CLERK, U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

THE DATE OF ENTRY IS ON
THE COURT'S DOCKET

The following constitutes the ruling of the court and has the force and effect therein described.

Signed October 18, 2017

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

In re:	§	
	§	
LIFE PARTNERS HOLDINGS, INC.,	§	CASE NO. 15-40289-RFN-11
et al.,	§	
	§	
Debtors.	§	
	§	
	§	
LIFE PARTNERS CREDITORS TRUST	§	
and ALAN M. JACOBS, as Trustee for Life	§	
Partners Creditors' Trust,	§	
	§	
Plaintiffs,	§	
	§	
v.	§	ADVERSARY NO. 15-4110
	§	Dist. Ct. No. 4:16-cv-00299-A
ABUNDANT INCOME, LLC, *et al.*,	§	
	§	
Defendants.	§	

REPORT AND RECOMMENDATION
REGARDING DEFENDANTS' MOTIONS TO DISMISS

TO THE HONORABLE UNITED STATES DISTRICT COURT:

I, Russell F. Nelms, United States Bankruptcy Judge, make the following report and recommendation regarding the motions to dismiss filed by various defendants in this adversary proceeding.

I. Nature of the Case and Grounds for the Motions To Dismiss.

This is my fifth report and recommendation in connection with matters related to the bankruptcy of Life Partners, Inc. Because Your Honor is well familiar with the facts that led to LPI's bankruptcy, I will not repeat them here.

In this lawsuit, the trustee of the Life Partners Creditors' Trust has sued 38 licensees of Life Partners for commissions they received between 2008 and 2015. The trustee alleges that the commissions are recoverable as fraudulent transfers under Texas law and as preferential and fraudulent transfers under the Bankruptcy Code. He seeks to subordinate or disallow any claims the licensees might have against the bankruptcy estates. Finally, standing in the shoes of the individual investors who assigned their claims to the Trust, the trustee sues for damages for negligent misrepresentation, damages or rescission for breach of the Texas Securities Act, and breach of fiduciary duty.

Numerous defendants have filed motions to dismiss the complaint. Many of the alleged grounds for dismissal are the same: failure to allege fraud with particularity under Rule 9(b); failure to allege plausible claims under Rule 8(a); and bar to recovery by statutes of limitations. Other grounds are specific to particular defendants. In this report and recommendation, I attempt to respond to all arguments of parties who urge dismissal.

II. Procedural Chronology.

Life Partners Holdings, Inc. ("LPHI") filed a voluntary petition under chapter 11 of the Bankruptcy Code on January 20, 2015. Thomas Moran was appointed as LPHI's trustee on March 19, 2015. Moran then filed petitions in bankruptcy for LPHI's subsidiaries, Life Partners, Inc. ("LPI"), and LPI Financial Services, Inc. ("LPFS") on May 19, 2015. Moran filed the original complaint in this case on December 29, 2015. He amended it on March 11, 2016. On June 6, 2016, I abated all adversary proceedings so that the debtors could proceed to confirmation on their joint plan.

On November 1, 2016, I confirmed the debtors' joint plan. The plan created the Life Partners Creditors' Trust and appointed Alan M. Jacobs as its trustee. After I lifted the abatement, the trustee (substituting as plaintiff for Moran) filed the Second Amended Complaint (which, for convenience, I refer to herein as the "complaint") on March 6, 2017. In that complaint, the trustee asserted for the first time claims of individual investors who, pursuant to the plan, assigned claims to the Trust.

Various defendants filed or amended previously-filed motions to dismiss the complaint. On April 18, 2017, Your Honor withdrew the reference of this adversary proceeding. In the same order, you referred all motions to dismiss to me for report and recommendation. I held hearings on the motions to dismiss on June 12, 2017 and June 27, 2017.

III. Standard of Review.

The Federal Rules of Civil Procedure require that each claim in a complaint include "a short and plain statement . . . showing that the pleader is entitled to relief." FED. R. CIV. P. 8(a)(2). The pleader need not provide "detailed factual allegations." *Bell Atlantic Corp. v.*

Twombly, 550 U.S. 544, 555 (2007). Rather, the claims must include enough factual allegations "to raise a right to relief above the speculative level." *Id.*

For a complaint to survive a motion to dismiss, it "must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Twombly*, 550 U.S. at 570). Under this plausibility standard, "a plaintiff's obligation to provide the grounds of his entitle[ment] to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do[.]" *Twombly*, 550 U.S. at 555 (internal quotation marks and citations omitted). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678 (citing *Twombly*, 550 U.S. at 556).

In assessing whether a complaint complies with Rule 8's plausibility standard, the court accepts "all well-pleaded facts as true and view[s] those facts in the light most favorable to the plaintiff." *Whitley v. Hanna*, 726 F.3d 631, 637 (5th Cir. 2013). In so doing, the court must engage in a "context-specific task that requires [it] to draw on its judicial experience and common sense. But where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged – but it has not show[n] – that the pleader is entitled to relief." *Iqbal*, 556 U.S. at 679 (internal citations and quotation marks omitted) (second alteration in original).

Further, in assessing a motion to dismiss, "courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of

which a court may take judicial notice." *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 251 (5th Cir. 2009).

A fraud claim is subject to a higher standard of pleading. FED. R. CIV. P. 9(b). Under this heightened standard, "the who, what, when, and where must be laid out *before* access to the discovery process is granted." *Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 178 (5th Cir. 1997) (emphasis in original).

IV. Analysis and Recommendations.

A. The Motions To Dismiss Count 1 Should Be Granted in Part and Denied in Part. The Trustee Should Be Granted Leave To Amend Count 1.

1. Rule 9(b) Does Not Apply to Count 1.

Several defendants move under Rule 9(b) to dismiss count 1, wherein the trustee seeks to avoid transfers made with the actual intent to hinder, delay, and defraud creditors. In count 1, the trustee employs section 544(b)(1) of the Bankruptcy Code to access section 24.005(a)(1) of the Texas Uniform Fraudulent Transfer Act ("TUFTA") to claw back fees and commissions paid to licensees. *See* TEX. BUS. & COM. CODE § 24.005(a)(1). The defendants contend that because the trustee's claims are premised on a fraudulent scheme, he must comply with the "who, what, and where" requirements mandated by Rule 9(b). I submit that Rule 9(b) does not apply to count 1.

In his complaint, the trustee does not allege that the defendants themselves acted with the intent to hinder, delay, or defraud creditors. Instead, he alleges that Brian Pardo and other insiders at LPI knew that investors were being misled about LPI's products, but they continued to sell them anyway. Specifically, the trustee alleges that by 2008, LPI had three years of empirical results by which to check the accuracy of Cassidy's LE projections. A comparison of actual-to-expected maturities revealed that Cassidy was far off the mark. Indeed, any such comparison demonstrated

that he had no expertise whatsoever in predicting life expectancies. Despite knowing this, LPI continued selling life settlements and viaticals based at least in part on Cassidy's predictions.

The trustee's theory is that every transaction after 2008 was fraudulent and, as such, gave rise to a debt owed by the company for damages suffered by any investor. The trustee contends that by paying well-above-market commissions from these transactions to the licensees, LPI intended to defraud its investors. So, while the cause of action is premised on the fraudulent scheme of Pardo and others, it is not premised on any actual fraud by the defendants here.

In *Moran v. Pardo (In re Life Partners Holdings, Inc.)*, No. 4:15-CV-905, Dkt. 192, at 17-18 (N.D. Tex. Dec. 20, 2016) (O'Connor, J.), the court was confronted with a motion to dismiss similar claims that were then asserted by Moran against Deborah and Kurt Karr. There, the court, citing *Janvey v. Alguire*, 846 F. Supp. 2d 662, 676 (N.D. Tex. 2011), held that Rule 9(b) does not apply to such claims. In *Janvey v. Alguire*, the court held that because the defendant's conduct is not even an element of such a claim, Rule 9(b) simply does not apply. 846 F. Supp. 2d at 676 (citations omitted). Because I agree with the analysis in *Janvey v. Alguire*, I recommend that you deny the motions to dismiss count 1 for failure to comply with Rule 9(b).

