IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

JAMES R. ZAZZALI, as Trustee for the DBSI Private Actions Trust, Plaintiff, v. ALEXANDER PARTNERS, LLC, et. al. Defendants.	)	C.A. No. 12-00828 GMS

REPLY BRIEF IN SUPPORT OF REPRESENTATIVE DEFENDANTS'[1] MOTION TO DISMISS AMENDED COMPLAINT FOR IMPROPER VENUE

Dated: May 30, 2014

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[1] Due to the large number of defendants joining in the motion to dismiss and Appendix, it is not feasible to list all of defendants on the cover page as required by Local Rule 7.1.3(a)(1). The defendants joining in the motion to dismiss are Jeffrey Augspurger, Ron Barton, Tod Billings, Trent Bryerly, Scott Cavey, Allan Crumes, Ron Davies, Tim Duma, Mike Eden, David Kowalski, Robert Kuh, Michael Myers, Dwain Owens, Mark Pearson and Royce Ruth (the "Representative Defendants").

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INTRODUCTION

Trustee's Answering Brief ("AB") in Opposition to Defendants Jeffrey Augspurger, Ron Barton, Tod Billings, Trent Bryerly, Scott Cavey, Allan Crumes, Ron Davies, Tim Duma, Mike Eden, David Kowalski, Robert Kuh, Michael Myers, Dwain Owens, Mark Pearson and Royce Ruth's (the "Representative Defendants") Motion to Dismiss the Amended Complaint for Improper Venue (D.I. 479) fails to respond or even address the contentions provided in their Motion to Dismiss (the "MTD") (D.I. 467). In the MTD, Representative Defendants responded to this Court's invitation in its Order dated September 23, 2013 (D.I. 421) to re-file a motion to dismiss under Rule 12(b)(3) to demonstrate, to the extent that the associated DBSI sales did not involve a Delaware SPE, that:

- The Trustee's Sole Basis in the Amended Complaint for Venue in Delaware is the Incorporation of the DBSI Companies within Delaware and the Formation of SPEs in Delaware to invest in DBSI TIC offerings; and
- Representative Defendants Did Not Sell DBSI SPEs Formed in the State of Delaware

Rather than respond to the MTD, in a complete reversal from the Trustee's previous pleadings that formed the basis for the Court's denial of prior motions to dismiss for lack of venue in this case and in clear disregard of the case law within this District Court, attempts to ***argue for its third time the very same argument twice denied*** in an effort to avoid the clear result of the deficiencies in its Complaint – the dismissal for lack of venue. The Answering Brief attempts to overrule two previous indistinguishable holdings in this District Court that the doctrines of collateral estoppel and res judicata do not preclude the Representative Defendants from raising improper venue. *See*, *Zazzali v. Swenson*, 852 F.Supp.2d 438 (2012); *Zazzali v. Hirschler Fleischer, P.C.*, 482 B.R. 495 (D. Del. 2012). *See* AB at page 5 (arguing that Representative Defendants "are precluded by res judicata and collateral estoppel from challenging the bankruptcy court's determination that venue was proper in Delaware."). The Trustee's allegation are based on the sworn declarations of its counsel that:

- "the issue of venue was squarely addressed in the Plan and Confirmation Order, which require venue in Delaware[,] and therefore, "the Trustee had no choice but to bring this action here." Id. at page 4.
- "[t]he Plan provides for venue of the Trustee's claims on behalf of the PAT in Delaware." Id. at page 5.

•Representative Defendants "had notice of the filing of the Plan and that they may later be sued, and they had an opportunity to object to the Delaware venue provisions contained in the Plan pre-confirmation[,]" based solely on the allegation without any case law to withstand such abrogation of their due process rights, that the Representative Defendants' "broker-dealer firms were all listed on the non-exclusive list of potential defendants for selling the same securities the [Representative Defendants] sold." *Id.* at pages 5-6.

