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

MICHAEL J. QUILLING, Receiver for ABC VIATICALS, INC. and Related Entities,	§	
Plaintiff,	§	
v.	§	
	§	**Civil Action No. 3:07-CV-0421-P**
INTERNATIONAL FIDELITY & SURETY LIMITED, INTERNATIONAL CONSULTANTS & MANAGEMENT LTD., SURETY MARKETING SOURCE, LLC, KPMG VANUATU, HAWKES LAW, KPMG INTERNATIONAL, BOSWELL, DERMOTT & PAWLETT, LLP, MOHAN & ASSOCIATES, DAVID A. GOLDENBERG, DAG INVESTMENTS, LLC, LPG INVESTMENTS, LLC, WED MARKETING, LLC, GALAX HOLDINGS, LTD., MARK WOLOK, LINDA WOLOK and ARIE KOTLER.	§	**ECF**
Defendants	§	

RESPONSE TO DEFENDANT ARIE KOTLER'S MOTION TO DISMISS

Michael J. Quilling
State Bar No. 16432300
Brent Rodine
State Bar No. 24048770
QUILLING, SELANDER, CUMMISKEY & LOWNDS, P.C.
2001 Bryan Street, Suite 1800
Dallas, Texas 75201

ATTORNEYS FOR PLAINTIFF

Bruce Kramer
Tennessee Bar No. 7472
Admitted Pro Hac Vice
BOROD & KRAMER, PC
Brinkley Plaza
80 Monroe, Suite G-1
Memphis, TN 38103
(901) 524-0200 (Telephone)
(901) 523-0043 (Facsimile)

SPECIAL COUNSEL FOR PLAINTIFF

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TO THE HONORABLE JORGE SOLIS, UNITED STATES DISTRICT COURT JUDGE:

Michael J. Quilling, as Receiver for ABC Viaticals, Inc. and other related entities, ("Plaintiff" or "Receiver") submits this response to Defendant Arie Kotler's Motion to Dismiss [Dkt. No. 48] and would respectfully show the Court as follows:

A. INTRODUCTION

In his 16-page Complaint and 48-page appendix of exhibits, the Receiver alleges ample facts to support each and every claim against Defendant Arie Kotler under Federal Rule of Civil Procedure 12(b)(6), Rule 9(b), and certainly under the relaxed pleading standards that apply in

receivership cases like this one. As explained more fully below, Kotler's Motion to Dismiss raises few substantive challenges to the pleadings as they actually appear in the Complaint. Instead, Kotler reads many of those allegations narrowly and in isolation while ignoring the entire appendix of exhibits.

Kotler also spends a great deal of time mischaracterizing the Receiver's causes of action and then seeking dismissal based on those mischaracterizations. First, he erroneously treats the Receiver's negligence claim as one for professional malpractice. Second, he conflates the Receiver's claims for negligence, aiding and abetting breach of fiduciary duty, and negligent misrepresentation as extensions of the Receiver's fraud claim, even though the Receiver need not allege fraudulent conduct to recover under those theories. Finally, Kotler attacks several alternate and inconsistent theories for recovery that are expressly permitted by Rule 8(e)(2).

In short, Kotler's Motion to Dismiss misreads the Complaint, mischaracterizes the Receiver's causes of action, and misstates the pleading standard that applies in this case. There is no basis to dismiss the causes of action alleged against Kotler and this Court should deny his Motion to Dismiss.

B. RELEVANT PROCEDURAL STANDARDS

1. The Federal Rules Do Not Require A Complaint To State Detailed Factual Allegations

The Federal Rules of Civil Procedure expressly allow "notice pleading." All that is necessary is "a short and plain statement of the claim showing that the pleader is entitled to relief" and "a demand for judgment for the relief the pleader seeks." FED. R. CIV. P. 8(c).

The pleading requirements established by the Federal Rules of Civil Procedure are extremely liberal. In *Conley v. Gibson*, 355 U.S. 41 (1957), the Supreme Court explained:

> the Federal Rules do not require a claimant to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is "a short and plain statement of the claim" that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests. The illustrative forms appended to the Rules plainly demonstrate this. Such simplified "notice pleading" is made possible by the liberal opportunity for discovery and other pretrial procedures established by the Rules to disclose more precisely the basis of both claim and defense and to define more narrowly the disputed facts and issues.

355 U.S. at 47-48 (footnote omitted). In other words, "[a] complaint . . . need not allege all that a plaintiff must eventually prove." *Atchinson v. Dist. of Columbia*, 73 F.3d 418, 421-22 (D.C. Cir. 1996).

2. A Complaint Must Be Sustained If Relief Could Be Granted Under Any Set Of Facts That Could Be Proved Consistent With The Allegations

The standards for considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) weigh heavily against dismissal. A motion to dismiss is "viewed with disfavor and is rarely granted." *Lowrey v. Texas A&M Univ. Sys.*, 117 F.3d 242, 247 (5th Cir. 1997). Dismissal is warranted "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984). In that regard, all well-pleaded facts in the complaint must be accepted as true and viewed in the light most favorable to the plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974); *Campbell v. San Antonio*, 43 F.3d 973, 975 (5th Cir. 1995).

The issue is not whether the plaintiff will ultimately prevail, but whether the plaintiff is entitled to offer evidence to support his claims. *Scheuer*, 416 U.S. at 236. Indeed, it may appear on the face of the pleadings that a recovery is very remote and unlikely, but that is not the test under Rule 12(b)(6). *Id.* A complaint must be sustained if relief could be granted under any set

of facts that could be proved consistent with the allegations. *Nat'l Org. for Women, Inc. v. Scheidler*, 510 U.S. 249, 256 (1994).