2. The Court Should Not Dismiss Count 1 on the Basis of Limitations.

Claims to avoid fraudulent transfers under section 24.005(a)(1) must be brought within four years after the transfer was made or, if later, within one year after the transfer was or could reasonably have been discovered. TEX. BUS. & COM. CODE § 24.010(a)(1). In count 1, the trustee seeks to avoid transfers that were made by the LPI entities from 2008 to 2015.

Numerous defendants move to dismiss all claims relating to transfers that took place before January 21, 2011, the date that is four years before LPHI filed bankruptcy, or May 19, 2011, the date that is four years before LPI and LPFS filed bankruptcy. The trustee asserts that section

24.010(a)(1)'s explicit provision for extension applies in this case. The trustee does not identify a particular accrual date, but he suggests that it is well after the debtors filed their petition in bankruptcy.

The defendants argue to the contrary. They argue that not only were the injuries allegedly suffered by investors discoverable, but they were, in fact, discovered as early as March 14, 2011, when a class action lawsuit alleging fraud was filed against LPI. (Alpha & Omega Br. ¶ 64.) The defendants point to other public events, including a lawsuit against LPI filed by the Securities and Exchange Commission on January 3, 2012 (along with the issuance of a final judgment finding LPI and its executives guilty of fraud entered on December 2, 2014), and the imposition of a new servicing fee on retail investors on October 14, 2014, all of which undercut the trustee's position regarding discoverability. Any of these events, the defendants allege, "could be or should be the beginning of the discovery period" if the discovery rule applies in this case. (*Id.*) Indeed, the trustee himself refers to a December 21, 2010 Wall Street Journal article "questioning the Company's LE estimates and business practices." (2nd Am. Compl. ¶ 147.) The same article "revealed that Life Partners 'has made large fees from its life insurance transactions while often significantly underestimating the life expectancies of people whose policies its customers invest in.'" (*Id.*)

"When a plaintiff discovered or could reasonably have discovered a transfer is generally a question of fact for the fact-finder." *Janvey v. Romero*, 817 F.3d 184, 189 (5th Cir. 2016) (citations omitted). But, "if reasonable minds could not differ about the conclusion to be drawn from the facts in the record, then the start of the limitations period may be determined as a matter of law." *Janvey v. Democratic Senatorial Campaign Comm., Inc. ("DSCC")*, 712 F.3d 185, 188-89 (5th Cir. 2013) (quoting *Cadle Co. v. Wilson*, 136 S.W.3d 345, 352 (Tex. App.—Dallas 2007)). "With

respect to TUFTA's one-year repose period . . . 'a fraudulent-conveyance claim does not accrue until the claimant knew or reasonably could have known *both* of the transfer *and* that it was fraudulent in nature.'" *Janvey v. Romero*, 817 F.3d at 188 (citations omitted) (emphasis in the original). "Whether the plaintiff exercised reasonable diligence to discover a fraudulent transfer is relevant to determining whether a plaintiff could reasonably have discovered a fraudulent transfer." *Id.* (citations omitted).

In this case, the defendants do not address whose knowledge and diligence specifically is determinative when it comes to asserting the claims in count 1. Consequently, I address these issues as they relate to Moran (who originated count 1), the debtors (who Moran represented when he filed count 1), and the investors (in whose shoes he stood in asserting claims under section 544(b)).

There are two distinct aspects of knowledge for accrual of claims under TUFTA: (1) knowledge of the transfer itself; and (2) knowledge of the fraudulent nature of the transfer. *Janvey v. Romero*, 817 F.3d at 188. Accrual does not commence until both elements have been satisfied. *Id.*

No one disputes that the trustee can assert claims to avoid transfers that occurred after December 29, 2011, the date that is four years before Moran filed count 1. No extension under section 24.010(a)(1) is necessary to reach such transfers. The question presented is whether count 1 can extend all the way back to transfers made in 2008.

If it is Moran's knowledge and diligence that count, then logic and the favorable inferences granted by case law to the plaintiff in the context of a motion to dismiss lead to the inescapable conclusion that Moran could not have known of the transfers or their fraudulent nature until he was appointed chapter 11 trustee of LPHI on March 19, 2015. According to *Smith v. American*

Founders Financial Corp., 365 B.R. 647, 677-79 (S.D. Tex. 2007), section 546(a) of the Bankruptcy Code gives the trustee two years to assert on behalf of the estate whatever claims are viable as of the date of filing. This analysis would have given Moran until January 20, 2017 to file claims on behalf of LPHI, and until May 19, 2017 to file claims on behalf of LPI and LPFS. Because Moran filed count 1 on December 29, 2015, all claims in count 1 are timely as to him.

If it is the knowledge of the debtors that is determinative, then the latest accrual date would arguably be December 29, 2011 because the debtors had knowledge of the fraudulent scheme at all relevant times. The trustee relies upon *Janvey v. DSSC* to reach earlier transfers. There, the court held that where the transferring entity is the "robotic tool" of its principal's Ponzi scheme, knowledge of the fraud should not be imputed to the entity itself because it is under the principal's coercion. 712 F.3d at 193. In *Moran v. Pardo,* the court relied upon *Janvey v. DSSC* to deny the defendants' motion to dismiss the trustee's claims against Pardo under TUFTA. No. 4:15-CV-905, at 11. Accepting as true the allegation that Pardo and others had control of the company and attempted to conceal the same fraudulent scheme at issue here, the court refused to impute the knowledge of the scheme to the company itself at the pleading stage, and therefore denied the motion to dismiss the claim on the basis of limitations. *Id.*

If Your Honor agrees with *Moran v. Pardo*, you should deny the motion to dismiss count 1 on the basis of limitations. Because such a ruling would effectively extend the time to bring such claims until at least January 20, 2017 (using LPHI's filing date and *Smith's* analysis of section 546(a)), there would be no basis to dismiss count 1 at this time.

If Your Honor believes that it is the knowledge and diligence of the investors that is at issue, then the investor lawsuits, the SEC action, and The Wall Street Journal article complicate the analysis. There is sound authority for the position that it is the knowledge of the investors

themselves that is the operative knowledge in a case such as this. First, section 544(b) only permits the trustee to step into the shoes of a creditor who could assert a claim under section 24.005(a)(1). As such, "'[l]ike Prometheus bound, the trustee is chained to the rights of creditors in the case under title 11.'" *Smith v. Am. Founders Fin. Corp.*, 365 B.R. at 658-59 (quoting *In re Radcliffe's Warehouse Sales, Inc.*, 31 B.R. 827, 832 (Bankr. W.D. Wash. 1983)). So, "[t]he trustee is also subject to defenses that could be asserted against the unsecured creditor." *Id.* at 659.

If it is the knowledge of investors that is the key element in the application of the discovery rule, then it is logical to argue that the investor lawsuits, the SEC action, and The Wall Street Journal article affect – if not *effect* – accrual of investor claims. The question is whether the fact of discovery by some must – as a matter of law – be conclusive as to discoverability as to all. I do not think so.

First, in count 1, the injuries allegedly suffered by the investors are excessive commissions that LPI paid to the licensees. Common sense dictates that even if the commissions (that is, the transfers) were disclosed to the investors, the licensees probably did not disclose how those commissions compared to others in the industry (that is, the fraudulent nature of the transfers). Moreover, the trustee alleges that Life Partners and the licensees affirmatively concealed such information. (2nd Am. Compl. ¶¶ 140, 157.)

Second, the fact that some investors learned of excessive commissions is consistent with Texas law that for the discovery rule to apply, the injury "need not be absolutely impossible to discover." *S.V. v. R.V.*, 933 S.W.2d 1, 7 (Tex. 1996).

