IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

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

REPLY BRIEF IN SUPPORT OF RON BARTON, TOD BILLINGS, TRENT BRYERLY, TIM DUMA, MIKE EDEN, MICHAEL MYERS AND MARK PEARSON'S MOTION TO DISMISS AMENDED COMPLAINT IN ITS ENTIRETY FOR FAILURE TO SUFFICIENTLY STATE CLAIMS FOR RELIEF

Dated: June 6, 2014

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

INTRODUCTION

The Trustee's Answering Brief ("AB") in opposition to Ron Barton, Tod Billings, Trent Bryerly, Tim Duma, Mike Eden, Michael Myers and Mark Pearson's ("Representative Defendants") continues to fight valiantly in its opposition to Representative Defendants' Motion to Dismiss for failure to sufficiently state claims for relief (D.I. 465). However, the Answering Brief fails to recover from the clear absence of a material misstatement made by Representative Defendants and utterly fails to put Representative Defendants on notice of the claims against them, much less provide the details of the serious allegations of fraud contained in the Amended Complaint, and accordingly should be dismissed under the Federal Rules of Civil Procedure 9(b) ("Rule 9(b)") and the PSLRA.

In amending its original Complaint filed on June 27, 2012 ("Complaint") (D.I. 1) to clarify certain allegations, as required by this Court's order on September 25, 2013 (D.I. 420), the Amended Complaint subtly withdraws its mistaken prior allegation, which formed a significant basis of this Court's previous holding, that "the implicit representation that the defendants conducted a due diligence investigation [in] [the] statement "that each Broker Defendant acknowledged its membership in the Financial Industry Regulatory Authority ("FINRA") and [the Securities Investor Protection Corporation ("SIPC")] and its attendant obligation to comply with all federal and state laws, rules, and regulations." (D.I. 420)[1] While the Trustee has withdrawn the basis for the Court's apparent holding of an implicit representation of due diligence, the Amended Complaint neither withdraws nor provides any additional basis for allegations and claims in the Amended Complaint, including that the Representative Defendants had the "ultimate responsibility of communicating each PPM's representations to the Investor[,]"

[1] This allegation, previously contained in the Complaint at ¶ 56, is strikingly absent from the Amended Complaint as the Exhibits to the Complaint, nor the Amended Complaint, provided any evidence of such statements.

see Amended Complaint ¶ 38, in contradiction of this Court's prior determination that the Representative Defendants did not possess the ultimate responsibility of communicating each PPM's representations as the speaker, drafter and creator of the PPM's was DBSI. (D.I. 420).

Respectively, the Representative Defendants request this Court to dismiss the claims against them failure to state a claim for much of the same reasons previously argued in pleadings filed in this Court, *see e.g.,* D.I. 264, as amended to reflect the Amended Complaint's abandonment of its prior allegation that was left without any factual or evidentiary support.

> *Word choices have consequences, and this word choice virtually leaps off the page. There is no principled way that we can treat it as meaningless.*
>
> *SEC v. Tambone*, 597 F.3d 436, 443 (1st Cir. 2010)

ARGUMENT

I. FAILURE TO PLEAD WITH PARTICULARITY REQUIRES DISMISSAL

The Trustee's allegation of securities and common law fraud, as amended in the Amended Complaint, fails to satisfy the heightened pleading requirements of Rule 9(b) and Private Securities Litigation Reform Act of 1995 ("PSLRA").[2] The Amended Complaint, after narrowly surviving a motion to dismiss, ***quietly discards*** its mistaken sole basis to distinguish the allegations from an "implied representation theory" – the allegedly express statement of the Representative Defendants' legal obligations creating an implicit due diligence representation:

> While the "implied representation theory" fails for lack of an actual misrepresentation, the implicit due diligence representation of Paragraph 56 is based on the allegedly express statements of the defendants. The implied

[2] 109 Stat. 737 (only applicable to the securities fraud claims).

