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

BALBOA CAPITAL CORPORATION, Plaintiff, v.	CIVIL ACTION NO. 3:18-cv-0898-M **LEAD CASE**
OKOJI HOME VISITS MHT LLC, ET AL., a Maryland limited liability company; ULNACS MEDICAL CARE PC, a Maryland corporation; GODSWILL OKOJI, and ASCENTIUM CAPITAL, LLC, a Delaware limited liability company; and DOES 1-10, inclusive, Defendants.	
SHAFIE TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0900-M
BUTT TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0901-M
PATEL TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0902-M
JOHNSTON TRANSITIONS MHT, LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0903-M
THI TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0904-M
WOLDEGIORGIS TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0907-M
SIDDIQUI TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0908-M
ORTEGA HOME VISITS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0909-M
LAS VEGAS TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0910-M
EL-SALIBI TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0916-M
POKU HOME VISITS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0917-M
OPAIGBEOGU MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0918-M

SOZI TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0919-M
DOCTOR NHUE HO HOME VISITS LLC ET AL.	CIVIL ACTION NO. 3:18-cv-0920-M
IMRAN TRANSITIONS MHT, LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0921-M
WAHAB TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0949-M
SAGHIR TRANSITIONS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0950-M
OSTROWSKY HOME VISITS MHT LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-0952-M
DOCTOR NHUE HO HOME VISITS, LLC, ET AL.	CIVIL ACTION NO. 3:18-cv-00920-M

RESPONSE TO ASCENTIUM CAPITAL LLC'S MOTION TO DISMISS

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I. SUMMARY OF ARGUMENT

Before Ascentium was required to file an answer and admit or deny Balboa's fraud and negligent misrepresentation claims, it filed a Motion to Dismiss under Rule 12(b)(6) based on arguments—which are unsupported by Balboa's factual allegations and the controlling jurisprudence—that Balboa's fraud and negligent misrepresentation allegations are not "specific" enough under Rule 8 and 9. Of course, Ascentium cherry-picks certain facts to support its argument while ignoring the specific factual allegations made by Balboa that clearly establish the "who, what, when, where, and how" of Ascentium's fraud and negligent misrepresentation concerning the MHT ponzi scheme. Instead, Ascentium's allegations of inadequate pleading are discredited by a simple reading of Balboa's Complaint as a whole and would also require a factual determination (which is inappropriate for a Rule 12(b)(6) motion). Accordingly, Ascentium's Motion to Dismiss should be denied with prejudice.

II. BRIEF BACKGROUND

Under Fed. R. Civ. P. 10(c), Balboa Capital Corporation ("Balboa") hereby incorporates the background facts provided on paragraphs 8-21 and 46-57 of its Second Amended Complaint ("Complaint") against Ascentium Capital LLC ("Ascentium").[1] Balboa submits those facts are sufficiently pled, plausible, and must be taken as true for purposes of deciding Ascentium's Motion.

Ascentium moves to have the Court dismiss Balboa's negligent misrepresentation and fraud claims for first, failure to satisfy the pleading requirements set forth in Rule 8 and 9(b), and second, that Balboa's negligent misrepresentation claim is time-barred. However, even a cursory reading of Balboa's Complaint plainly shows that the allegations of Ascentium's fraudulent conduct are

[1] Balboa's Second Amended Complaint (DE 169).

well-pleaded. (*See* ¶¶ 8-21 and 46-57 of Balboa's Second Amended Complaint). In short, those allegations detail numerous false statements made by Ascentium's key employees to induce Balboa into funding the sale of MHT licenses, when Ascentium knew that MHT's business model was a ponzi scheme.