Third, when a plaintiff could reasonably have discovered a transfer is generally a question for the fact-finder. *Janvey v. Romero*, 817 F.3d at 189. Embodied in this inquiry is the question of whether a particular plaintiff exercised reasonable diligence to discover the fraudulent

conveyance. *Id.* Only if reasonable minds could not differ on these issues should the court take the issue out of the fact-finder's hands.

I cannot conclude as a matter of law that every investor who purchased fractional interests from LPI knew or should have known of the excessive nature of the commissions before December 29, 2014, which is one year prior to the date that Moran filed count 1. Accordingly, I recommend you deny the motions to dismiss count 1 on the basis of limitations.

3. The Court Should Grant the Motions To Dismiss Count 1 for Failure To Comply with Rule 8(a), But the Trustee Should Be Granted Leave To Amend.

In count 1, the trustee does not allege which of the debtors made allegedly fraudulent transfers to which defendants. In a proceeding to avoid transfers by multiple debtors, especially when the debtors' bankruptcy cases were not substantively consolidated, identifying the transferee's transferor should be a minimum requirement.

I recommend that you grant the motions to dismiss for failure to comply with Rule 8(a), but that you grant the trustee leave to amend count 1 to specify transfers subject to avoidance by identifying (1) the transferring entity, (2) the respective transferee, and (3) those amounts paid by the transferring entity to the particular transferee. If the trustee fails to amend count 1 in compliance with your directions, I recommend that count 1 be dismissed with prejudice.

B. The Motions To Dismiss Count 2 Should Be Granted in Part and Denied in Part. The Trustee Should Be Granted Leave To Amend Count 2.

1. Count 2 Adequately Alleges the Insolvency of the Debtors.

Several defendants move to dismiss count 2 because it fails to allege the insolvency of the debtors, an essential element of proof under section 24.005(a)(2) of TUFTA. As support for this argument, the defendants cite *American Cancer Soc. v. Cook*, 675 F.3d 524, 527-28 (5th Cir. 2012). In *Cook*, the district court held that the plaintiff had met her burden proving actual intent

to defraud by providing an affidavit that described the debtor's operations as a "Ponzi-like" scheme. In so ruling, the district court relied upon *Warfield v. Byron*, where the Fifth Circuit had held that transfers from a Ponzi scheme are presumptively fraudulent because as a matter of law Ponzi schemes are insolvent from inception. 436 F.3d, 551, 558 (5th Cir. 2006). In *Cook*, the Fifth Circuit held that the district court erred by applying the *Warfield's* presumption of fraudulent intent because not all securities frauds are Ponzi schemes. 675 F.3d at 526, 528.

Cook does not compel dismissal of count 2. First, *Cook* involved the trial court's error in applying the presumption of fraudulent intent as a matter of proof instead of as a matter of pleading. Second, and more importantly, the trustee does not rely on the allegation that Life Partners was a Ponzi scheme in order to support his claim of insolvency. Instead, the trustee alleges that by selling fractional interests based upon misleading LEs, and then paying exorbitant commissions, Life Partners immediately created liabilities that it had no ability to repay. According to the trustee, this led to a condition of perpetual insolvency.

A finder of fact may agree or disagree with the trustee's theory. But, the fact that the defendants disagree with it does not constitute grounds to dismiss count 2.

2. The Trustee's Overly-Broad Allegations (1) Include Claims that Are Barred by Limitations and (2) Fail To Identify Which Debtor Transferred Money to the Defendants.

Several defendants argue that the trustee's claims to recover fraudulent transfers under section 544 lack sufficient specificity to comply with Rule 8 and, as such, lack plausibility. This argument has merit.

In count 2, the trustee relies upon section 544 of the Bankruptcy Code to incorporate section 24.005(a)(2) of TUFTA. Claims under this section are extinguished as to any transfers made more than four years prior to the petition date. TEX. BUS. & COM. CODE § 24.010(a). *See also Nathan*

v. Whittington, 408 S.W.3d 870, 874 (Tex. 2013) (holding that TUFTA is a statute of repose, not a statute of limitations). In *Smith v. American Founders Financial Corp.*, the court held that section 546 of the Bankruptcy Code preempts TUFTA so that a trustee has two years to bring any claim that was viable as of the filing of the bankruptcy petition. 365 B.R. at 679. But, the time to bring claims under section 24.005(a)(2) of TUFTA is not extended by the discovery rule.

In count 2, the trustee seeks to avoid transfers to licensees from 2011 to 2015. In order for a defendant to determine if he is the target of avoidance under count 2, he must refer to Exhibit 4 to the complaint, a chart that reflects payments to licensees by year and amount from 2008 to 2015.

In count 2, the trustee does not allege which of the debtors made allegedly fraudulent transfers to which defendants. The failure to specify the transferor is important here because LPI and LPFS have different filing dates and, hence, different look-back periods from LPHI. Claims to avoid transfers made by LPHI are extinguished as to transfers that occurred before January 20, 2011. Claims to avoid transfers made by LPI and LPFS are extinguished as to transfers made before May 19, 2011.

I recommend that Your Honor (1) dismiss all claims under count 2 that are related to transfers by LPHI that were made before January 20, 2011; and (2) dismiss all claims under count 2 related to transfers by LPI and LPFS before May 19, 2011. The dismissal of the foregoing claims should be with prejudice.

I further recommend that you grant the motions to dismiss count 2 for failure to comply with Rule 8(a), but that you grant the trustee leave to amend count 2 to specify transfers subject to avoidance by identifying (1) the transferring entity, (2) the respective transferee, and (3) only those amounts paid by the transferring entity to the particular transferee within the limitations period

identified herein. If the trustee fails to amend count 2 in compliance with your directions, I recommend that count 2 be dismissed with prejudice.

C. The Motions To Dismiss Counts 3 and 4 Should Be Granted in Part and Denied in Part. The Trustee Should Be Granted Leave To Amend Counts 3 and 4.

1. Rule 9(b) Does Not Apply to Counts 3 and 4.

Several defendants move to dismiss counts 3 and 4 for failure to comply with Rule 9(b). For the same reasons that I outline above, I recommend that you deny the motions to dismiss counts 3 and 4 for failure to comply with Rule 9(b).

2. The Court Should Deny the Motions To Dismiss Counts 3 and 4 for Lack of Standing.

Several defendants contend that if the commission payments were made by someone other than the debtors or were withheld from investor funds which remained in an investor-owned escrow account, the trustee would not have standing to avoid claims under section 548 of the Bankruptcy Code. (*See* Dewitt & Dunn Br. ¶ 3, n.4; Curtis Cole Br. 2, n.3).

The trustee has alleged that the property that was transferred belonged to the debtors. As such, even if the money was transferred by an escrow agent, it is logical to infer that the escrow agent was a mere conduit for the debtors. *See, e.g.*, *Southmark Corp. v. Schulte, Roth & Zabel, L.L.P.*, 242 B.R. 330, 338 (N.D. Tex. 1999). Because reasonable inferences are drawn in the plaintiff's favor at this stage, the motions to dismiss for lack of standing should be denied.

3. The Trustee's Overly-Broad Allegations (1) Include Claims that Are Barred by Limitations, and (2) Fail To Identify Which Debtor Transferred Money to the Defendants.

In counts 3 and 4, the trustee relies upon section 548 of the Bankruptcy Code to recover actual and constructively fraudulent transfers. Several defendants allege that the trustee's claims

in counts 3 and 4 lack sufficient specificity to comply with Rule 8 and, as such, lack plausibility. This argument has merit.

Fraudulent transfer claims under section 548 are barred as to transfers made two years before the petition date. 11 U.S.C. § 548(a)(1). In counts 3 and 4, the trustee appears to limit his claims to payments made in the two years before the debtors' bankruptcies.

Still, there is a problem with counts 3 and 4. The trustee does not allege which of the debtors made allegedly fraudulent transfers to which defendants. The failure to specify the transferor is important because LPI and LPFS have different filing dates and, hence, different look-back periods from LPHI. Claims under section 548 are barred for transfers made by LPI before January 20, 2013. When it comes to LPI and LPFS, claims under section 548 are barred as to transfers that were made before May 19, 2013.