> representation theory attacked by the Moving Defendants would infer a representation from the mere fact of the brokers' legal obligations-Paragraph 56, on the other hand, finds a due diligence representation in the defendants' explicit statements [in each] Subscription Agreement … that each Broker Defendant acknowledged its membership in the Financial Industry Regulatory Authority ("FINRA") and SIPC and its attendant obligation to comply with all federal and state laws, rules, and regulations."[3]

While the Trustee's Answering Brief states unequivocally that it "alleged that the 12(b)(6) Defendants ***expressly undertook the obligation to conduct due diligence and investigate DBSI***[,]" nothing could be further from the truth. In fact, the Amended Complaint withdraws any reference to an alleged express statement that Representative Defendants "acknowledged its membership in [FINRA] and SIPC and its attendant obligation to comply with all federal and state laws, rules, and regulations[,]" see Complaint at ¶ 56, and replaced it with the allegation that:

> ***Implicit*** with being a licensed securities broker or registered representative is an acknowledgment of the broker's or representative's obligation to comply with all state and federal securities laws and FINRA rules. Moreover, in every instance where a Subscription Agreement was executed in connection with the sale of a DBSI security, the relevant Defendant acknowledged its obligations to comply with all "state and federal securities laws and NASD Rule 2810."
> Amended Complaint at ¶ 42.

To add insult to injury, this is not correct as the Subscription Agreements ***DO NOT*** "acknowledge[] [Representative Defendants] obligations to comply with all 'state and federal

[3] (D.I. 420) (citing Complaint at ¶ 56). This Court stated that "it cannot locate the supposed statement acknowledging FINRA and SIPC duties" and ordered the Trustee "to clarify this issue by amendment of the Complaint." Further, this Court provided that "[i]f the allegation of Paragraph 56 concerning this statement was mistaken, the only remaining actionable misrepresentation will be the Subscription Agreement's "suitable investment" certification."

securities laws and NASD Rule 2810.'" *Id*. Rather, the representations and warranties in the Subscription Statement are ***limited only*** to investor suitability of the assignee investors by affirming *to the DBSI-affiliated issuer* to "substantiate compliance with state and federal securities laws and with NASD Rule 2810." Amended Complaint at Ex. G.[4] The plain language is not an acknowledgment as the Amended Complaint provides, and an absolute leap from the Answering Brief's claim of an express statement, but solely to verify that the investor is suitable. *See* Black's Law Dictionary 1443 (7th ed. 1999) (definition of "substantiate" is "to establish the existence or truth of (a fact, etc.), esp. by competent evidence, to verify.") The express statements of the Representative Defendants in the Letters of Intent and/or Purchaser Questionnaires ***DO NOT*** even reference state and federal securities laws or NASD Rule 2810, but is limited solely to investor suitability and states that Representative Defendants "have not undertaken any investigation or review of, and expressly disclaim any obligation to investigate or review, any information related to any covenants, representations or warranties of Buyer beyond those that apply to the standards of suitability established by Seller." Amended Complaint at Ex. H.

The allegations in the Amended Complaint have been whittled down to an "implied representation theory" that "cannot support a securities fraud claim." (D.I. 420) (*citing SEC v. Tambone*, 597 F.3d 436, 447-49 (1st Cir. 2010)(en banc); *Gabriel Capital, LP v. Natwest Fin., Inc.*, 137 F. Supp. 2d 251, 262-63 (S.D.N.Y. 2000)). Absent any express statement, the Trustee is requesting the Court to "impose primary liability under Rule 10b–5(b) on these securities

[4] This 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*, 2010 WL 184074 (D. Del. 2010) (citations omitted).

professionals whenever they fail to disclose material information not included in a prospectus, regardless of who prepared the prospectus. That would be tantamount to imposing a free-standing and unconditional duty to disclose. The imposition of such a duty flies in the teeth of Supreme Court precedent." *SEC v. Tambone*, 597 F.3d at 447-48.[5] In the best case, the allegations amount to legal conclusions, which this Court is not required to accept as true in the Motion to Dismiss. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) ("Although for the purposes of a motion to dismiss we must take all of the factual allegations in the complaint as true, we 'are not bound to accept as true a legal conclusion couched as a factual allegation'") (*quoting Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).[6]

After review of the allegations and the lack of any express statements of any legal obligations, this Court should dismiss the Amended Complaint as the remaining claims are based solely on "conclusory allegations" that fail "to link such [regulatory] practices with specific" obligations of the Representative Defendants. *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 773 (1st Cir. 2011).