3. Traditional Pleading Standards Are Even More Relaxed In Receivership Cases

District courts have "broad powers and wide discretion" to fashion appropriate relief in equity receivership proceedings like the case at hand. *SEC v. Basic Energy & Affiliated Res., Inc.*, 273 F.3d 657, 668 (6th Cir. 2001). That discretion includes the authority to use abbreviated, summary procedures when necessary to resolve disputes more quickly and efficiently than ordinary litigation. *Id.* In the context of receivership cases, those abbreviated procedures do not even have to comply with the Federal Rules of Civil Procedure—district courts have discretion to disregard the Rules altogether. *SEC v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992). All that is required is that the adverse parties have notice of the proceedings and an opportunity to present evidence and arguments. *Basic Energy*, 273 F.3d at 668; *Elliott*, 953 F.2d at 1567.

Receivers are also held to a lower pleading standard when stating fraud claims under Federal Rule of Civil Procedure 9(b). That rule typically requires averments of fraud to be stated "with particularity." FED. R. CIV. P. 9(b). However, less detail is required when—as in this case—the information surrounding the allegations is "peculiarly within the knowledge of the defendant." *Cadle Co. v. Schultz*, 779 F. Supp. 392, 396 (N.D. Tex. 1991); *Quilling v. Stark*, 2006 WL 1683442, *6 (N.D. Tex. June 19, 2006); *United States v. Home Care Servs., Inc.*, 1999 WL 222356, *2 (N.D. Tex. Apr. 9, 1999); 5A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FED. PRAC. & P. §1298 at 192, 232 (2004). This follows the same reasoning that affords bankruptcy trustees latitude in pleading fraud claims under Rule 9(b). *See, e.g., Pardo v. Avanti*

(*In re APF Co.*), 274 B.R. 634, 638 (Bankr. D. Del. 2001); *Barr v. Charterhouse Group Int'l, Inc.* (*In re Everfresh Beverages, Inc.*), 238 B.R. 558, 581 (Bankr. S.D.N.Y. 1999). Like trustees, the Receiver is saddled with the task of reconstructing transactions between ABC and the defendants from only bits and pieces of financial records maintained by a corrupt and mismanaged business. *See id.* Those difficulties are compounded by the fact that ABC's principles have invoked their Fifth Amendment rights and cannot provide any information. Since only Kotler and the other Defendants know the specific facts and circumstances surrounding these transactions, the pleading requirements of Rule 9(b) must be relaxed in this case.

4. The Heightened Pleading Standards Of Rule 9(b) Do Not Apply To Claims For Fraudulent Transfer, Aiding And Abetting Breach Of Fiduciary Duty, Or Negligence

In his Motion to Dismiss, Kotler urges the Court to extend the pleading requirements of Rule 9(b) beyond the scope of that rule and apply them to claims for fraudulent transfer, aiding and abetting breach of fiduciary duty, and negligence. (Mot. to Dismiss at 7-12, 17) However, by its express terms, Rule 9(b) only applies to "averments of fraud or mistake." FED. R. CIV. P. 9(b). Case law does not favor extending that rule to other claims. *See, e.g., Leatherman v. Tarrant County*, 507 U.S. 163 (1993); *Carlon v. Thaman* (*In re NationsMart Corp. Sec. Litig.*), 130 F.3d 309, 315 (8th Cir. 1997) (Rule 9(b) only applies when fraud or mistake is as an element of the claim).

In arguing that Rule 9(b) should extend to the Receiver's claims for negligence and aiding and abetting breach of fiduciary duty, Kotler cites an unreported case that is clearly distinguishable from the case at hand. (Mot. to Dismiss at 7) In *Ingalls v. Edgewater Private Equity Fund III, L.P.*, 2005 WL 2647962 (S.D. Tex. Oct. 17, 2005), the Court considered

whether Rule 9(b) applied to a bankruptcy trustee's claim that corporate officers breached their fiduciary duties to the company by "defrauding it" of money and business opportunities. *Id.* at *5. Since the very language of that allegation "sounds in fraud," the Court applied the pleading requirements of Rule 9(b). *Id.*

Unlike in *Ingalls*, the Receiver's claims for negligence and aiding and abetting breach of fiduciary duty do not, by their terms, sound in fraud. Rule 9(b) only applies to causes of action that "include fraud or mistake as an element" of the claim. *Carlon*, 130 F.3d at 315 (declining to apply Rule 9(b) to a claim that "does not require proof of fraud for recovery"). As explained below, the elements of both claims are well-settled in Texas and do not require the Receiver to plead fraudulent conduct.[1] Applying Rule 9(b) in such an instance "comports neither with Supreme Court precedent nor with the liberal system of 'notice pleading' embodied in the Federal Rules of Civil Procedure." *Id.*

In arguing that Rule 9(b) should extend to claims under the Uniform Fraudulent Transfer Act ("UFTA"), Kotler relies upon this Court's opinion in *Quilling v. Stark*, 2006 WL 1683442 (N.D. Tex. June 19, 2006). (Mot. to Dismiss at 7) Although the Court overseeing that case upheld the Receiver's fraudulent transfer claim under the higher pleading standard of Rule 9(b), it noted that applying the rule was "debatable under Fifth Circuit law." *Id.* at *5 n.4, *citing Indiana Bell Tel. Co., Inc. v. Lovelady*, 2006 WL 485305, * 1 (W.D. Tex. Jan. 11, 2006). To prevail under the UFTA, the Complaint must allege that the transfers were made to "hinder, delay or defraud creditors." TEX. BUS. & COM. C. § 24.005(a)(1). The Receiver submits that this is distinct from the traditional notions of "fraud" anticipated by Rule 9(b). *Id.*; *see also China*

[1] Although the Receiver has also alleged a fraud claim against Kotler elsewhere in the Complaint, his claims for negligence and aiding and abetting breach of fiduciary duty may be supported by mere reckless or negligent behavior and, therefore, are not subject to Rule 9(b).