I recommend that Your Honor (1) dismiss all claims under counts 3 and 4 related to transfers by LPHI that occurred before January 20, 2013; and (2) dismiss all claims under counts 3 and 4 related to transfers made by LPI and LPFS before May 19, 2013. The dismissal of the foregoing claims should be with prejudice.

I further recommend that you dismiss counts 3 and 4 for failure to comply with Rule 8(a), but that you grant the trustee leave to amend counts 3 and 4 to specify the transfers subject to avoidance by identifying (1) the transferring entity, (2) the respective transferee, and (3) only those amounts paid by a transferring entity to the particular transferee within the limitations periods identified herein. If the trustee fails to amend counts 3 and 4 as directed by Your Honor, I recommend that they be dismissed with prejudice.

D. The Court Should Grant the Motions to Dismiss Count 5, But the Trustee Should Be Granted Leave To Amend.

Several defendants move to dismiss count 5 because it lacks specificity and, so, plausibility. I agree.

In count 5, the trustee alleges that "certain licensees" received preferences. In order for a defendant to determine whether he is alleged to have received a preference, he must refer to Exhibit 4 appended to the complaint. Exhibit 4 is a chart that summarizes payments to defendants from 2008 to 2015. One column sets forth dollar amounts received by certain defendants from "10/14." According to the trustee, these payments are preferences.

There are several problems with count 5. First, count 5 does not disclose which debtor allegedly transferred money to the defendants. Where a single adversary proceeding involves preferential transfers by several non-consolidated debtors, it is incumbent upon the plaintiff to at least identify which debtor transferred money to the recipient of the alleged preference.

Moreover, the failure to identify a particular transferor is important here because LPI and LPFS did not file bankruptcy on the same date as LPHI. So, the preference period for LPI and LPFS is not the same as that for LPHI.

Because LPHI filed its petition on January 20, 2015, the trustee cannot reach transfers made by LPHI before October 22, 2014.[1] It is therefore not sufficient to plead that a particular defendant received a payment "from" October 2014 because payments made before October 22, 2014 – by definition – are not preferences.

[1] The trustee has not alleged that the licensees were insiders. So, the one-year period that applies to insider preferences does not apply in this case.

LPI and LPFS filed their petitions on May 19, 2015. As such, only payments made after February 18, 2015 are preferences. So, any transfers after "October 2014" but before February 18, 2015 are not preferences in those cases.

The Court should grant the defendants' motions to dismiss count 5: (1) as to any transfers made by LPHI prior to October 22, 2014; and (2) as to any payments made by LPI and LPFS prior to February 18, 2015. The dismissal of these claims should be with prejudice. Additionally, the Court should grant the motions to dismiss count 5 for failure to comply with Rule 8(a), but the Court should grant the trustee leave to amend count 5 to identify – at a minimum – the dollar amounts paid to a particular transferee by a particular debtor during the respective preference period. If the trustee fails to amend count 5 in accordance with the Court's directions, count 5 should be dismissed with prejudice.

E. The Motions To Dismiss Count 6 Should Be Denied.

Some defendants contend that the trustee does not have standing to seek recovery of avoided transfers under 11 U.S.C. § 550 to the extent that this count purports to rely on the investor-assigned claims (counts 10 to 12). (Alpha & Omega Br. ¶ 26; Am. Safe Retirements ¶ 26.) Because I understand that the trustee's section 550 claim is not based on the investor-assigned claims, I recommend that Your Honor deny the defendants' motions to dismiss count 6 on this ground.

F. The Motions To Dismiss Count 7 Should Be Granted.

Several defendants move to dismiss the trustee's breach of contract claim in count 7. In his omnibus response to the motions to dismiss, the trustee represented that he would voluntarily withdraw his breach of contract claims. (Pls.' Omnibus Resp. to Defs.' Mots. Dismiss 9; Pls.' Br. in Supp. of Omnibus Resp. to Mots. Dismiss 25.) But, the trustee has not filed a motion to dismiss

the breach of contract claims. Therefore, I recommend that Your Honor grant the defendants' motions to dismiss count 7.

G. The Motions To Dismiss Count 8 Should Be Denied.

In count 8, the trustee seeks to equitably subordinate the defendants' claims to the claims of all other stakeholders pursuant to section 510(c) of the Bankruptcy Code. He alleges that the licensees engaged in inequitable conduct by furthering the perpetuation of a wide-ranging fraud.

1. The Trustee Has Standing To Pursue Equitable Subordination Claims.

Some defendants allege that the trustee does not have standing to bring the equitable subordination claim to the extent that this count purports to rely on the investor-assigned claims. (Alpha & Omega Br. ¶ 26; Am. Safe Retirements ¶ 26.) Because I understand that the trustee's equitable subordination claim is not based on the investor-assigned claims, I recommend that Your Honor deny the defendants' motions to dismiss count 8 on this ground. Moreover, it is well established that the trustee does have standing to bring the estate's claims under section 510(c). *In re Bernard L. Madoff Investment Securities LLC*, 515 B.R. 117, 159 (Bankr. S.D.N.Y. 2014); *In re Lockwood*, 14 B.R. 374, 381 (Bankr. E.D.N.Y. 1981).

2. The Trustee's Equitable Subordination Claims Are Not Governed by Rule 9(b).

Numerous defendants contend that the equitable subordination claims, grounded in fraud, do not meet Rule 9(b)'s heightened pleading standard. Consistent with my recommendations as to counts 1 and 3, I submit that this ground for dismissal should be rejected as to count 8 as well. Equitable subordination claims, by their nature, do not require the establishment of fraud by the defendant. *In re Derivium Capital, LLC*, 380 B.R. 407, 426 (Bankr. D.S.C. 2006) ("The pleading of fraud or wrongful conduct is not necessary for a claim of equitable subordination."). So long as the trustee sufficiently pleads that the defendants engaged in inequitable conduct in order to

gain "an unfair advantage over other creditors," the equitable subordination claims should survive the motions to dismiss. *Id.* The trustee has sufficiently pleaded that the defendants engaged in inequitable conduct that gave them an unfair advantage over other creditors.

3. Count 8 Should Not Be Dismissed on the Basis of *In Pari Delicto*.

Certain defendants contend that the trustee's equitable subordination claims are barred by the defense of *in pari delicto*. *In pari delicto* acts as a bar to recovery where the plaintiff has contributed to the alleged wrongdoing. It is generally inappropriate to take up *in pari delicto* at the motion-to-dismiss stage. *Reneker v. Offill*, No. 3:08-CV-1394-D, 2010 WL 1541350, at *7-8 (N.D. Tex. Apr. 19, 2010). The defense applies where: (1) the plaintiff, as a result of his own actions, "bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the . . . laws and protection of the . . . public." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-11 (1985). While a persuasive argument can be made that the debtors, while under Pardo's management, contributed to the violations the trustee seeks to redress, the trustee is entitled to the favorable inference at this stage that preclusion of the suit would significantly interfere with the protection of the public. *See Floyd v. CIBC World Markets, Inc.*, 426 B.R. 622, 642-43 (S.D. Tex. 2009) (holding that at the pleadings stage, the court cannot determine whether public policy demands relief). For this reason, I recommend that the defendants' motions to dismiss count 8 be denied.

H. The Motions To Dismiss Count 9 Should Be Denied.

Some defendants contend that the trustee does not have standing to seek disallowance of claims under 11 U.S.C. § 502(d) to the extent that this count purports to rely on the investor-assigned claims. (Alpha & Omega Br. ¶ 26; Am. Safe Retirements ¶ 26.) Because I understand

that the trustee's section 502(d) claim is not based on the investor-assigned claims, I recommend that Your Honor deny the defendants' motions to dismiss count 9 on this ground.

I. The Motions To Dismiss Count 10 for Failure To State a Claim Under Rule 8(a) Should Be Granted. The Court Should Grant the Trustee Leave To Amend Count 10 To Comply with Rule 8(a). The Motions To Dismiss Count 10 on Other Grounds Should Be Denied.