In August 2016, Cliff McKenzie, Ascentium's Senior Vice President, approached Patrick Ontal, Balboa's Sales Director, with a business opportunity.[2] According to McKenzie, Ascentium had for several years been financing the sale of licenses by America's Medical Home Team, Inc. ("MHT") to individual doctors. McKenzie stated that although the program was successful, Ascentium had reached its portfolio limit of $40 million and it wanted to refer Balboa to the MHT program as it would need a new financier since Ascentium was no longer funding the program.[3] McKenzie was "effusive in his praise for MHT" and explained the program in detail.[4]

Then, on October 19, 2016, Phil Silva, Balboa's President, contacted Hernan Traversone, Ascentium's Chief Credit Officer, to inquire into Ascentium's experience with the MHT program.[5] Mr. Traversone stated that MHT was an excellent vendor and that it had not experienced any defaults on any of the more than $40 million in financing it provided to the program.[6] Based on the representations made by Ascentium's McKenzie and Traversone, Balboa funded prospective doctors entering the MHT program.

As Balboa later discovered, however, while Ascentium was praising the MHT program to Balboa, it knew that the structure was a ponzi scheme—as far back as early 2016—as it knew the monthly payments being made by MHT were exclusively from the sale of new MHT licenses and

[2] Balboa's Second Amended Complaint at ¶ 10 (DE 169).
[3] *Id.*
[4] *Id.* at ¶¶ 10-15.
[5] *Id.* at ¶ 16.
[6] *Id.* at ¶ 17.

not from the successful operation of the businesses.[7] Importantly, while it was making its glowing recommendations and material misrepresentations of the MHT program to Balboa, behind the scenes Ascentium was demanding that MHT immediately pay a number of its loans in full.[8]

After Ascentium discovered that the MHT program was a ponzi scheme, it understood that MHT would need an additional funding source to continue making payments on the outstanding Ascentium loans. And as Balboa would later discover, Ascentium's reason for its abrupt refusal to continue funding the MHT program for the purported reason of "routine portfolio risk management" was a blatant misrepresentation.[9] Rather, Ascentium needed Balboa to take its place at the "bottom" of the pyramid scheme.

As Balboa plainly laid out in its Complaint, the misrepresentations made by Ascentium clearly give notice to Ascentium of the exact fraudulent statements and nondisclosures that are the subject of Balboa's claims. Moreover, Balboa made these specific factual allegations based on its own knowledge of the events and before it has the opportunity to conduct discovery and discover the true extent of Ascentium's fraudulent conduct.

III. STANDARDS OF REVIEW

A. Rule 8 and Notice Pleading

Under the liberal pleading approach of the Federal Rules, plaintiffs are only required to make a short and plain statement of the claim showing that they are entitled to relief.[10] Rule 8 mandates "notice pleading" which does not require plaintiffs to affirmatively plead facts satisfying the evidentiary framework. In the context of a Rule 12(b)(6) motion to dismiss, courts should not

[7] *Id*. at ¶ 19.
[8] *Id.*
[9] *Id.*
[10] Fed. R. Civ. Proc. 8(a).

apply evidentiary standards because doing so conflicts with Rule 8(a).[11] Litigants are entitled to discovery before being put to their proof, and treating allegations in the complaint as a statement of a party's proof leads to windy complaints and defeats the function of Rule 8.[12]

B. Rule 9(b) Standard of Review

Moreover, Federal Rule of Civil Procedure 9(b) contains a narrowly applicable heightened pleading standard that requires a plaintiff to plead the circumstances constituting fraud with particularity.[13] That standard is satisfied when the plaintiff "specif[ies] the statements contended to be fraudulent, identif[ies] the speaker, state[s] when and where the statements were made, and explain[s] why the statements were fraudulent."[14] Rule 9(b)'s particularity requirement is merely "supplemental to the Supreme Court's interpretation of Rule 8(a) requiring enough facts to state a claim to relief that is plausible on its face."[15] Thus, Rule 9(b) requires only "simple, concise, and direct allegations of the circumstances constituting fraud" that presents a plausible claim when taken as true.[16]