Resource Products (U.S.A.) Ltd. v. Fayda Int'l, Inc., 788 F. Supp. 815, 819 (D. Del. 1992) ("Because the plaintiff need not prove actual or constructive fraud under the [UFTA], Rule 9(b) does not apply to pleadings made pursuant to those provisions"). However, even if this district does generally adopt the pleading standards of Rule 9(b) for fraudulent transfer claims, those standards are still relaxed in receivership cases like this one. *Cadle Co.*, 779 F. Supp. at 396; *Stark*, 2006 WL 1683442 at * 6.

Furthermore, to the extent that the Receiver must state with particularity the underlying intent to hinder, delay, or defraud creditors, he has adequately done so in explaining that ABC was a Ponzi scheme. (Compl. at ¶¶ 30, 49) Under the Uniform Fraudulent Transfer Act, transfers from a Ponzi scheme establish fraudulent intent as a matter of law. *Quilling v. Gilliland*, 2002 WL 373560, *2 (N.D. Tex. Mar. 6, 2002); *SEC v. Cook*, 2001 WL 256172, *3 (N.D. Tex. Mar. 8, 2001); *see also In re Ramirez Rodriguez*, 209 B.R. 424, 434 (Bankr. S.D. Tex. 1997); *In re Independent Clearing House Co.*, 77 B.R. 843 (Bankr. D. Utah 1987). Kotler does not question the facts supporting the Ponzi scheme's existence and the Receiver submits that conclusion is incontrovertible.

5. Even If The Complaint Is Subject To Rule 9(b), It Alleges The Fraudulent Conduct With Particularity And Must Be Sustained

Even if Rule 9(b) did apply in this case, the Complaint satisfies that rule by pleading the circumstances surrounding Kotler's fraudulent conduct with particularity. Rule 9(b) does not require a party to state all facts pertinent to a fraud action. *Mitchell Energy Corp. v. Martin*, 616 F. Supp. 924, 927 (S.D. Tex. 1985). Rather, the particularity demanded by Rule 9(b) differs with the facts of each case. *Hart v. Bayer Corp.*, 199 F.3d 239, 248 n.6 (5th Cir. 1999). Allegations

under Rule 9(b) must still be as short, plain, simple, direct, and concise as is reasonable under the circumstances. *Corwin v. Marney, Orton Invs.*, 788 F.2d 1063, 1068 (5th Cir. 1986).

Typically, under Rule 9(b), a complaint must "specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Williams v. WMX Techs, Inc.*, 112 F.3d 175, 177 (5th Cir. 1997); *Zuckerman v. Foxmeyer Health Corp.*, 4 F. Supp. 2d 618, 622 (N.D. Tex. 1998). However, it is well-established that Rule 9(b) is read in conjunction with Rule 8, which only requires that the complaint give "fair notice" of the claim and the grounds on which it rests. *Norman v. Apache Corp.*, 19 F.3d 1017, 1023 (5th Cir. 1994); *Cadle Co.*, 779 F. Supp. at 396. Therefore, a plaintiff satisfies Rule 9(b) if he sufficiently pleads the circumstances constituting fraud so that the defendant may file an adequate answer. 5A WRIGHT & MILLER, FED. PRAC. & P. § 1298 at 236 (2004). As explained more fully below, the Complaint and appendix of exhibits clearly notify Kotler of all currently known facts surrounding the alleged fraudulent conduct for purposes of Rule 9(b) or any other applicable pleading standard.

6. Ordinarily, A Plaintiff Should Have An Opportunity To Amend The Complaint Before The Case Is Dismissed

The Federal Rules of Civil Procedure "reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits." *Conley v. Gibson*, 355 U.S. 41, 48 (1957). It is the well established policy of the Federal Rules of Civil Procedure that a plaintiff is to be given every opportunity to state a claim. *Hitt v. City of Pasadena*, 561 F.2d 606, 608 (5th Cir. 1977). A district court should give plaintiff the opportunity to file an amended or supplemental complaint before dismissing the case. *Czosek v. O'Mara*, 397 U.S. 25, 27 (1970).

Accordingly, if the Court concludes that the Complaint and exhibits do not comply with Rule 9(b), then the Plaintiff should be granted leave to amend.

C. STATEMENT OF FACTS

The Receiver's Complaint and attached exhibits adequately notify Kotler of the claims against him and the basis for relief. The substance of all facts known by the Receiver regarding Kotler's role in this case is summarized below. Any additional facts that Kotler asks the Receiver to plead are peculiarly within the Defendants' knowledge and do not support dismissal of this case. *Cadle Co.*, 779 F. Supp. at 396.