1. Count 10 Fails To State a Claim for Negligent Misrepresentation.

Several defendants argue that the trustee's claim for negligent misrepresentation fails to comply with Rule 8(a).

Under Texas law, negligent misrepresentation is established by showing: (1) the defendant made a representation in the course of his business, or in a transaction in which he has a pecuniary interest; (2) the defendant supplied "false information" for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffered pecuniary loss by justifiably relying on the representation. *General Elec. Capital Corp. v. Posey*, 415 F.3d 391, 395-96 (5th Cir. 2005) (citing *Clardy Mfg. Co. v. Marine Midland Bus. Loans, Inc.*, 88 F.3d 347, 357 (5th Cir. 1996)).

Some of the defendants argue that count 10 is deficient in at least two ways. First, they say that the trustee only attributes one misleading act to the defendants themselves, that being the failure to disclose to the investors the extent of the defendants' commissions. (Curtis Cole Br. 20.) Even so, they argue that the trustee concedes that the commissions were disclosed in the closing materials executed by the investors. (*Id.*)

The defendants paint with too broad a brush, but their point is well-taken. In fact, the trustee alleges that the commissions were "hidden" in the closing materials. (2nd Am. Compl. ¶ 119.) According to the trustee, the commissions were "buried" in the difference between what LPI paid for the life settlements and what it charged the investors. (*Id.*) According to the trustee, the failure

to disclose substantial hidden commissions was unreasonable and improper. (*Id.* at ¶ 122.) The weakness in the trustee's position is that while failing to disclose the exact amount of a licensee's commission or even to disclose how those commissions compare to industry standards may in retrospect seem unfair, it does not amount to "supplying false information for the guidance of others in their business." *Posey*, 415 F.3d at 395-96.

Still, in count 10 the trustee alleges more than just failure of the licensees to disclose the extent of their commissions. He alleges that the defendants negligently passed along many false and misleading representations by way of the offering materials prepared by LPI, its officers and insiders. The defendants argue that their conduct is not actionable because the defendants themselves did not prepare the materials. The trustee argues that as parties with a pecuniary interest in the transactions, the licensees had the duty to exercise reasonable care and competence with respect to the information that they passed along to the investors.

As with any other tort, a negligent misrepresentation claim is premised on the existence of /a duty, which in this case is implied in *Posey's* third element. Here, that duty can be defined as the duty to exercise reasonable care or competence in obtaining and communicating the information that prompted the investors to purchase life settlements. In *Gallier v. Woodbury Financial Services*, the court observed that "case law recognizes the common-sense intuition that those not skilled in finance rely heavily on experts to inform their decisions." 171 F. Supp. 3d 552, 566 (S.D. Tex. 2014); *see also Cook Consultants, Inc. v. Larson*, 700 S.W.2d 231, 234 (Tex. App.—Dallas 1985, writ ref'd n.r.e.). The trustee relies upon *Gallier* as authority for his position that all licensees owed investors the duty to investigate LPI's representations in connection with the sale of fractional interests. But, the trustee's interpretation of *Gallier* is too broad. *Gallier* did

not recognize such a duty by all brokers to all investors. Instead, it was premised upon the notion that *experts* have such a duty to *those not skilled in finance*. *Id.*

This is consistent with *Cook Consultants v. Larson*, which held that business people who rely on the advice and expertise of those who hold themselves out as possessing unique skills are entitled to expect that such persons will exercise those skills with due care. 700 S.W.2d at 234. To the extent that *Gallier* is instructive, much less controlling, the trustee does not adequately plead its application here. To the extent that the trustee suggests that all licensees were experts and that all investors were not skilled in finance, any such allegations are conclusory and draw no favorable inferences in the context of a Rule 12(b)(6) motion.

Moreover, to the extent that the trustee relies upon the relationship of broker and investor alone to create the duty to investigate and disclose, Texas law is to the contrary. In *Insurance Company of North America v. Morris*, the court held: "Generally, no duty of disclosure arises without evidence of a confidential relationship." 981 S.W.2d 667, 674 (Tex. 1998). Moreover, "confidential relationships . . . arise when the parties have dealt with each other in such a manner for a long period of time that one party is justified in expecting the other to act in its best interest." *Id.*

In his complaint, the trustee generally alleges a relationship of trust and confidence. (2nd Am. Compl. ¶ 117.) And, he alleges that each licensee was a financial or investment advisor. (*Id.*) But both of these allegations are conclusory and, by themselves, are entitled to no weight. The trustee alleges no specific facts that give them weight. And in failing to do so, he fails to allege the existence of a relationship that would give rise to the duty to investigate and disclose.

It is quite possible that many licensees held themselves out as experts in the field of life settlements. It is also quite possible that many – if not most – investors were not skilled in finance

and investing. And, it is quite possible that many licensees developed confidential relationships with their respective investors. But, it is also possible that none of these conditions applied in a particular transaction. For example, it is possible that an investor purchased his interest from his brother-in-law and that neither was skilled in finance or had any expertise in fractional interests. But, before the defendants are put to the trouble and expense of defending allegations of negligent misrepresentation, the trustee should meet his minimal pleading requirement by pointing to facts that would give rise to the very duty upon which his claim is premised.

Given the number of investors and licensees in this case, the pleading burden required by Texas law may be impossible for the trustee to meet. But the fact that it is difficult does not excuse the trustee from meeting Rule 8(a)'s pleading requirement. *See Ackerman v. Northwestern Mut. Life Ins. Co.*, 172 F.3d 467, 470 (7th Cir. 1999) ("You cannot get around the requirements of the rule just by joining a lot of cases into one.")

I recommend that you dismiss count 10 with respect to all defendants who have urged its dismissal on this ground. But, I recommend that you grant the trustee leave to amend count 10 to allege sufficient facts that would support the existence of a confidential relationship. To the extent that he is unable to do so, I recommend that count 10 be dismissed with prejudice.

2. The Court Should Deny the Motions To Dismiss Count 10 on the Basis of Lack of Bankruptcy Jurisdiction.

Several defendants argue that count 10 must be dismissed because the court lacks subject matter jurisdiction over the assigned claims. They allege that the assigned claims are neither core, nor "related to" the debtors' bankruptcy cases.

Because the claims alleged in count 10 are claims that, prior to their assignment, involved only non-debtor third parties, the first question is whether bankruptcy jurisdiction ever existed as to such claims. Clearly, the claims of investors against licensees are not core claims. At best, the

only basis for bankruptcy jurisdiction is that such claims were "related to" the bankruptcy cases. 11 U.S.C. § 1334(b). A proceeding is "related to" a case if "the outcome of that proceeding could *conceivably* have any effect on the estate being administered in bankruptcy." *Wood v. Wood (In re Wood)*, 825 F.2d 90, 93 (5th Cir. 1987) (emphasis in original) (internal quotation marks and citations omitted). Some nexus is required "between the related civil proceeding and the Title 11 case" for the bankruptcy jurisdiction to exist. *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 752 (5th Cir. 1995). An action is considered to be "related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Walker v. Cadle Co. (In re Walker)*, 51 F.3d 562, 569 (5th Cir. 1995) (internal quotation marks and citations omitted).

As an initial matter, a proceeding does not have to involve the debtor as a party in order to invoke "related to" jurisdiction. *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, MDL No. 1446, 2005 WL 6220721, at *3 (S.D. Tex. July 25, 2005). Instead, there need only be some nexus between the civil proceeding and the bankruptcy case. *Id.* at *6.