The Answering Brief filed by the Trustee improperly attempts to amend the Complaint, without filing of a motion with this Court for leave to amend pursuant to the requirements under Rule 15(a) of the Federal Rules of Civil Procedure, to introduce additional arguments for venue in Delaware lacking any legal, factual or evidentiary support and without any valid purpose. As a result, Representative Defendants respectfully move this Court to dismiss the Amended Complaint (D.I. 436) for improper venue in its entirety pursuant to Rule 12(b)(3) of the Federal Rules of Civil Procedure for improper venue as neither the Amended Complaint nor the Answering Brief provide a basis for venue in Delaware and the Trustee's Answering Brief, and sworn declarations in support thereof, do not warrant the opportunity to transfer or amend its complaint under general principles of equity, fairness and justice.

STATEMENT OF RELEVANT FACTS

I. Plan, Confirmation Order nor PAT Restrict Venue Solely To Delaware.

The Plan, Confirmation Order and Private Actions Trust do not restrict venue only to Delaware.[2]

[2] Plan provides only that the Bankruptcy Court will retain jurisdiction of the Chapter 11 Cases. See In re: DBSI, Inc., No. 08-12687 (Bankr. D. Del. filed June 9, 2009), Second Amended Joint Plan of Liquidation ("Plan"), Article XII, page 138 (D.I. 5699). The Private Actions Trust Agreement (the "PAT") provides only that the "Bankruptcy Court shall retain exclusive jurisdiction to enforce the terms of this Private Actions Trust Agreement[.]" See In re: DBSI, Inc., Private Actions Trust Agreement ("PAT"), Section 11.3 Jurisdiction, page 35 (D.I. 5923). The Confirmation Order only addressed venue for purposes of the Chapter 11 Cases in relation to the DBSI and certain affiliated Chapter 11 debtors (the "Debtors"). See In re: DBSI, Inc., Findings of Fact, Conclusions of Law and Order Confirming Second Amended Joint Chapter 11 Plan of Liquidation ("Confirmation"), page 3.

II. Only Holders of Claims are Bound to the Provisions of the Plan

The Plan provides that "the provisions of the Plan shall bind any Holder of a Claim." *See* Plan, page 134.

Representative Defendants are not Holders of a Claim – the Plan defines "Holder" to mean "an Entity holding a Claim, Interest or a Beneficial Interest, or any authorized agent thereof." *See* Plan, page 16.

III. The Bankruptcy Filings Provided No Notice to Representative Defendants.

Neither the Plan, Confirmation Order nor even the PAT Agreement provide any notice of a potential claim against the Representative Defendants. See Plan, Confirmation and PAT Agreement.

Schedule 11 does not list the Representative Defendants by name and only lists certain insiders of DBSI, due diligence providers, auditors, appraisers, broker/dealers and registered investments advisors, and a reference to "[c]ertain primary real estate brokers and agents to be determined." *See* Ex. A to AB.

IV. Trustee's Only Basis for Venue in Delaware is Incorporation of DBSI Companies[3] and the formation of SPEs[4] within Delaware to for investments in DBSI TIC offerings.

The sole remaining allegation, as determined by the Court in its ruling applicable to the determination of venue, is the Trustee's allegations that "[a]t least two-hundred-ninety-one (291) DBSI-created entities whose securities entities whose securities were sold to members of the PAT were formed in the State of Delaware[,]"Complaint ¶ 23, and that "DBSI required approximately 90% of their TIC Investors to make their investments in TIC offerings through newly- formed special purpose entities." Complaint ¶ 25.

[3] *See* Amended Complaint ¶¶ 22-31. "DBSI Companies" shall mean the Consolidated Debtor and Non-Debtor Entities identified in the Plan, including exhibits thereto. *Id*. ¶ 8(f).
[4] "SPE" shall mean special purpose entity. *Id*. ¶ 8(t).

V. Representative Defendants Did Not Sell Any DBSI Securities Formed in the State of Delaware

As previously demonstrated and extensively documented with the relevant certificates of formations, *see* Exhibits to MTD (D.I. 467), which the Trustee has failed to contradict, Representative Defendants, pursuant to the allegations contained in the Complaint and Exhibit A thereto (D.I. 436-1), sold securities to the assignees of the PAT (PAT Beneficiary) in the SPE entities, which were formed in the State of Idaho.

ARGUMENT

I. Doctrines of Collateral Estoppel and Res Judicata Have Already Been Denied by This District Court in Two Similar Cases Brought by the Trustee.