ABC purchased numerous bonds issued and backed by International Fidelity & Surety Limited ("IFS") and International Consultants & Management Ltd. ("ICM"). (Compl. at ¶¶ 26-27) Although Kotler purported to serve as their managing director and beneficial owner, those companies were fictitious and without any actual offices, employees, or facilities. (*Id.* at ¶¶ 23-24, 35, 46) Accordingly, they simply exist on paper as an alter ego for Kotler and his associates to sell fraudulent and nonexistent bonds. (*Id.* at ¶¶ 24, 35, 39, 46, 53) The fraudulent nature of IFS' bonding scheme is evidenced by the fact that it continued to issue bonds to ABC even when its true owners diverted the entire premium amount for their personal use. (*Id.* at ¶ 27)

As managing director and a beneficial owner of IFS and ICM, Kotler joined the other Defendants in issuing bonds, payment guarantees, and financial statements to ABC that contained numerous false representations. (*Id.* at ¶¶ 23, 26, 29, 36, 40, 42, 44, 46-47) The substance of those misrepresentations are attached to the Complaint as Exhibits 3-6.

In conducting business as IFS and ICM, Kotler joined the other Defendants in making the following fraudulent statements and misrepresentations, among others:

(1) That IFS and ICM maintained offices in Connecticut and the Republic of Vanuatu. (*Id.* at ¶ 24) Neither company has or had an actual office at either location. (*Id.*)

(2) That IFS and ICM were legitimate companies that could issue and guarantee the bonds sold to ABC. (*Id.* at ¶¶ 23-24, 26, 29, 42, 44, Ex. 3-6) Those companies, however, were fictitious and existed only on paper. (*Id.* at ¶¶ 24, 35, 46)

(3) That IFS and ICM were solvent companies that had the financial resources to back the bonds to ABC. (*Id.* at ¶¶ 29, 36, 42, 44, Ex. 3-6) However, IFS and ICM were insolvent and the financial statements provided to ABC were false in all material respects. (*Id.* at ¶¶ 29, 36, 39, 40, 47, 53)

(4) That the bonds and financial guarantees issued to ABC were legitimate. (*Id.* at ¶¶ 26, 42, 44, Ex. 3-6) Those bonds proved to be fraudulent and nonexistent because ABC's premiums were systematically diverted towards other personal and unrelated expenses. (*Id.* at ¶¶ 27, 35, 39, 46, 53)

(5) That the bond amounts would be paid within a specified time following the insured's death. (*Id.* at ¶¶ 22, 26, Ex. 5) IFS and ICM, however, were at all times insolvent and could not honor those obligations under the bond and guarantee. (*Id.* at ¶¶ 24, 35, 39, 46, 53)

Kotler and the other Defendants knew that ABC purchased those bonds to secure payment of benefits for each life insurance policy in its portfolio. (*Id.* at ¶¶ 22, 26-27) Nevertheless, they willfully made these and other fraudulent statements with conscious indifference to the welfare of bond purchasers like ABC. (*Id.* at ¶ 53)

D. ARGUMENT AND AUTHORITIES

1. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Fraud

The Receiver's Complaint contains ample facts stating a claim for fraud against Kotler. To state a claim for fraud, the Receiver must show that: (1) Kotler made a material representation; (2) that representation was false; (3) that it was known to be false or was made recklessly without any knowledge of its truth and as a positive assertion; (4) that it was made with the intent that ABC act upon it; (5) ABC relied on that representation; and (6) ABC thereby suffered injury. *Eagle Props. Ltd. v. Scharbauer*, 807 S.W.2d 714, 722-23 (Tex. 1990). As set forth above, the Complaint alleges that Kotler made numerous fraudulent representations to ABC as the managing director, beneficial owner, and alter ego of two fictitious companies, IFS and ICM. (Compl. at ¶¶ 24, 35, 46) The substance of those representations appeared in the fraudulent bonds and payment guarantees issued to ABC. (*Id.* at ¶¶ 23-24, 26, 29, 36, 42, 44, Ex. 3-6) Among other things, ABC was told that IFS and ICM were legitimate companies, that they were solvent, that they possessed the financial resources to cover their bond obligations, that the bonds issued to ABC were legitimate, and that IFS and ICM would pay those bond obligations as they became due. (*Id.*) Copies of the fictitious statements themselves are attached to the Complaint as Exhibits 3-6. As explained in the Complaint, those statements were patently false. (*Id.*) In fact, they are so contrary to the facts set forth in the Complaint that Kotler, as the managing director and beneficial owner of those fictitious companies, must have known that they were false when made. (*Id.* at ¶¶ 24, 35, 46) Kotler knew that, from their inception, those companies were shells that held no assets. (*Id.* at ¶ 24) Finally, the Receiver alleges that those

representations were made with the intent that ABC rely on them and that ABC suffered damages as a result of doing so. (*Id.* at ¶ 44)

In his Motion to Dismiss, Kotler chooses to ignore the 48-page appendix of exhibits supporting the Receiver's Complaint. Those exhibits provide examples of the fraudulent statements themselves—far more than is required by Rule 9(b), Rule 12(b)(6), or the relaxed pleading standards that apply in receivership cases. Therefore, even if Rule 9(b) did apply to the Receiver's cause of action for fraud, it is difficult to imagine how his Complaint could have stated those facts with any more "particularity." FED. R. CIV. P. 9(b). The Receiver submits that any facts omitted from the Complaint are particularly within the Defendants' knowledge and cannot support dismissal of their claim for fraud against Kotler. *Cadle Co.*, 779 F. Supp. at 396.

2. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Aiding And Abetting Breach of Fiduciary Duty

The Receiver's Complaint states adequate facts supporting a claim against Kotler for aiding and abetting ABC's breach of fiduciary duty. To state a claim for aiding and abetting breach of fiduciary duty, the Receiver must show that Kotler knowingly joined a fiduciary in breaching its duties. *In re Performance Nutrition, Inc.*, 239 B.R. 93 (Bankr. N.D. Tex., 1999) (citing *Jackson v. Smith*, 254 U.S. 586, 589 (1921)); *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942). The Complaint alleges that ABC breached its fiduciary duties to investors by, among other things, improperly diverting investor funds to purchase fraudulent bonds and misrepresenting the viability of those bonds to investors. (Compl. at ¶¶ 21-22, 27, 34-36, 49) As managing director and beneficial owner of IFS and ICM, Kotler joined ABC in breaching its duties by providing the fraudulent bonds to ABC that served as the basis for those misrepresentations and breach of duty. (*Id.* at ¶¶ 27, 35, 39, 46, 53)

In challenging the facts supporting this claim, Kotler again ignores allegations clearly stated in the Complaint. First, he claims that the Complaint does not identify IFS and ICM as the fictitious companies selling nonexistent bonds even though the Receiver expressly stated that fact numerous times. (Mot. to Dismiss at 11; Compl. at ¶¶ 24, 26, 35) Second, he claims that the Complaint provides no basis for "Kotler's [] knowledge regarding IFS and ICM," although the Complaint clearly explains that Kotler was the managing director and a beneficial owner of those fictitious companies. (Mot. to Dismiss at 11; Compl. at ¶ 23) Finally, Kotler claims that the Complaint fails to set forth the misrepresentations made to ABC's investors. (Mot. to Dismiss at 11) To the contrary, it clearly states that ABC represented that its investments were backed by viable bonds from a legitimate and solvent bonding company—which was patently false. (Compl. at ¶¶ 22, 35, 39, 46, 53) Clearly, the Receiver has stated a claim for aiding and abetting breach of fiduciary duty under any applicable pleading standard.[2]

Kotler also challenges the Receiver's standing to bring a claim for aiding and abetting breach of fiduciary duty. (Mot. to Dismiss at 19-20) He claims that ABC only owed fiduciary duties to its investors, whose interests are not represented by the Receiver in this case. (Mot. to Dismiss at 19) This argument fails for two reasons. First, ABC's fiduciary duties to its investors included careful and competent management of their investor trusts—which the Receiver does represent in this case. *Order Clarifying and Modifying Order Appointing Receiver* [Dkt. No. 19]. Second, as Kotler notes, this Court has entered orders expressly authorizing the Receiver to bring causes of action on behalf of ABC's investors:

> The Receiver is hereby authorized to institute such actions or proceedings to impose a constructive trust, obtain possession

[2] As stated previously in Section B.4, Kotler does not provide a valid legal basis for applying the pleading standard of Rule 9(b) to claims for aiding and abetting breach of fiduciary duty.

> and/or recover judgment with respect to persons or entities who received assets or funds or proceeds traceable to investor monies. All such actions shall be filed in this Court. The Receiver is specifically authorized to pursue such actions on behalf of and for the benefit of the constructive trust beneficiaries, including without limitation any and all investors who may be the victims of the fraudulent conduct alleged herein by the Commission. The Receiver is hereby appointed as the representative of such investors for the purpose of making requests to any authority, foreign or domestic, for the return of the funds that such investors contributed to the Defendant, wherever such funds may have been transferred and for the purpose of filing actions to recover such funds wherever the Receiver may deem necessary.

Order Appointing Receiver [Dkt. No. 8] at ¶ 14.

In support of his argument, Kotler cites *Scholes v. Schroeder*, 744 F. Supp. 1419 (N.D. Ill. 1990), which is distinguishable from the case at hand. In *Scholes*, the Court held that a receiver for three companies could not state causes of action that belonged solely to its investors. *Id.* at 1421. However, it noted that its ruling would be different if "one or another of those companies has a claim on its own behalf, the recovery from which will result in the enhancement of its assets, thus ultimately benefiting the investors in that company." *Id.* at n.5. The facts here present such a case. The Receiver has been appointed both for ABC and for its investor trusts. Those trusts exist as separate entities that have "a claim on [their] own behalf" through the Receiver. *Id.*; *Order Clarifying and Modifying Order Appointing Receiver* [Dkt. No. 19]. ABC's fiduciary duties required it to avoid mismanagement of the investor funds held in those trusts. (Compl. at ¶¶ 21, 34-35) However, it failed to do so partially as a result of the fraudulent conduct alleged against Kotler acting through IFS and ICM. (*Id.*) The Receiver, therefore, has standing to state his claim for aiding and abetting breach of fiduciary duty against those Defendants.

3. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Negligence

The Complaint contains sufficient facts to state a claim against Kotler for negligence. To state a claim for negligence, the Receiver must show that: (1) Kotler owed a duty to ABC; (2) that duty was breached; (3) that the breach proximately and foreseeably caused injury to ABC; and (4) that ABC suffered damages. *Van Horn v. Chambers,* 970 S.W.2d 542, 544 (Tex. 1998). The Complaint clearly states that, in causing IFS and ICM to market and sell bonds to ABC, Kotler had a duty to honor and back those bonds through a legitimate and solvent company. (Compl. at ¶ 39) He breached that duty by, among other things, marketing and selling fraudulent and nonexistent bonds through insolvent and fictitious companies under his direction. (*Id.* at ¶¶ 24, 29, 35-36, 39, 40, 42, 44, 46, 53) Those acts proximately and foreseeably caused ABC to suffer actual damages as a result. (*Id.* at ¶ 39)

In his Motion to Dismiss, Kotler erroneously argues that the Receiver cannot state a claim for negligence while alleging knowing and intentional conduct elsewhere in the Complaint. (Mot. to Dimsiss at 16 n.12) To the contrary, it is well-settled that the Receiver may plead multiple, and even inconsistent, theories of recovery. FED. R. CIV. P. 8(e)(2).