The investors' pre-petition claims against licensees could have had a conceivable impact upon the debtors and the administration of their estates. According to the trustee, the defendants negligently passed along false and misleading information that was promulgated by the debtors. Many of those who invested through the defendants filed proofs of claim alleging the same wrongful conduct by the debtors. Under the Texas Civil Practice and Remedies Code, a liable defendant is only liable for the percentage of damages equal to that defendant's percentage of responsibility. TEX. CIV. PRAC. & REM. CODE § 33.013(a). In any suit by an investor against a licensee, the licensee could have sought to determine the percentage of responsibility as between

himself and the LPI entities. *Id.* §§ 33.003, 33.004. If it was determined that the licensee and an LPI entity were jointly and severally liable, and the licensee paid a percentage of damages greater than his percentage of liability, he would be entitled to contribution from any LPI entity that was jointly and severally liable with him. *Id.* § 33.015. Because contribution claims are explicitly addressed by the Bankruptcy Code, there can be no doubt any such licensee claims for contribution would not only be "related to" the debtors' bankruptcy cases, but in fact would be core. *See* 11 U.S.C. § 502(e); 28 U.S.C. § 157(b)(2)(B). Accordingly, I believe that investors' claims against licensees were related to the debtors' bankruptcy cases.

Still, as a general rule, "[a]fter a debtor's reorganization plan has been confirmed, the debtor's estate, and thus bankruptcy jurisdiction, ceases to exist, other than for matters pertaining to the implementation or execution of the plan." *Craig's Stores of Tex., Inc. v. Bank of La. (In re Craig's Stores of Texas, Inc.)*, 266 F.3d 388, 390-91 (5th Cir. 2001). In determining whether "related to" jurisdiction over a proceeding exists post confirmation, courts have considered various factors including: (1) when the claims arose; (2) whether there are any provisions in the confirmed plan for the retention of jurisdiction over such claims; (3) the extent to which the plan has been consummated; (4) the nature of the parties involved; (5) whether state or bankruptcy law applies; and (6) indices of forum shopping. *See In re Encompass Servs. Corp.*, 337 B.R. 864, 873 (Bankr. S.D. Tex. 2006). The balance of these factors weighs in favor of retaining subject matter jurisdiction over the assigned claims.

First, although the investor-assigned claims were not asserted until after confirmation, they are based on the defendants' conduct that occurred pre-petition. The breaches and misrepresentations complained of arise out of acts that contributed to the filing of the petitions in the first place.

Second, the confirmed plan contains a "Retention of Jurisdiction" provision. Retention of jurisdiction provisions do not by themselves confer bankruptcy jurisdiction that does not exist already by virtue of statutory authority. *U.S. Brass Corp. v. Travelers Ins. Group, Inc. (In re U.S. Brass)*, 301 F.3d 296, 303 (5th Cir. 2002) ("[T]he source of the bankruptcy court's jurisdiction is neither the Bankruptcy Code nor the express terms of the Plan. The source of the bankruptcy court's jurisdiction is 28 U.S.C. §§ 1334 and 157. . . .") (internal quotation marks and citations omitted). However, if jurisdiction exists, effect to retention of jurisdiction provisions is generally given. *Binder v. Price Waterhouse & Co., LLP (In re Resorts Int'l, Inc.)*, 372 F.3d 154, 161 (3d Cir. 2004). Indeed, "the existence of such provisions, coupled with the fact that such provisions were critical parts of the [p]lan negotiation process, is telling of the parties' intent to keep those matters within the purview of the bankruptcy court." *In re Am. Housing Foundation*, No. 09-20232-RLJ, 2015 WL 5781396, at *14 (Bankr. N.D. Tex. Sept. 30, 2015). When a retention of jurisdiction provision contains broad enough language to encompass the claims in question, jurisdiction over those claims is proper. The Retention of Jurisdiction provision in the joint plan here is broad enough to cover the negligent misrepresentation claims. The defendants' allegation that there is no mention in the plan of the assigned claims is simply incorrect. For example, section 4.05 of the plan expressly provides that the investor causes of action would be assigned to the estate.

Third, bankruptcy jurisdiction exists so long as the plan has not been fully consummated. *In re U.S. Brass Corp.*, 301 F.3d at 305. Here the plan has been substantially consummated, but not fully consummated. As in *U.S. Brass Corp.*, full consummation has not occurred because the trustee has the obligation to pursue chapter 5 claims and the assigned claims. *Id.*

Fourth, the relationship between the parties is the same as it was at the inception of the bankruptcy cases. The investors had claims against the defendants, for which the defendants might well have had contribution claims against the debtors. The most significant change since case inception is that due to the assignment of the claims to the Trust, many investors' claims now benefit all beneficiaries of the Trust rather than specific injured investors. While jurisdiction cannot be created by crafting an estate impact where one previously did not exist (*see, e.g.*, *In re Zale Corp.*, 62 F.3d at 755), where jurisdiction does exist, a plan that preserves individual rights for the benefit of the entire estate only bolsters the argument for retention of jurisdiction.

Fifth, the negligent misrepresentation claims are state law claims. While this factor might weigh against retaining jurisdiction in some cases, it does not do so here. Even though the trustee must look to state law to support this claim, he does so in order to benefit the thousands of victims of Pardo's scheme who became creditors of the debtors' estates.

Finally, there is no evidence of forum shopping by the trustee.

Giving due weight to each of these factors, I believe that they weigh in favor of the Court retaining jurisdiction over the investor-assigned claims.

3. The Court Should Deny the Motions To Dismiss Count 10 on the Basis of Lack of Standing Due to Improper Assignment.

Several defendants move to dismiss count 10 on the ground that the investor claims were improperly assigned to the Trust and thus, the trustee does not have authority to bring those claims. I recommend that you deny the motions to dismiss on this ground.

Here, *Segner v. Securities America, Inc.*, No. 3-10-CV-1884-F, at 13-14 (N.D. Tex. Aug. 4, 2011) (Furgeson, J.) (Dkt. 131) is instructive and persuasive. In *Segner*, the court deemed the process of voluntary assignment to be the determinative factor that distinguished that case from other cases in which the liquidating trustee attempted to assert claims in which he had no interest.

As in *Segner*, the debtors' joint plan afforded investors a mechanism to assign their claims to the trustee via the plan solicitation process. By electing to leave open a box on the ballot form, the investors voluntarily assigned their claims to the trustee, thereby giving the trustee an interest in those claims.

The defendants point to *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575 (5th Cir. 2008) to support what appears to be a lack-of-standing argument. (Alpha & Omega Br. ¶¶ 15-16; Am. Safe Retirements Br. ¶¶ 15-16.) But, the defendants' reliance on *In re Seven Seas Petroleum* is misplaced. There, the court held only that a trustee does not have a "right to bring claims that belong *solely* to the estate's creditors." 522 F.3d at 584. As the court pointed out in *Segner*, once a creditor assigns a claim to the trustee, the claim no longer belongs "solely" to the creditor. Case No. 3-10-CV-1884-F, at 11. Because I find *Segner* persuasive, I recommend that you deny the motion to dismiss count 10 on the basis that the trustee lacks standing due to the improper assignment of investor claims to the Trust.

4. The Claims in Count 10 Are Not Barred by Limitations.

In Texas, the statute of limitations for negligence is two years. *Hendricks v. Thornton*, 973 S.W.2d 348, 364, n.19 (Tex. App.—Beaumont 1998, pet. denied). The defendants argue that all claims in count 10 relating to transactions that occurred before March 6, 2015 (two years before the trustee filed count 10) are time-barred. (*See, e.g.*, Alpha & Omega Br. ¶ 71; Am. Safe Retirements Br. ¶ 71.) The trustee argues that Texas's common law discovery rule permits him to reach transactions as far back as 2008.

Before turning to the application of the discovery rule as it relates to count 10, it is important to draw two distinctions between the discovery rule as it applies to count 1 and as it applies to count 10. First, the Texas common-law discovery rule is different from that found in

TUFTA section 24.010(a). *Janvey v. Romero*, 817 F.3d at 18, n.4. Second, because in count 10 the trustee asserts claims of individual investors, section 546(a) is not available to extend the time to bring claims that may have been viable as of the date of the bankruptcy petitions. So, the trustee must rely solely upon investors' knowledge and diligence when applying Texas's common law discovery rule to reach transactions dating to 2008.