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[11] *Swierkiewicz v. Sorema N.A.*, 53 U.S. 506, 510-514, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002).
[12] *In re Electronic Data Systems Corp. "ERISA" Litigation*, 305 F.Supp.2d. 658, 669 (E.D.Tex. 2004); 153 F.3d 516, 519 (7th Cir. 1998).
[13] *See City of Clinton v. Pilgrim's Pride Corp.*, 632 F.3d 148, 153 (5th Cir. 2010); FED. R. CIV. P. 9(b).
[14] *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 208 (5th Cir. 2009) (internal quotations and citations omitted); *see Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 339 (5th Cir. 2008) ("Rule 9(b) requires the complaint to set forth 'the who, what, when, where, and how' of the events at issue.").
[15] *United States ex rel. Grubbs v. Kanneganti*, 565 F.3d 180, 185 (5th Cir. 2009) (*citing Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).
[16] *Kanneganti*, 565 F.3d at 186; *see also Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir. 1997) (holding that Rule 9(b)'s requirements do not "reflect a subscription to fact pleading").

C. Rule 12(b)(6)

In the Fifth Circuit, "a motion to dismiss under Rule 12(b)(6) is viewed with disfavor and is rarely granted."[17] As a result, the Court must liberally construe the allegations in the complaint and must draw all reasonable inferences in Balboa's favor.[18] In short, this strict standard of review has been summarized as follows: "[t]he question therefore is whether in the light most favorable to the plaintiff and with every doubt resolved in his behalf, the complaint states any valid claim for relief."' [19]

While the claims at issue must be liberally construed in favor of the claimant, and all facts pleaded in those claims must be taken as true,[20] the claims must, however, contain sufficient factual allegations, as opposed to legal conclusions, to state a claim for relief that is "plausible on its face."[21] When there are well-pleaded factual allegations, a court should presume they are true, even if doubtful, and then determine whether they plausibly give rise to an entitlement to relief.[22]

Balboa's Second Amended Complaint easily meets these pleading standards.

IV. ARGUMENT

A. Balboa has Pled Specific, Plausible Facts for each Element of its Fraud and Negligent Misrepresentation Claims

Under Texas law, the elements of fraud are:

> (1) a material misrepresentation was made; (2) it was false; (3) when the misrepresentation was made, the speaker knew it was false or the statement was recklessly asserted without any knowledge of its truth; (4) the speaker made the false representation with the intent

[17] *Harrington v. State Farm Fire & Cas. Co.*, 563 F.3d 141, 147 (5th Cir. 2005).
[18] *Lovick v. Ritemoney, Ltd.*, 378 F.3d 433, 437 (5th Cir. 2004).
[19] *Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498 (5th Cir. 2000) *(citing Conley v. Gibson*, 355 U.S. 41, 45–46).
[20] *Harrington*, 563 F.3d at 147; *Massey v. EMC Mortg. Corp.*, 546 F. App'x 477, 480 (5th Cir. Nov. 5, 2013).
[21] *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009); *Whitaker v. Collier*, 862 F.3d 490, 506 (5th Cir. 2017); *Patrick v. Wal-Mart, Inc.*, 681 F.3d 614, 617 (5th Cir. 2012).
[22] *See Iqbal*, 556 U.S. at 679.

> that it be acted on by the other party; (5) the other party acted in reliance on the misrepresentation; and (6) the party suffered injury as a result.[23]

Furthermore, the elements of negligent misrepresentation under Texas law are:

> (1) the representation is made by a defendant in the course of his business, or in a transaction in which he has a pecuniary interest; (2) the defendant supplies "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 suffers pecuniary loss by justifiably relying on the representation.[24]

For the reasons discussed below, Balboa's Complaint exceeds the federal pleading requirements under Rule 8 and 9 by specifically describing factual allegations of Ascentium's fraudulent conduct for each element of its fraud and negligent misrepresentation claims.

B. Balboa Sufficiently Pled both the Reliance and Causation Elements of its Claims

In section I of Ascentium's Motion, it improperly alleges that Balboa has not sufficiently pled facts related to reliance and causation.[25] Specifically, Ascentium asserts that because Ascentium's misrepresentations induced Balboa into loaning money to the doctors, and Balboa is asserting contract claims against those doctors, Balboa cannot establish that it relied on Ascentium's misrepresentations or that Ascentium's misrepresentations caused Balboa's damages. In other words, says Ascentium, it has no liability for fraudulently inducing Balboa to take its place at the bottom of the pyramid scheme.