Kotler also attempts to mischaracterize the Receiver's negligence claim as one for professional malpractice. (Mot. to Dismiss at 14-16) The Complaint, however, clearly states that the accounting firm defendants—not Kotler—owed a duty of care commensurate with other professionals under the same circumstances. (Compl. at ¶¶ 36, 40) Kotler's only substantive challenge to the Receiver's "conventional 'negligence' claim" is that the Complaint does not allege personal injury or property damage necessary to overcome the "economic loss rule." (Mot. to Dismiss at 16 n.12)

Under Texas law, the economic loss rule "precludes recovery of economic losses in tort cases when the loss is the subject matter of a contract between the parties." *Tarrant County Hospital District v. GE Automation Servs., Inc.*, 156 S.W.3d 885, 888 n.5 (Tex. 2005); *S.W. Bell Tel. Co. v. DeLanney,* 809 S.W.2d 493, 494 (Tex. 1991); *Jim Walter Homes, Inc. v. Reed,* 711 S.W.2d 617, 617-18 (Tex. 1986). It is a "court-adopted rule" to determine when a plaintiff is barred from alleging tort injuries arising from a contract with the defendant. *Tarrant County Hosp. Dist.*, 156 S.W. 3d at 895.

In raising the economic loss rule in this case, Kotler erroneously presupposes that the fraudulent bonds and payment guarantees will necessarily be proven valid, binding contracts with ABC. Under the factual allegations in the Complaint, however, those contracts might be proven illegal, invalid, and not subject to the economic loss rule. By stating both a negligence claim and a breach of contract claim, the Complaint preserves the Receiver's right to recover damages no matter how the Court resolves that issue. *See* FED. R. CIV. P. 8(e)(2) (permitting alternate, hypothetical, and inconsistent claims).

4. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Fraudulent Transfer

The Complaint contains ample facts to support a fraudulent transfer claim against Kotler. Under the circumstances, the matter is very straightforward. *See* TEX. BUS. & COM. C. § 24.005(a)(1). As the Supreme Court held in the original Ponzi scheme case, payments made from commingled funds amassed in the course of such a scheme are inherently avoidable as fraudulent transfers. *Cunningham v. Brown*, 265 U.S. 1 (1924). The Complaint alleges that, in purchasing nonexistent bonds, ABC transferred funds to one or more of Kotler's associates, that ABC was an insolvent Ponzi scheme at the time it made those transfers, and that those transfers

were made with the intent to hinder, delay, or defraud creditors. (Compl. at ¶¶ 26-27, 49) The Complaint fully describes each bond issued to ABC and states the amount of investor funds fraudulently transferred to purchase them. (*Id.* at ¶¶ 26-27)

In his Motion to Dismiss, Kotler challenges the Receiver's standing to state a fraudulent transfer claim in this case. (Mot. to Dismiss at 20-22) His challenge is based on the premise that ABC is not a "creditor" entitled to recover under the Uniform Fraudulent Transfer Act ("UFTA"). (Mot. to Dismiss at 21) That statement is untrue. The UFTA gives the broadest possible definition to "creditor," so as to include any estate that has a legal, equitable, or other right to payment or property.[3] TEX. BUS. & COM. C. § 24.002 (3), (4), (9). Analogous cases demonstrate that receivers clearly have standing to recover funds from third parties under the UFTA. *SEC v. Cook*, 2001 WL 256172, *2 (N.D. Tex. Mar. 8, 2001) (noting that "a receiver represents not only the entity in receivership, but also the interests of its creditors"); *see also Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) (fraudulent corporation's right to recovery arose once the receiver was appointed); *Warfield v. Carnie*, 2007 WL 1112591 (N.D. Tex. Apr. 13, 2007); *Quilling v. Cristell*, 2006 WL 316981, *5 (W.D.N.C. Feb. 9, 2006); *Quilling v. Grand Street Trust*, 2005 WL 1983879, *5 (W.D.N.C. Aug. 12, 2005); *Quilling v. Gilliland*, 2002 WL 373560 (N.D. Tex. Mar. 6, 2002).

Kotler misconstrues case law from other districts for the proposition that the Receiver does not have standing to recover ABC funds fraudulent transferred by its principal officers. For example, he claims that *Troelstrup v. Index Futures Group, Inc.*, 130 F.3d 1274 (7th Cir. 1997) should prevent the Receiver from stating a fraudulent transfer claim in this case on behalf of

[3] The Receiver also represents the interests of ABC's investor trusts that have independent standing as "creditors" under the UFTA. *Order Clarifying and Modifying Order Appointing Receiver* [Dkt. No. 19]; TEX. BUS. & COM. C. § 24.002 (4), (9) (defining "creditor" to include estates, trusts, and business trusts).