II. ABSENT EXPRESS REPRESENTATION, FRAUD CLAIMS FAIL FOR LACK OF PROMISE OR OBLIGATION

[5] In *Gabriel Capital*, the Court stated "plaintiff fails to cite a single case that requires an investment advisor to conduct an independent investigation as to the accuracy of the statements made in an offering memorandum when there is nothing that is obviously suspicious about those statements. In the absence of such allegations, the third-party defendants could not have 'failed to review or check information that they had a duty to monitor.'" *Gabriel Capital*, 137 F. Supp. 2d at 262 (citations omitted).

[6] *See also Tracinda Corp. v. DaimlerChrysler AG*, 364 F. Supp. 2d 362, 396-97 (D. Del. 2005) aff'd, 502 F.3d 212 (3d Cir. 2007) ("To support a fraud action, 'a representation must be definite; mere vague, general or indefinite statements are insufficient.'") (citations omitted); *See also, Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 174-75 (2d Cir. 2005) (While "all reasonable inferences are drawn in the plaintiff's favor on a motion to dismiss on the pleadings, 'conclusions of law or unwarranted deductions of fact are not admitted.'") (citations omitted).

The Amended Complaint, absent an express representation or statement, rests on the "suitable investment" certification as the "only remaining actionable misrepresentation[,]"(D.I. 420), and should be dismissed as the claims for fraud can no longer can rely on the alleged misrepresentation in any agreement of the Representative Defendants. While "[p]rivate actions may succeed under Section 10(b) if there are particularized allegations that the contract itself was a misrepresentation, i.e., the plaintiff's loss was caused by reliance upon the defendant's specific promise to perform particular acts while never intending to perform those acts[,]…where a breach of contract is the basis for a Section 10(b) claim, the 'promise ... must encompass particular actions and be more than a generalized promise to act as a faithful fiduciary.'" *Capital Mgmt. Select Fund Ltd. v. Bennett*, 680 F.3d 214, 226 (2d Cir. 2012)

III. NO IMPLIED RIGHT OF ACTION SOLELY FOR A SELF-REGULATORY RULE VIOLATION

The "only remaining actionable misrepresentation"[7] attempts to morph a claim for violation of securities industry rules into a claim for securities fraud – abrogating the long-standing rule that private rights of action should be determined by the express language and legislative history of the statute, not inferred by the courts regardless of artful pleading. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 571 (1979).[8]

The Answering Brief provides no compelling argument in opposition. First, the Trustee argues that the legal obligations forming the basis of this Court's holding of an express statement

[7] (D.I. 420) ("[i]f the allegation of Paragraph 56 concerning this [supposed statement acknowledging FINRA and SIPC duties] was mistaken, the only remaining actionable misrepresentation will be the Subscription Agreement's 'suitable investment' certification.")

[8] The Supreme Court provided that the "question of the existence of a statutory cause of action is, of course, one of statutory construction…SIPC's argument in favor of implication of a private right of action based on tort principles, therefore, is entirely misplaced…. And where, as here, the plain language of the provision weighs against implication of a private remedy, the fact that there is no suggestion whatsoever in the legislative history that § 17(a) may give rise to suits for damages reinforces our decision not to find such a right of action implicit within the section." *Id.*

continue to provide "affirmative representations that they had undertaken sufficient due diligence[,]"[9] even though it has substantially modified its allegations based on the clear language of the Subscription Agreements in question. *See* supra, Section I. Second, *Mihara v. Dean Witter & Co., Inc.,* 619 F.2d 814 (9th Cir. 1980), as the Trustee highlights, provides "NASD rules may set a broker's common law duties of care toward clients[,][10] but not does not oppose the clear authority in the Motion to Dismiss that "[b]ased upon the standards in *Touche Ross* and *Transamerica*, we conclude there is no implied right of action for an NASD rule violation." *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 681 (9th Cir. 1980) (citations omitted).