To state this proposition is to demonstrate its absurdity, and Ascentium offers no cases to support it. The only case cited by Ascentium is *Blue Gordon C.V. v. Quicksilver Jet Sales, Inc.*,

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[23] *Kajima Int'l, Inc. v. Formosa Plastics Corp., USA*, 15 S.W.3d 289, 292 (Tex. App.-Corpus Christi 2000, pet. denied) (*citing DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990)).
[24] *Gen. Elec. Capital Corp. v. Posey*, 415 F.3d 391, 395–96 (5th Cir. 2005)
[25] Ascentium's Motion to Dismiss at 8 (DE 247).

444 Fed. App'x. 1 (5th Cir. 2011). In *Blue Gordon*, the plaintiff alleged the defendant had wrongfully terminated a contract, and brought claims for breach of contract, fraudulent inducement, and fraud by nondisclosure. The Fifth Circuit found that the defendant's termination of the contract was justified by the plaintiff's own breach, and thus the breach of contract claim failed as a matter of law. The court went on to state that to establish causation for the fraud claims the plaintiff had "to show that its injury – the ultimate termination of the Agreement – was caused [the defendant's] alleged misrepresentations or nondisclosures." *Id.* at 10. The court held that the plaintiff had not done so as a matter of law, because "the cause of [the plaintiff's] injuries was its own failure to cure defaults under the Agreement, which had no causal connection to [the defendant's] alleged misrepresentations or nondisclosures." *Id.* at 11.

Tellingly, Ascentium makes no effort to explain how these facts are analogous to this case; they are not. There is no contract between Balboa and Ascentium, nor any contract that Balboa has allegedly breached. Balboa has not alleged a breach of contract claim against Ascentium, nor that Ascentium fraudulently induced Balboa to enter into a contract with Ascentium. Instead, Balboa alleges that Ascentium made material misrepresentations and omissions intending that Balboa would loan money to borrowers whom Acentium knew were highly unlikely to pay that money back. And, as Acentium knew would happen, that money has not been paid back.[26] Thus Balboa's injury – the loaning of money that has not been paid back – was directly caused by Ascentium's fraudulent conduct.

[26] To be sure, Balboa has also alleged that the borrowers and gurarantors are contractually liable to pay those damages. As the Court is aware, however, the borrowers have raised defenses, including defenses that the "hell or high water" clauses are unenforceable, and that the failure to join Ascentium both constitutes a failure to join an indispensable party and also exonerates the guarantors under California Civil Code section 2845.*See, e.g., Balboa Capital Corp. v. Okoji Home Visits MHT LLC*, No. 3:18-cv-907-M, Answer to Second Amended Complaint (DE 219), ¶¶ 79-82.

Ascentium also half-heartedly contends Balboa has not "plausibly alleged" the justifiable reliance element of its fraud claim.[27] Beyond a heading and topic sentence, however, Ascentium offers no real argument on this point, nor could it. Balboa has specifically alleged that it "justifiably and reasonably relied upon Ascentium's representation in commencing its involvement with MHT."[28] Specifically, Balboa alleged, "[a]nd in fact, Balboa did rely on Mr. Traversone's representations, and based on Ascentium's credit reference, Balboa decided to proceed with financing MHT Licenses."[29] Ascentium does not acknowledge these allegations in its brief, much less explain why they are not sufficient. Accordingly, Acentium's "reliance" argument is without merit and provides no support for dismissal of this action.

C. Balboa has Satisfied its Pleading Obligations under Rule 9(b) for its Fraud Claim Against Ascentium

1. Balboa Pled Which Statements were False and Why they were False

Next, Ascentium argues that Balboa failed to plead with particularity which statements were false and how they were false. In support, Ascentium cherry-picks certain factual allegations from the Balboa Complaint while ignoring the factual allegations that are fatal to its Motion to Dismiss. For instance, critically absent from Ascentium's argument is the remaining portion of paragraph 19 of Balboa's Complaint explaining how the specific statements of Ascentium's Chief Credit Officer (Hernan Traversone) and Ascentium's Senior Vice President's (Cliff McKenzie) were false:

> In early 2016 – more than six months prior to Mr. Silva's conversation with Mr. Traversone – Ascentium was aware that the vast majority of its borrowers had not established a home health care practice at all, much less a profitable practice. Ascentium also knew that to the extent monthly payments were being made, they were being made by MHT and being funded solely out of sales of new

[27] Ascentium's Motion to Dismiss at 8-10 (DE 247).
[28] *See* Balboa's Second Amended Complaint at ¶ 50 (DE 169).
[29] *Id.* at ¶ 18.