This District Court has already heard this argument on two different occasions and ruled the "Defendants' venue challenge is not barred by collateral estoppel." *Zazzali v. Swenson*, 852 F.Supp.2d 438, 444 (D. Del. 2012). *See also*, *Zazzali v. Hirschler Fleischer, P.C.*, 482 B.R. 495 (D. Del. 2012). "Under the doctrine of collateral estoppel, a party is precluded from re-litigating an issue if, among other requirements, 'the identical issue was decided in a prior adjudication.'" *Swenson*, 852 F.Supp.2d at 444 (citations omitted). The Court held that the "Confirmation Order ***only relates to the Bankruptcy Court's retention of jurisdiction*** over all actions brought on behalf of the DBSI Private Litigation Trust and DBSI Private Actions Trust." *Zazzali*, 852 F.Supp.2d at 444. The doctrine of collateral estoppel is inapplicable as Representative Defendants were "not a party to the DBSI bankruptcy proceeding or in privity with a party." *Zazzali v. Hirschler Fleischer, P.C.*, 482 B.R. at 508 (D. Del. 2012).

This District Court, in *Zazzali v. Swenson*, 852 F.Supp.2d 438 (D. Del. 2012), has already heard the argument as to the Representative Defendants being barred by Res Judicata, in another case brought by the Trustee, and ruled the Representative Defendants' venue challenge is not "barred by res judicata. Res judicata, or claim preclusion, prevents a party from asserting claims

that were or could have been brought in a prior proceeding." *Id*. at 444 (*citing In re Mullarkey*, 536 F.3d 215, 225 (3d Cir.2008) ("The doctrine of res judicata bars not only claims that were brought in a previous action, but also claims that could have been brought.")). *See also, Hirschler Fleischer, P.C.*, 482 B.R. at 507. This District Court in *Hirschler Fleischer, P.C.* determined that Representative Defendants were "not a party to the bankruptcy proceeding (or in privity with a party), and res judicata only applies if 'there has been (1) a final judgment on the merits in a prior suit involving (2) the same claim and (3) the same parties or their privies.' *In re Montgomery Ward, LLC*, 634 F.3d 732, 736–37 (3d Cir. 2011) (internal quotation marks omitted). The defendant in *Hirschler Fleischer* argued that the "[Trustee] 'cites no case suggesting that a third party to the plan must intervene at the time of plan confirmation to litigate the issue of standing in a future adversarial proceeding that trustee might or might not file against that third party.'" *Hirschler Fleischer, P.C.*, 482 B.R. 495 at 507-08 (citing *In re Resorts Int'l, Inc.*, 372 F.3d 154 (3d Cir.2004) (holding that, notwithstanding provisions of confirmed reorganization plan, bankruptcy court lacked jurisdiction over malpractice claim brought by trustee against accounting firm)).

The Trustee has already filed a motion for reconsideration for the holdings as to res judicata and collateral estoppel in *Zazzali v. Swenson*, in which the Trustee was denied its motion for reconsideration on May 9, 2012. Swenson, 852 F. Supp. 2d 438 (D. Del. 2012), reconsideration denied (May 9, 2012).

Therefore, this District Court has held that both the doctrines of Res Judicata and Collateral Estoppel did not apply to the DBSI Insiders in *Swenson* and a primary legal service provider in *Hirschler Fleischler*, even though both were involved in not only the bankruptcy cases, but also provided with notice on Schedule 11 of the Plan.

II. Retention of Venue in Delaware Was NOT Squarely Addressed in the Plan.

Contrary to the Trustee's false claim that the "issue of venue was squarely addressed in the Plan and Confirmation Order, which require venue in Delaware[,]" neither the Plan, Confirmation Order nor even the PAT Agreement make any reference, discussion, mandate or otherwise restrict the Trustee to venue solely within the District of Delaware. *See* Plan, Confirmation, and PAT provisions in Statement of Relevant Facts, infra. This District Court is not "obligated to accept as true 'bald assertions,' 'unsupported conclusions and unwarranted inferences,' or allegations that are 'self-evidently false,'" and in reviewing a motion to dismiss, the Court may not only consider the allegations contained "'in the complaint, exhibits attached to the complaint and matters of public record,'" but may also "'consider an undisputedly authentic document that a defendant attaches as an exhibit to a motion to dismiss if the plaintiff's claims are based on the document[.]'" *Collins & Aikman Corp. v. Stockman*, CIV. 07-265-SLR-LPS, 2010 WL 184074 (D. Del. 2010) (citations omitted).

