought against Rothstein Kass") (emphasis added); docket #594 (Receiver's Motion to Enter Final Bar Order) (filed April 21, 2021) (p. 3) (§ I ¶ (d)) ("Continuing to litigate the Rothstein Kass action will result in the expenditure of Receivership Assets for payment of attorney's fees, expert witness fees, and other litigation expenses **and will risk the remaining Rothstein Kass insurance policy proceeds being eroded** through payment of defense costs for the litigation) (emphasis added). Indeed, the theme in Receiver's Motion for a Bar Order is the contention that assets are being depleted and that the likelihood of a potential recovery would be reduced, if this Court were to deny his request for a bar order. *See* docket #594 (Receiver's Motion to Enter Final Bar Order) (filed April 21, 2021) (p. 3) (§ I ¶ (d)); (p. 18) (¶ 41); (p. 20) (¶¶ 45-46).

Given that State Court Plaintiffs have now filed Rothstein Kass' insurance policies and cash indemnity information under seal reflecting that Rothstein Kass has proceeds at its disposal that are over three times the amount of *both* Receiver and State Court Plaintiffs' claims—only now does Receiver and Rothstein Kass state that these issues are no longer relevant. The fact that there is plenty of insurance and cash reserves available to pay all claims suggests that Receiver and Rothstein Kass have bartered for a bar order at the expense of State Court Plaintiffs' claims—not because there are scarce resources, but to artificially inflate the true value of Receiver's claims at the expense of State Court Plaintiffs' property interest.

E.
Assuming *Arguendo* that Receiver Had Settled State Court Plaintiffs' Claims, No Bar Order would be Necessary

Assuming *arguendo* that Receiver had standing to bring, did bring, and had standing to settle State Court Plaintiffs' claims, which he does not, a final bar order would be wholly unnecessary because the litigation would result in *res judicata*.

The fact that Receiver and Rothstein Kass want a separate bar order entered extinguishing State Court Plaintiffs' claims underscores the point that State Court Plaintiffs' claims have not been litigated in this forum. It is undisputed that State Court Plaintiffs will receive nothing from Receiver's settlement. *See, e.g., Securities and Exchange Commission v. Stanford International Bank, Limited*, 927 F.3d 830, 845 (5th Cir. 2021) (reversing district court's entry of a bar order finding "the court abused its discretion by extinguishing Appellants' claims to the policy proceeds, while making no provision for them to access the proceeds through the Receiver's claims process.").

The Motion for a Bar Order should be denied, the settlement should otherwise be approved, and the stay should be lifted.

II.
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,

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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 7th day of June 2021.

/s/ Joe Kendall

JOE KENDALL