> MHT Licenses. In fact, Ascentium had demanded in early 2016 that MHT immediately pay a number of its loans in full. Ascentium was not terminating its participation in the MHT program due to routine portfolio risk management, as Mr. Traversone claimed, but because Ascentium recognized that MHT was ponzi scheme.[30]

Accordingly, Ascentium's argument that Balboa failed to allege which of the statements were false and how those statements were false is contradicted by the plain allegations made in Balboa's Complaint. Contrary to Ascentium's interpretation, Balboa sufficiently pled the "who, what, where, when, and how" allegations that Ascentium contends are required to state a fraud claim under Rule 9(b).

Moreover, the cases cited by Ascentium's are factually distinguishable and do not support its arguments. For example, in *Laura Johnson Family Properties, Ltd.*, this Court dismissed a fraud claim where a plaintiff failed to adequately plead that a statement was false when there were confusing interpretations of the allegations made in the pleadings.[31] This is certainly not the case in the instant matter. Based on Balboa's specific allegations, there is no confusion or differing interpretations of what constituted explicit false statements by Ascentium. In fact, Balboa clearly pled which Ascentium employees (Traversone and McKenzie) made false statements along with the dates and Ascentium's motive in inducing Balboa into financing the MHT Ponzi scheme.

2. Balboa did not "Puzzle-Plead" its Allegations against Ascentium

Similarly, Ascentium cites *In re Alamoso Holdings, Inc.* for the position that "puzzle pleading" techniques do not specifically identify specific allegations for each of the individually named defendants.[32] In that case, "the Complaint recites a list of allegedly false and misleading statements extracted from press releases, analysts' reports, and public filings and then follows the

[30] *See* Balboa's Second Amended Complaint at ¶ 19 (DE 169).
[31] *Laura Johnston Family Props. v. Allen Eng'g Contr., Inc.*, No. 3:16-cv-03378-M, 2017 WL 6459529, *10 (N.D. Tex. Dec. 18, 2017).
[32] *In re Alamosa Holdings, Inc. Sec. Litig.*, 382 F. Supp. 2d 832, 856 (N.D. Tex. 2005).

list with a summary paragraph that charges in a conclusory fashion that all the cited statements were false and misleading because of a separately located second list Plaintiffs label as the true facts."[33] Additionally, there were numerous defendants with vague allegations aimed at the defendants *in globo* and which were based on press releases and public information.[34]

Again, Ascentium fails to explain how these allegations have anything to do with this complaint, in which Balboa attributed specific false statements to specific individuals. Instead of making general allegations against numerous defendants based on vague press releases or publicly available information, Balboa makes specific allegations of fraud from the statements made by Traversone and McKenzie—key members of Ascentium's senior management team. In fact, Balboa lists the specific false statements made by Ascentium along with "why" and "how" the statement was false, and the motive Ascentium had in making the false statements. Therefore, Ascentium's cited cases do not apply to the facts before this Court and should not be persuasive or controlling.