III. Previous Declarations in Similar Cases Contradict the Trustee's Allegations of Applicability of the Bankruptcy Code to its Role as PAT Trustee.

In opposing a motion to dismiss for lack of standing, the Trustee responded that "it has authority to bring claims on behalf of the PAT [because the Trustee] contends that a post-bankruptcy trustee ***who is not asserting claims on behalf of the estate*** is entitled, like any assignee, to bring claims on behalf of assigning creditors." *Hirschler Fleischer, P.C.*, 482 B.R. 495 at 509 (D. Del. 2012) (emphasis added). This District Court determined, that [i]n essence, the Trustee is arguing that ***the Bankruptcy Code is not relevant to an assessment of its authority to pursue claims on behalf of the PAT***." *Id*. (emphasis added).

IV. The Cases Cited by the Trustee Do Not Provide Precedent for the Trustee's Allegations in the Answering Brief

The Trustee misstates, misleads and omits several key facts in its authority for its position in the Answering Brief, which do not provide authority for the Trustee's Allegations:

- *Donaldson v. Bernstein*, 104 F.3d 547, 554 (3d Cir. 1997)
  - However, the Court clarifies that "[a]nother court, in denying a motion to revoke confirmation, was careful to point out that res judicata would not bar a common law action for damages for fraud 'where the alleged fraud could not have been asserted in the bankruptcy proceedings, the underlying factual claims were not actually adjudicated, and the relief sought would not upset the confirmed plan of arrangement.'" *Donaldson v. Bernstein*, 104 F.3d 547, 555 (3d Cir. 1997) (citations omitted)
  - Present claim against the Representative Defendants could not have been asserted against the Representative Defendants in the bankruptcy proceedings as the PAT was formed to hold "Non-Estate Causes of Action." *See* Complaint at ¶ 14.
- *Meyer v. Young Conaway Stargatt & Taylor LLP*, 2011 WL 1317282 (D. Idaho 2011)
  - However, Court's additional holding was based on "unique circumstances of [the] case, which are clearly distinguishable from the instant case:
    - Highlands & Southcreek was a debtor in the Bankruptcy cases.
    - Case involved a motion for transfer of venue from Idaho in which "[n]ot one of the parties has any connection to Idaho." *Id*.
    - The malpractice claim involves conduct in a Delaware bankruptcy.
    - The law firm's engagement agreement provided jurisdiction in Delaware.
- 11 U.S.C.A. § 1141(a)
  - Defendants are not "debtors,…any creditor, equity security holder, … in the debtor[.]" *Id*.
- *Stoll v. Gottlieb*, 305 U.S. 165, 170-71 (1938)
  - However, the Supreme Court was dealing with the a "plea [that] was based upon an adjudication under the reorganization provisions of the Bankruptcy Act[.]"

V. Allegations Not Contained in the Complaint Attempts to Amend Complaint in Violation of Rule 15(a) of the Federal Rules of Civil Procedure and is Fatal

The Answering Brief, by introducing aforementioned allegations, attempts to introduce new allegations to establish venue in Delaware for the claims against Representative Defendants. However, the Federal Rules of Civil Procedure require that "a party may amend its pleading only with the opposing party's written consent or the court's leave." Fed. R. Civ. P. 15(a). Here, the Trustee does not request leave to file an amended complaint even within the Answering Brief. Similar to the plaintiff in *Ranke v. Sanofi-Synthelabo Inc.*, if the Trustee:

> had been in possession of facts that would have augmented their complaint and possibly avoided dismissal, they should have pled those facts in the first instance. They failed to do so. In Ramsgate Court Townhome Assoc. v. West Chester Borough, 313 F.3d 157 (3d Cir.2002), we addressed that issue directly. The

> Ramsgate plaintiffs concluded their opposition to a motion to dismiss by stating: "However, in the event that the Court concludes that the Complaint fails to state claims upon which relief may be granted, Plaintiffs ... respectfully request that they be granted leave to amend the Complaint." *Id*. at 161. We noted that such a conclusory remark was not a motion to amend, and deemed fatal the fact that, like appellants here, plaintiffs did not provide the District Court with a proposed amended complaint. *Id*. "As a consequence, the court had nothing upon which to exercise its discretion." *Id*. (*citing Lake v. Arnold*, 232 F.3d 360, 374 (3d Cir.2000)). *Ranke v. Sanofi-Synthelabo Inc.*, 436 F.3d 197 (3d Cir. 2006) (citations in original).