In Texas, "a cause of action accrues when a wrongful act causes some legal injury, and even if all resulting damages have not yet occurred." *S.V. v. R.V.*, 933 S.W.2d 1, 4 (Tex. 1996). But, the date for accrual can be extended by two exceptions, fraudulent concealment and the discovery rule. *Id.*

As I understand it, the trustee does not rely upon fraudulent concealment to extend accrual. Instead, he relies solely upon the discovery rule. Under Texas common law, the discovery rule "may be stated as the legal principle that a statute of limitations barring prosecution of an action . . . runs, not from the date of the [defendant's] wrongful act or omission, but from the date the nature of the injury was or should have been discovered by the plaintiff." *Weaver v. Witt*, 561 S.W.2d 792, 793-94 (Tex. 1977). In order for the discovery rule to apply, the injuries must be (1) inherently undiscoverable, and (2) objectively verifiable. *S.V.*, 933 S.W.2d at 6.

In this case, the injuries are objectively verifiable for pleading purposes in that (1) excessive commissions, if charged, can be objectively proven, and (2) damages resulting from investors paying mark-ups for policies with no real market value are objectively proveable as well.

The real question presented by the defendant's motion is whether the injuries suffered by the investors were inherently undiscoverable. This is a question to be resolved by the court. *Via Net v. TIG Ins. Co.*, 211 S.W.3d 310, 313 (Tex. 2006). But, if an injury is determined by the court to be inherently undiscoverable, the question of when a party should have discovered his injury is

a question of fact. *Hooks v. Samson Lone Star, LP*, 457 S.W.3d 52, 55 (Tex. 2015). "An 'inherently undiscoverable' injury need not be absolutely impossible to discover." *Gallier*, 171 F. Supp. 3d at 564 (quoting *S.V.*, 933 S.W.2d at 7). Instead, "[the inquiry] focuses categorically on the type of injury alleged rather than on the circumstances of the particular case." *Id.* (quoting *Beavers v. Metro Life Ins. Co.*, 566 F.3d 436, 439 (5th Cir. 2009)).

I believe that the injuries allegedly suffered by investors here were inherently undiscoverable. As the trustee explains in his complaint, life settlements are much more complex than they might appear. For example, an actuarial table assigning a life expectancy of 88 to insureds who are 80 is not meant to suggest that all 80-year-olds will die by age 88. (2nd Am. Compl. ¶ 113.) Instead, statistically only half of 80-year-olds will die by age 88. (*Id.*) An investor holding this inaccurate perception of mortality tables might be doubly misled by a Cassidy LE that assigned an LE of two-to-four years to an 80-year-old insured.

Many investors purchased fractional interests in reliance upon the old notion that the only things that are certain in life are death and taxes. While the old axiom may be true, it gives no hint as to the complexity of predicting mortality. According to the complaint, investors looked to LPI and the licensees to make those evaluations for them. Many times, investors often relied upon friends or relatives who were licensees. But, in doing so, they bet on a product whose risks would only become manifest with the passage of time. I believe that the injuries, by their nature, were inherently undiscoverable.

It is instructive that in *Life Partners Creditors' Trust v. Pardo*, a jury found that the investors, in the exercise of reasonable diligence, should have discovered Pardo's fraud by July 2015. *See Life Partners Creditors' Trust v. Pardo*, Case No. 4:17-CV-00034-0, Jury Charge, Dkt. 359, at 12. The jury's finding is consistent with what I observed in my court. When LPHI filed

its bankruptcy, many investors – even those whose positions had been long for years – thought that "maturity" (that is, the death of the insureds) was right around the corner. Indeed, Pardo and many of the licensees continued to promote this belief throughout the course of the case. However, on June 12, 2015, Moran testified about his preliminary findings after his appointment as trustee. Among other things, he testified that:

(a) LPI would typically buy a policy on an eight-year LE, but sell it on a four-year LE;

(b) Cassidy's LEs were half of those given by independent third parties;

(c) Licensees represented that 90-95% of insureds would die in two-to-four years, when the real LE was eight years;

(d) Over 80% of insureds had lived beyond the Cassidy LEs;

(e) By virtue of these misrepresentations, "money paid by investors was in effect stolen;"

(f) The total cost for LPI to buy the policies was $348 million, but fees and commissions paid to LPI and licensees by investors were $392 million; and

(g) These commissions were "unheard of" in this industry.

(Hr'g Tr., Dkt. 501). Moran gave this testimony to a packed courtroom. Many parties monitored the hearing by telephone. The transcript of the June 12 hearing was posted on the court's public website on June 22, 2015. While the nature of the investors' injuries may have been inherently undiscoverable when they bought their policies, after Moran's testimony, the cat was definitely out of the bag. In my opinion (at least for pleading purposes), given the high visibility of the case and the damning nature of Moran's testimony, investors exercising reasonable diligence should have discovered the nature of their injuries no later than July 1, 2015. Under Texas law, the two-

year statute of limitations for negligence would commence on that date. Because the trustee filed count 10 on March 6, 2017, count 10 is timely for pleading purposes.

5. Count 10 Should Not Be Dismissed for Failure To Comply with Rule 9(b).

Some defendants argue that because the trustee's claims in count 10 rely on proof of a fraudulent scheme by LPI, the trustee must comply with the pleading requirements of Rule 9(b). For the reasons that I recommend that you deny the motions to dismiss count 1 on this basis, I recommend that you deny them as to count 10 as well.

J. The Motions To Dismiss Count 11 Should Be Granted in Part and Denied in Part.

1. The Court Should Deny the Motions To Dismiss on the Basis of Lack of Bankruptcy Jurisdiction.

I addressed several motions to dismiss count 10 on the basis of lack of bankruptcy jurisdiction. For the same reasons that I recommend that you deny the motions to dismiss count 10 on that basis, I recommend that Your Honor deny the motions to dismiss count 11 on that basis as well.

2. The Court Should Deny the Motions To Dismiss on the Basis of Lack of Standing Due to Improper Assignment.

I addressed the motions to dismiss count 10 on the basis of lack of standing due to improper assignment. For the same reasons that I recommend that you deny the motions to dismiss count 10 on that basis, I recommend that Your Honor deny the motions to dismiss count 11 on that basis as well.

3. The Trustee's Overly-Broad Allegations Include Claims That Are Barred by Limitations.

Several of the defendants have moved to dismiss count 11 because it alleges claims that are barred by the statute of limitations. I agree. In count 11, the trustee, standing in the shoes of individual investors who assigned their claims to the Trust, seeks damages or rescission for the

sale of unregistered securities (fractionalized interests) by unlicensed brokers. As authority for this cause of action, the trustee relies upon Article 581-33A(1) of the Texas Securities Act (found at TEX. CIV. STAT. § 33A(1)). Claims under that act must be brought within three years after the sale of the security if no offer of rescission was made. TEX. CIV. STAT. § 33H(1). Even though the trustee contends that the statute of limitations is extended by the discovery rule, he cites no authority for that position.

In order for a licensee to determine whether he is a potential target of a claim under count 11, he must refer to Exhibit 4 appended to the complaint, which lists commissions paid to licensees by year. Because count 11 itself does not purport to limit its reach to transactions occurring within three years before the filing of count 11 (March 6, 2017), it appears that the trustee is asserting investors' claims under the TSA from 2008 to 2015. But, even if the trustee is purporting to limit his claims to those transactions occurring during 2014 and 2015, claims accruing before March 6, 2014 are barred by limitations.

For this reason, I recommend that Your Honor grant the motions to dismiss count 11 with prejudice as to transactions occurring before March 6, 2014.

4. The Court Should Deny the Motions To Dismiss Count 11 on the Basis that the Trustee Cannot Tender Interests in Order to Effect Rescission.