3. Ascentium's Misrepresentations were not Merely Opinions

Ascentium's argument that Balboa's allegations are based on unactionable "opinions" is unsupported by law and belied by the specific allegations of Balboa's Complaint. First, Balboa alleges misrepresentations of fact – e.g., that Ascentium had observed "no hard defaults" and that it was exiting the MHT program due to "routine portfolio risk management." Second, it is well-

[33] *Id*. at 857.
[34] *Id.*

established that an opinion can constitute fraud[35]if the speaker had knowledge of its falsity.[36] "An expression of an opinion as to the happening of a future event may also constitute fraud where the speaker purports to have special knowledge of facts that will occur or exist in the future."[37] Furthermore, "when an opinion is based on past or present facts, an action for fraud may be maintained."[38]

For example, in *Trenholm v. Radcliff*, the Texas Supreme Court upheld a jury's fraud verdict despite arguments by the appellant that his statements were only an expression of an "opinion" and not actionable.[39] The misrepresentations at issue in *Trenhom* involved statements made by a real estate developer to induce a homebuilder to purchase lots in a subdivision. Specifically, the developer represented that a trailer park near the proposed development was in the process of being moved, that the property was sold, and that the residents were informed that their leases would not be renewed.[40] However—like in the instant matter—the representations made by the developer were false and the homebuilder obtained a jury verdict against the

[35] *See Trenholm v. Ratcliff* 646 S.W.2d 927, 930 (Tex. 1983) ("An opinion may constitute fraud if the speaker has knowledge of its falsity."); *Wagner v. Casteel*, 663 P.2d 1020, 1022 (Ariz. Ct. App. 1983) (holding that defendant's representation was more than a mere expression of opinion since defendant was aware of its falsity when it was made); *Ogier v. Pac. Oil & Gas Dev. Corp*., 282 P.2d 574, 580 (Cal. App. 1955) ("[A]n expression of opinion is actionable if the party expressing it does not honestly entertain that opinion."); *Wemple St. Bank v. Cont'l Ill. Co*., 279 Ill. App. 224 (App. Ct. 1 Dist. 1935) (any statement that is known to be false when made can be actionable "although the statement is only in the form of an opinion"); *Hartwig v. Bitter*, 139 N.W.2d 644, 658 (Wis. 1966) (an opinion is actionable if at the time of the representation the speaker is aware of facts incompatible with his opinion).

[36] *Trenholm v. Ratcliff*, 646 S.W.2d 927, 930 (Tex.1983); *Sergeant Oil & Gas Co., Inc. v. National Maintenance & Repair, Inc*., 861 F.Supp. 1351, 1358 (S.D.Tex.1994) (*citing Brooks v. Parr*, 507 S.W.2d 818, 820 (Tex.Civ.App.—Amarillo 1974, no pet.); *Texas Indus. Trust, Inc. v. Lusk*, 312 S.W.2d 324, 327 (Tex.Civ.App. —San Antonio 1958, writ ref'd)).

[37] *Id*.

[38] *Id.*

[39] *Trenholm v. Ratcliff* 646 S.W.2d 927, 930 (Tex. 1983).

[40] *Id*. at 929.

developer. In upholding the verdict, the Texas Supreme Court noted that the "[developer's] representation was not merely an expression of an opinion that the trailer park would be moved in the future. He falsely represented that the trailer park had been sold, and that notices had been given to the tenants. These are direct representations of present facts which are so intertwined with his future prediction that the whole statement amounts to a representation of facts."[41]

Similarly, Balboa has alleged direct statements made by Ascentium's senior management team that were false. While Ascentium's key executives were singing the praises of the MHT program to Balboa, it knew that "the vast majority of its borrowers had not established a home health care practice at all, much less a profitable practice."[42] Despite Ascentium's knowledge of the MHT ponzi scheme, Mr. Traversone represented to Balboa that "MHT was an excellent vendor."[43] And like the developer in *Trenholm*, Ascentium's false statements to induce Balboa to start funding the ponzi scheme were not merely opinions, but were sufficient fraudulent statements to maintain a fraud claim like the plaintiff in *Trenholm*.[44]

4. Ascentium's Misrepresentations were not "Puffery"

Next, Ascentium maintains—without referencing Balboa's specific allegations—that Ascentium's statements were "puffery" which is insufficient to satisfy Rule 9(b). In support, Ascentium cites the Texas appellate case of *Fitzgerald v. Water Rock Outdoors, LLC*, where the plaintiffs based their fraud claims on "statements made by [defendants] such as that [defendant] is a high quality custom homebuilder with years of experience, is hardworking and honest, and employs top-quality subcontractors."[45] The Texas court held that the statements were not "material