ABC. (Mot. to Dismiss at 21) *Troelstrup*, however, addresses the narrow issue of standing when the receiver is appointed only for the individual who perpetrated the fraud and not for the corporate entity whose funds were depleted by the fraudulent transfers. *Id.* at 1277. The Seventh Circuit went to great lengths in explaining that the receiver in *Troelstrup* was only appointed "for [the individual] both under [his] real name and under various aliases." *Id.* It then distinguished its ruling from that in *Scholes v. Lehman*, 56 F.3d 750, 753-54 (7th Cir. 1995), where the receiver had standing to recover funds fraudulently transferred from the entity in receivership. *Troelstrup*, 130 F.3d at 1277; *see also Scholes*, 56 F.3d at 754. Obviously, the holding in *Scholes* is analogous to this case were the Receiver has been appointed for ABC and, therefore, has standing to assert fraudulent transfer claims to recover the funds used to purchase bonds from IFS and ICM.

5. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Negligent Misrepresentation

The Receiver has also alleged sufficient facts to support a claim for negligent misrepresentation against Kotler. To prevail on his negligent misrepresentation claim, the Receiver must show that: (1) Kotler participated in making representations to ABC in the course of his purported business; (2) those representations contained false information for the guidance of ABC in its business; (3) reasonable care or competence was not observed in obtaining or communicating that information; (4) ABC justifiably relied on those misrepresentations; and (5) ABC suffered pecuniary loss as a result. *Fed. Land Bank Ass'n of Tyler v. Sloan*, 825 S.W.2d 439, 442 (Tex. 1991). The Complaint clearly alleges that, as managing director and beneficial owner of IFS and ICM, Kotler participated in making numerous misrepresentations to ABC. (Compl. at ¶¶ 23-24, 26, 29, 36, 42, 44, Ex. 3-6) Among other things, Kotler held out IFS and

ICM as companies that were legitimate, that were solvent, that possessed the financial resources to cover their bond obligations, that issued legitimate bonds to ABC, and that would pay those bond obligations as they became due. (*Id.*) The statements were false and made without reasonable care or competence. (*Id.* at ¶¶ 24, 27, 35, 39, 42, 46, 53) They were made for ABC's guidance in an attempt to convince it to buy bonds purportedly backing its portfolio of life insurance policies. (*Id.* at ¶¶ 26, 42, Ex. 3-6) ABC justifiably relied on those representations and suffered damages as a result. (*Id.* at ¶¶ 26-27, 42, Ex. 5)

Kotler's only challenge to the factual allegations supporting this claim is the "absence of any particularized allegations." (Mot. to Dismiss at 17) This appears to be another plea to extend Rule 9(b)'s pleading requirements beyond its scope and should be denied for the reasons stated in Section B.4, above. The Receiver also submits that the Complaint and attached exhibits adequately present facts supporting his claim for negligent misrepresentation under any applicable pleading standard.

6. After Taking All Allegations In The Complaint As True, The Receiver Has Stated A Claim For Civil Conspiracy

The Receiver has also properly stated a civil conspiracy claim against Kotler. To prevail on a civil conspiracy claim, the Receiver must show: (1) two or more persons; (2) who sought to accomplish an object; (3) had a meeting of the minds on the object or course of action; (4) committed one or more unlawful, overt acts; and (5) damages proximately resulted. *Chon Tri v. J.T.T.*, 162 S.W.3d 552, 556 (Tex. 2005). In this case, the Complaint clearly alleges that Kotler and the other Defendants intended to market and sell fraudulent bonds through fictitious and insolvent companies. (Compl. at ¶¶ 24, 35, 39, 46, 53) In furtherance of that objective, they undertook a course of action that included fraudulent and tortuous acts, involving numerous

fraudulent statements directed towards ABC. (*Id.* at ¶¶ 24, 27, 35, 39, 42, 46, 53) As a result of their conduct, ABC suffered damages. (*Id.* at ¶¶ 26-27, 32, 35, 39, 42, 44, 46, 49, 51, 53)

Liability for civil conspiracy must depend on some underlying tort claimed by the Receiver. *Tilton v. Marshall*, 925 S.W.2d 672, 681 (Tex. 1996). Kotler maintains that the Complaint lacks this underlying tort.[4] (Mot. to Dismiss at 17-18) The Complaint, however, clearly alleges that Kotler is liable for numerous underlying torts, including fraud, negligent misrepresentation, and aiding and abetting breach of fiduciary duty. (Compl. at ¶¶ 34, 42, 44) It also states that, from the conspiracy's inception, Kotler intentionally engaged in tortuous conduct as the managing director and a beneficial owner of two fictitious companies that issued the fraudulent bonds to ABC. (Compl. at ¶¶ 24, 27, 35, 39, 46, 53) Accordingly, the Receiver has stated all elements necessary to support his civil conspiracy claim.