IV. SEVERAL COMMON LAW CLAIMS ARE TIME-BARRED

In opposing the application of the various statute of limitations to the common law causes of action, the Trustee argues the same tired argument previously addressed in this Court's order that the affirmative defense "'may be raised on a motion under rule 12(b)(6), but only if the time alleged in the statement of a claim shows that the cause of action has not been brought within the statute of limitations[,]'" and "whether the Trustee's claims are time barred "is not apparent on the face of the complaint," the Court should allow for additional discovery. However, in addition to the absence of any affirmative basis for the application of the discovery rule, the Trustee attempts to gloss over that several of the common law claims are time-barred regardless of the discovery rule's application.

For example, the Trustee's first adversary action, based on the same facts was filed in November 2010, which would bar common law claims of: fraud in Arizona, Ariz. Rev. Stat. § 12-541(5), fiduciary duty in Virginia, Va. Code Ann. § 8.01-243 as well as breaches of fiduciary duty in California for any claims based on investments made before June 27, 2007. *Sakai v.*

[9] *See* Amended Complaint at page 12.
[10] *Id.*

Merrill Lynch Life Ins. Co., 2008 WL 4193058 (N.D. Cal. 2008) ("Where a financial advisor or broker provides advice about investments, a fiduciary duty is breached when the client is encouraged to purchase an investment with a level of risk that is not appropriate for the client, or is not properly informed of the speculative nature of an investment.") (citations omitted).

V. TRUSTEE PROVIDES NO AUTHORITY IN OPPOSING THE LACK OF FIDUCIARY DUTY AS A MATTER OF LAW

The cases provided by the Trustee in the Answering Brief provide no legal authority for the arguments made in Representative Defendants' Motion to Dismiss – claims for breach of fiduciary duty fail as a matter of law as to stockbrokers in certain states. The Trustee, in opposing the Motion to Dismiss, would have been better served by citing the definition of a fiduciary in the Restatements than the cases cited in its Answering Brief, which only provide the common definition of a fiduciary relationship, not its application to the specific facts and parties in the instant case.

The Trustee's opposition lacks merit and is uninformed of not only various state laws, but also the heavily reported studies and rule proposals by the Securities and Exchange Commission and Congress. *See* Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (January 2011); Finke, M.S. and Langdon, T. 2012. The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice, Journal of Financial Planning, 25(7), 28-37 (finding only four states have imposed an unambiguous fiduciary standard on broker-dealers).

VI. FAIRNESS TO REPRESENTATIVE DEFENDANTS FAVORS DECLINING SUPPLEMENTAL JURISDICTION

The Court should decline to exercise supplemental jurisdiction and dismiss the state law claims because the Trustee failed to state a cognizable claim under federal law. 28 U.S.C § 1367(c)(3).

> [A] federal court should consider and weigh in each case, and at every stage of the litigation, the values of judicial economy, convenience, fairness, and comity in order to decide whether to exercise jurisdiction over a case brought in that court involving pendent state-law claims. When the balance of these factors indicates that a case properly belongs in state court, as when the federal-law claims have dropped out of the lawsuit in its early stages and only state law claims remain, the federal court should decline the exercise of jurisdiction by dismissing the case without prejudice.
>
> *Carnegie-Mellon Univ. v. Cohill*, 484 U.S. 343, 350 (1988).

The Trustee requests the Court to exercise supplemental jurisdiction primarily on the basis of fairness (only to the Trustee) and an implication of some sort of previously unstated scheme liability (other than its arguable use of group pleading) in that the defendants are "closely intertwined." The Trustee is stepping into the shoes of the assignee investors and each claim should be viewed separately, not only under rules of civil procedure, but on the basis that the facts will likely result in different circumstances for each individual defendant – performance of due diligence, statements to the investors, application of statute of limitations, etc. Further, when viewing the fairness to the parties, Representative Defendants respectfully request this Court to not overlook that the Trustee was funded with a warchest of $1 millioin and "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). In contrast,

Representative Defendants' funds are severely limited and have significantly exhausted savings to combat the claims of the Trustee.

CONCLUSION

For the foregoing reasons, Representative Defendants respectfully request that the Court grant its motion and dismiss the Trustee's Amended Complaint and grant any such other and further relief as this Court deems just and proper.

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