[41] *Id*. at 930-931.
[42] *See* Balboa's Second Amended Complaint, ¶¶ 15, 19 (DE 169).
[43] *See* Balboa's Second Amended Complaint, ¶¶ 17-19 (DE 169).
[44] *Trenholm v. Ratcliff* 646 S.W.2d 927, 931 (Tex. 1983).
[45] *Fitzgerald v. Water Rock Outdoors, LLC*, 536 S.W.3d 112, 118(Tex. App. –Amarillo 2017, pet. denied).

misstatements," but were mere "puffing" or opinion and did not constitute fraud.[46] In contrast, however, the allegations from *Fitzgerald* are completely different from Balboa's allegations.

In the Fifth Circuit, a statement is "puffery" when it is "of the vague and optimistic type …contain[ing] no concrete factual or material misrepresentation."[47] In the instant matter, Ascentium's false and material misstatements concerning the MHT ponzi scheme were made to induce Balboa into funding the program which is drastically different from the statements in *Fitzgerald.* Ascentium was aware that the payments coming from the MHT program were not from profitable businesses, but from the sales of new MHT licenses—a classic ponzi scheme.[48] Therefore, Ascentium's glowing recommendations of the MHT program (despite its knowledge to the contrary) were false and an attempt to keep Balboa in the dark so that Balboa "would provide funding that would be used to pay off Ascentium's nonperforming loans."[49] These statements from the Complaint are one of many direct and material misrepresentations made by Ascentium and are not "puffery" under the controlling jurisprudence.

D. Balboa Sufficiently Pled Facts that Trigger Ascentium's Duty to Disclose as a Matter of Law

1. A Duty to Disclose Arose as a Matter of Law After Ascentium's False Statements to Balboa

Ascentium's argument that Balboa has failed to adequately plead "fraud-by-omission" is similarly without merit. Under Texas law, fraudulent concealment or fraud by non-disclosure is a sub-category of fraud that occurs when a party with a duty to disclose a material fact fails to

[46] *Id.*
[47] *Southland Sec. Corp. v. INSpire Ins. Sols., Inc.*, 365 F.3d 353, 372 (5th Cir. 2004).
[48] *See* Balboa's Second Amended Complaint, ¶¶ 19-21 (DE 169).
[49] *Id.* at ¶ 21.

disclose that fact."[50] Furthermore, fraud by omission is a subcategory of fraud because an omission or non-disclosure may be as misleading as a positive misrepresentation of fact when a party has a duty to disclose.[51] To state a claim for fraud based on nondisclosure, Texas law requires a plaintiff to allege:

> (1) the defendant concealed or failed to disclose a material fact that the defendant knew the plaintiff was ignorant of or did not have the opportunity to discover; (2) the defendant intended to induce the plaintiff to take some action by concealing or failing to disclose the material fact; and (3) the plaintiff suffered as a result of acting on the defendant's nondisclosure.[52]

Ascentium asserts Balboa has failed to allege a duty to disclose, because there was no fiduciary relationship between the parties and they did not engage in a transaction with each other. Ascentium concedes, however, that these are not the only conditions giving rise to a duty to disclose.[53] To the contrary, an affirmative duty to disclose may arise by operation of law (1) where a person voluntarily discloses some information; (2) when a person makes a representation and new information makes that earlier misrepresentation false or misleading; and (3) when a person makes a partial disclosure and conveys a false impression.[54]

Moreover, the Fifth Circuit has explained, "there is always a duty to correct one's own prior false or misleading statements, such that a speaker making partial disclosures assumes a duty to

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[50] *GMAC Commercial Mortg. Corp. v. East Texas Holdings, Inc.*, 441 F.Supp.2d 801, 807 (E.D. Tex. 2006) (*citing Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171, 181 (Tex.1997)).

[51] *Manon v. Solis*, 142 S.W.3d 380, 387 (Tex. App.—Houston [14th Dist.] 2004, pet. denied)

[52] *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 341 (5th Cir. 2008) (*citing Bradford v. Vento*, 48 S.W.3d 749, 754-55 (Tex. 2001)).