7. Defendant's Comments Regarding Alter Ego Liability Do Not Support Dismissal

Without question, the Complaint states sufficient facts to impose alter ego liability on Kotler for the acts of IFS and ICM. Kotler states that alter ego liability must be premised on commingling funds, inadequate capitalization, or failing to observe corporate formalities. (Mot. to Dismiss at 14) The Complaint alleges precisely that. No corporate formalities were observed because IFS and ICM were fictitious and without any actual offices, employees, or facilities. (Compl. at ¶¶ 24, 35, 46) They existed only on paper as a front for Kotler and his associates to sell fraudulent and nonexistent bonds. (*Id.* at ¶¶ 24, 27, 35, 39, 46, 53) At all times, premium payments due to IFS were simply diverted for the personal use of Kotler's associates. (*Id.* at ¶ 27) In reality, IFS and ICM were insolvent and their corporate financial statements were false in

[4] Kotler's argument simply concludes that no underlying tort has been pleaded "with the particularity required by FED. R. CIV. P. 9(b)." (Mot. to Dismiss at 18) As stated previously in Sections B.3 and B.4, Rule 9(b)'s pleading standard does not apply to the underlying torts alleged in the Complaint.

all material respects. (*Id.* at ¶¶ 29, 36, 39, 40, 47, 53) Therefore, as managing director and a beneficial owner of those sham companies, Kotler was necessarily part of IFS's and ICM's fraudulent activity for purposes of imposing alter ego liability. (*Id.* at ¶¶ 24, 35, 46)

8. Defendant's Comments Regarding Impermissible "Group Pleading" Do Not Support Dismissal

Kotler asks the Court to dismiss the claims for fraud, fraudulent transfer, aiding and abetting breach of fiduciary duty, and negligence because the Complaint fails to "identify fraudulent conduct specifically attributable to Kotler." (Mot. to Dismiss at 8) He states that the Complaint demonstrates "group pleading" that does not allege "a particular false representation . . . on the part of Kotler." (*Id.* at 9)

The cases cited in Kotler's Motion to Dismiss examined whether the alleged instance of "group pleading" comported with the heightened pleading requirements of Federal Rule of Civil Procedure 9(b). *See Unimobil-84, Inc. v. Spurney*, 797 F.2d 214, 217 (5th Cir. 1986); *Zuckerman v. Foxmeyer Health Corp.*, 4 F. Supp. 23 618, 626 (N.D. Tex. 1998); *Haskin v. R.J. Reynolds Tobacco Co.*, 995 F. Supp. 1437, 1439-40 (M.D. Fla. 1998); *Ingalls v. Edgewater Private Eq. Fund III, L.P.*, 2005 WL 2647962 (S.D. Tex. Oct. 17, 2005). As explained above, however, Rule 9(b)'s requirements should not apply in this case because the fraudulent conduct is "peculiarly within the knowledge of the defendant." *Cadle Co.*, 779 F.Supp. at 396 (N.D. Tex. 1991); *Stark*, 2006 WL 1683442 at *6; *United States v. Home Care Servs., Inc.*, 1999 WL 222356 (N.D. Tex. Apr. 9, 1999).

Case law further demonstrates that, even if Rule 9(b) did apply, the Complaint contains specific allegations that do not constitute impermissible group pleading. For example, in *Zuckerman v. Foxmeyer Health Corporation*, 4 F. Supp. 2d 618 (N.D. Tex. 1998), the plaintiffs

stated claims for fraud under the Securities Exchange Act of 1934 against several pharmaceutical companies and their corporate executives. The individual corporate executives named as defendants filed a motion to dismiss alleging that the complaint contained impermissible group pleading. In denying that motion, the Court held that the prohibition on group pleading is "applied in tandem with the presumption that senior executives of a corporate defendant may be held personally liable for misrepresentations contained in a public statements issued for the corporation." *Id.* at 622, 624 n.4. The Court noted that, when a fraudulent statement is made through a corporate entity, Rule 9(b) only requires that complaint "clearly name each individual defendant whom they allege had a hand in the misrepresentation." *Id.* at 626.

In this case, the Complaint clearly states the factual basis for finding Kotler individually responsible for the activities of IFS and ICM. (Compl. at ¶¶ 24, 35, 46) In particular, the Receiver seeks to hold Kotler liable for making fraudulent representations through those fictitious companies as their managing director and beneficial owner. (*Id.* at ¶¶ 24, 27, 35, 39, 46, 53) Therefore, under any pleading standard, the Receiver has clearly identified Kotler as the responsible officer and explained how he "had a hand in the misrepresentations" made by IFS and ICM. *Zuckerman*, 4 F. Supp. 2d at 626; *In re Capstead Mort. Corp.*, 258 F. Supp. 2d 533, 562 (N.D. Tex. Mar. 31, 2003) (Rule 9(b) satisfied by "identifying" the officer or director responsible for the company's statement).

D. Prayer For Relief

WHEREFORE, PREMISES CONSIDERED, the Receiver requests that the Court deny Defendant Arie Kotler's Motion to Dismiss and grant the Receiver such other and further relief, general or special, at law or in equity, to which he may be justly entitled.

Respectfully submitted,

QUILLING, SELANDER, CUMMISKEY & LOWNDS, P.C.
2001 Bryan Street, Suite 1800
Dallas, Texas 75201
(214) 871-2100 (Telephone)
(214) 871-2111 (Facsimile)

By: */s/ Michael J. Quilling*
Michael J. Quilling
State Bar No. 16432300
Email: mquilling@qsclpc.com
Brent Rodine
State Bar No. 24048770
Email: brodine@qsclpc.com

ATTORNEYS FOR PLAINTIFF

BOROD & KRAMER, PC
Brinkley Plaza
80 Monroe, Suite G-1
Memphis, TN 38103
(901) 524-0200 (Telephone)
(901) 523-0043 (Facsimile)

By: */s/ Bruce Kramer*
Bruce Kramer
Tennessee Bar No. 7472
Admitted Pro Hac Vice

SPECIAL COUNSEL FOR PLAINTIFF

CERTIFICATE OF SERVICE

On the 6th day of August, 2007 a true and correct copy of this motion was sent to all interested parties through the Court's electronic filing system.

/s/ Michael J. Quilling