VI. The Court Should Dismiss without Leave for Discovery, Amendment or Transfer as the Trustee's Allegations Lack any Legal, Factual or Evidentiary Support

The Trustee should not be "permitted to take limited discovery relating to the questions of jurisdiction and venue[]" as requested in its Answering Brief. AB at page 7. The Trustee has been in control of the DBSI enterprise since August 3, 2009 and "the Trustee had the benefit of a three million dollar investigation into the DBSI fraud, which involved interviewing sixty-one witnesses and resulted in a detailed, 369–page report listing the examiner's findings of fact and conclusions." *Hirschler Fleischer, P.C.*, 482 B.R. 495, 511-12 (D. Del. 2012).[5]

Yet, with all such funds, the Trustee previously alleged, after adequately researching both the legal and factual allegations in the Complaint, that venue was proper because "[a]t least two-hundred-ninety-one (291) DBSI-created entities whose securities entities whose securities were sold to members of the PAT were formed in the State of Delaware[,]" Complaint ¶ 23, and that "DBSI required approximately 90% of their TIC Investors to make their investments in TIC offerings through newly- formed special purpose entities." Complaint ¶ 25.

In stark contrast to the statement by the Trustee that the claims here are "certainly not frivolous," the Trustee's opposition in the Answering Brief lacks any legal, factual or evidentiary support and seems to fit the four corners of the definition of frivolous provided under Rule 11 of the Federal Rules of Civil Procedure. Even the case sited by the Trustee for the proposition that

[5] In a contrast of equities, Representative Defendants' funds are limited and have simply investigated the clearly erroneous allegations previously argued by the Trustee by simply searching the website of Idaho and Delaware's Secretary of State.

limited discovery should be allowed is not applicable. *See* AB at page 7. *Compagnie Des Bauxites de Guinee* provided that the logic for allowing limited discovery for the purposes of determining in personam jurisdiction had "been best stated by the Court of Appeals for the First Circuit":

> A plaintiff who is a total stranger to a corporation should not be required, unless he has been undiligent, to try such an issue on affidavits without the benefit of full discovery. If the court did not choose to hear witnesses, this may well have been within its province, but in such event plaintiff was certainly entitled to file such further interrogatories as were reasonably necessary and, if he wished, to take depositions. The condemnation of plaintiff's proposed further activities as a "fishing expedition" was unwarranted. When the fish is identified, and the question is whether it is in the pond, we know no reason to deny a plaintiff the customary license.
> *Compagnie Des Bauxites de Guinee v. L'Union Atlantique S.A. d'Assurances*, 723 F.2d 357, 362 (3d Cir. 1983) (quoting *Surpitski v. Hughes-Keenan Corporation*, 362 F.2d 254, 255–56 (1st Cir.1966)).

As the Third Circuit has previously noted "the original complaint, filed in state court, was verified as true and correct under penalty of perjury[.] Although the fact that the original complaint was verified does not alter the principle that an amended complaint will supersede the original, that verification places a heavy burden on Plaintiffs to explain why the number of pre-sold units was incorrect. We also note that although complaints filed in federal court are usually not verified by the parties, Rule 11 of the Federal Rules of Civil Procedure requires an attorney to certify that a pleading 'is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation' and that 'the factual contentions have evidentiary support.'" *W. Run Student Hous. Associates, LLC v. Huntington Nat. Bank*, 712 F.3d 165, 173 (3d Cir. 2013) (citations omitted).

CONCLUSION

For the foregoing reasons, particularly based on the allegations of venue in Delaware against the Representative Defendants lacking any legal, factual or evidentiary support,

Representative Defendants respectfully move this Court to dismiss the Amended Complaint (D.I. 436) for improper venue in its entirety pursuant to Rule 12(b)(3) for improper venue.

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