In count 11, the trustee, standing in the shoes of investors, seeks either damages or rescission under the TSA. In order for an investor to rescind the transaction, he must tender the security back to the seller. TEX. CIV. STAT. § 33(D)(1). Several defendants argue that the joint plan creates practical impediments to the trustee's ability to tender such interests. For example, under the plan the investors whose claims the trustee now owns may have assigned their *claims* to the Trust, but they did not necessarily assign their *fractional interests* to the Trust. This raises the logical question of how the trustee can effectively tender an interest he does not own.

The defendants' point is well-taken, but it does not support dismissal of the claims for rescission. It is possible that investors who assigned their claims to the Trust, but retained their positions, would be willing to tender some or all of their positions to the defendants in full or partial satisfaction of their claims. The defendants' motions in this regard do not go to the sufficiency of the pleadings, but to the trustee's ability to perform if successful. That is not a basis to dismiss under Rule 12(b)(6).

K. The Court Should Dismiss Count 12 Because the Trustee Has Failed To Allege Facts Showing the Existence of a Fiduciary Relationship. The Court Should Grant the Trustee Leave To Amend Count 12. The Motions To Dismiss Count 12 on Other Grounds Should Be Denied.

1. The Court Should Grant the Motions To Dismiss Count 12 for Failure To Adequately Plead the Existence of a Fiduciary Relationship.

Many defendants move to dismiss count 12 because they allege that the trustee has failed to plead facts that give rise to a fiduciary relationship. I agree.

The existence of a fiduciary duty is not presumed. *Hellmuth, Obata & Kassabaum, L.P. v. Efficiency Energy, L.L.C.*, No. H-142945, 2015 WL 4126911, at *7 (S.D. Tex. July 8, 2015). While a special relationship of trust and confidence can give rise to a fiduciary duty, such a relationship must exist "prior to, and apart from, the agreement made the basis of the suit." *Floyd v. CIBC World Market, Inc.*, 426 B.R. at 651 (quoting *Associated Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 288 (Tex. 1998)). While it is true that an unlicensed broker may in some instances owe a fiduciary duty to his customers (*see, e.g.*, *S.E.C v. Helms*, No. A-13-CV-01036ML, 2015 WL 5010298, at *16 (W.D. Tex. Aug. 21, 2015)), such a possibility does not vitiate the requirement that the plaintiff allege sufficient facts to support the existence of such a relationship.

Because the issue of fiduciary status is a mixed question of law and fact, it is typically premature to determine that status at the motion-to-dismiss stage. *In re Elec. Data Sys. Corp. "ERISA" Litig.*, 305 F. Supp. 2d, 658, 665 (E.D. Tex. 2004). But, where the allegations to support a fiduciary relationship are purely conclusory, dismissal is appropriate. *See Guajardo v. Freddie Records, Inc.*, No. H-11-1774, 2013 WL 12144152, at *29 (S.D. Tex. Apr. 9, 2013).

The allegations giving rise to fiduciary duties in this case are essentially the following:

> The Licensees also had duties because they necessarily established a relationship of trust and confidence. Indeed, serving as a financial or investment advisor placed a person in a fiduciary relationship with the client.

(2nd Am. Compl. ¶ 117.) These allegations are wholly conclusory. Indeed, the first sentence is the very definition of a conclusory allegation. The second sentence is premised upon the sweeping conclusion that each and every licensee was a financial advisor or an investment advisor with respect to every investor with whom he dealt. The trustee has pleaded no facts to support this allegation even as to one licensee. And, it is easy to envision transactions as to which no such relationship existed.

It may very well be impractical for the trustee to meet the requirements necessary to sustain his pleading burden under Rule 8(a) as to count 12. But, the fact that this may be difficult does not excuse the trustee from complying with Rule 8(a). *See Ackerman v. Northwestern Mut. Life Ins. Co.*, 172 F.3d at 470.

I recommend that you grant the motions to dismiss count 12 as to all defendants who have urged its dismissal for failure to adequately allege the existence of a fiduciary relationship. I further recommend that the trustee be granted leave to amend, but that it be dismissed with prejudice if he fails to amend as directed by Your Honor.

2. Count 12 Should Not Be Dismissed for Lack of Bankruptcy Jurisdiction.

I addressed the motions to dismiss count 10 on the basis of lack of bankruptcy jurisdiction. For the same reasons that I recommend denial of the motions to dismiss count 10 on that basis, I recommend that Your Honor deny the motions to dismiss count 12 on that basis as well.

3. The Court Should Deny the Motions to Dismiss Count 12 on the Basis of Lack of Standing Due to Improper Assignment.

I addressed the motions to dismiss count 10 on the basis of lack of standing due to improper assignment. For the same reasons that I recommend that you deny the motions to dismiss count 10 on that basis, I recommend that Your Honor deny the motions to dismiss count 12 on that basis as well.

4. The Claims in Count 12 Are Not Barred by Limitations.

In Texas, the statute of limitations for breach of fiduciary duty is four years. TEX. CIV. PRAC. & REM. CODE § 16.004(a)(5). *See also Dunmore v. Chicago Title Ins. Co.*, 400 S.W.3d 635, 640 (Tex. App.—Dallas 2013, no pet.). The defendants argue that the claims in count 12 relating to transactions that occurred before March 6, 2013 (four years before the trustee filed count 12) are time-barred. (*See, e.g.*, Alpha & Omega Br. ¶ 70; Am. Safe Retirements Br. ¶ 70). For the same reasons the trustee claims that the application of Texas's common law discovery rule enables him to reach transactions that took place in 2008, he argues the discovery rule applies to his breach of fiduciary duty claim as well.

For the same reasons I find count 10 timely, I find count 12 timely as well. I believe that the injuries suffered by investors here were inherently undiscoverable, but are objectively verifiable. Therefore, I recommend that Your Honor deny the defendants' motions to dismiss count 12 on the basis of limitations.

5. Count 12 Should Not Be Dismissed for Failure To Comply with Rule 9(b).

Some defendants argue that because the trustee's claims in count 12 rely on proof of a fraudulent scheme by LPI, the trustee must comply with the pleading requirements of Rule 9(b). For the reasons I recommend that you deny the motions to dismiss count 1 on this basis, I recommend that you deny them as to count 12 as well.

L. The Motions To Dismiss the Constructive Trust Claim Should Be Denied.

1. The Trustee Has Standing To Allege the Constructive Trust Claim.

Several defendants contend that the trustee lacks standing to bring a constructive trust claim as it is an equitable remedy and, as such, derivative of the investor assigned claims. (Alpha & Omega Br. ¶¶ 9, 26; Am. Safe Retirements Br. ¶¶ 9, 26.) In *Moran v. Pardo*, Civil Action No. 4:15-CV-905-0, the court addressed the question of the trustee's standing to pursue such a constructive trust claim. Relying on *Janvey v. Alguire*, 846 F. Supp. 2d at 673-75, the court held that the trustee did have standing to pursue such a claim. I agree with the analysis in *Moran*, and, therefore, recommend that Your Honor deny the motions to dismiss the trustee's constructive trust claim on this ground.

2. The Constructive Trust Claim Should Not Be Dismissed on the Basis of *In Pari Delicto.*

Some defendants allege that the trustee is barred from seeking a constructive trust by the defense of *in pari delicto*. (Curtis Cole Br. 23; DeWitt & Dunn Br. ¶ 57.) As I have discussed in section G.3 above, because *in pari delicto* requires a fact intensive examination of whether preclusion of the suit would interfere with the protection of the public, I recommend that you deny the motions to dismiss on this basis.

M. If the Court Does Not Dismiss Counts 1, 2, 3, 4, 5, 10, and 12, the Court Should Grant the Defendants' Motions for More Definite Statement as to Those Counts.

Numerous defendants have moved to compel the trustee to make a more definite statement of his claims. Due to certain pleading defects, I have recommended that you grant the motions to dismiss counts 1, 2, 3, 4, 5, 10, and 12, subject to the trustee's right to amend. To the extent that you choose not to dismiss those claims, but otherwise agree with my analysis, I recommend that you grant the motions for more definite statements as to those counts.

 # # # END OF REPORT AND RECOMMENDATION # # #