[53] DE 247 at 10-11.

[54] *In re Enron Corporation Securities, Derivative & "ERISA" Litigation*, 540 F. Supp. 2d 759, 771 (S.D. Tex. 2007) (*citing Hoggett v. Brown*, 971 S.W.2d 472, 487 (Tex. App.—Houston [14th Dist.] 1997, pet. denied). *See also Union Pacific Resources, 247 F.3d at 586; GMAC Commercial Mortg. Corp. v. East Texas Holdings, Inc.*, 441 F. Supp. 2d 801, 808 (E.D. Tex. 2006) (emphasis added).

tell the whole truth even when the partial disclosure was not legally required."[55] A duty to speak arises by operation of law when "one party voluntarily discloses some but not all material facts, so that he must disclose the whole truth, i.e., material facts, lest his partial disclosure convey a false impression."[56]

The Complaint alleges numerous facts establishing the existence of a duty to disclose under this settled law. For example, Balboa alleged that both McKenzie and Traversone voluntarily stated that Ascentium was ending its participation in the MHT program due to routine portfolio risk management. This statement was false on its own, but even if it were true in part, it would nonetheless trigger the obligation to disclose that the real reason for Ascentium's conduct was its realization that it had been funding a Ponzi scheme, and needed a new source of funding to attempt to recoup its losses. Moreover, both McKenzie and Traversone stated there had been "no hard defaults." Again, that statement was false on its own, but even if technically true it created the false impression that the doctor/borrowers were generating sufficient revenue to cover the loan payments. In fact, both McKenzie and Traversone knew that vast majority of doctor/borrowers had not established a practice at all, and that the only payments being made on the loans were funded by additional license sales, not operating revenue. Having made such voluntary statements with the deliberate intent to create a false impression of MHT's bona fides as a business, Ascentium cannot escape liability for failing to disclose the true facts of its own experience with MHT.

Ascentium's cited cases do not support its argument either because of different facts or different procedural postures. *Admiral Ins. Co.* arose from a statement by a primary insurer's

[55] *Rimade Ltd. v. Hubbard Enterprises, Inc.*, 388 F.3d 138, 143 (5th Cir. 2004).
[56] *Rimade* at 143, *citing, Union Pacific Resources Group, Inc. v. Rhône-Poulenc, Inc.*, 247 F.3d 574, 586 (5th Cir. 2001).

attorney to the excess carrier's attorney, during litigation, that the primary would keep the excess carrier "informed of a change in 'game plan'." The court found the statement "to be banter between attorneys and certainly not an agreement as contemplated by Texas law."[57] While the court discussed ways a duty to disclose can be found in an "arm's-length transaction," it did not hold that a transaction is required for the duty to disclose to trigger, nor suggest any disagreement with the settled law that a duty to disclose can arise in other contexts as outlined above.

Ascentium's citation to *Marshall v. Kusch* fares no better. In *Marshall*, the court found there was no evidence that the defendant made any misrepresentation directly to the plaintiff. Instead, the defendant—a seller of real estate—told "potential buyers of the property that there was no anthrax on the property and that he had made these representations in the presence of Tom, a real estate broker."[58] Then, the property was sold to Buyer B and then sold again to Buyer C. After an anthrax outbreak, Buyer C sued the seller. However, the court ultimately found that there was no evidence that the misrepresentation was communicated to Buyer C and that the seller owed no duty to disclose to Buyer C. The court did not hold that in order for a duty to disclose to arise, there has to be contractual privity or a transaction. Just the opposite—if the seller would have made a misrepresentation to Buyer C—as what happened in the instant matter—there would have been a valid fraud claim.

In sum, Balboa specifically alleges that Ascentium made false statements to induce Balboa to fund the MHT Ponzi scheme. While Ascentium was under no duty to disclose any information of the MHT scheme to Balboa, once it voluntarily did so, thereby creating a false impression as to the validity of the MHT program, a duty arose by operation of law, and Ascentium was required

[57] *Admiral Ins. Co., Inc. v. Arrowood Indem. Co.*, 471 B.R. 687, 710 (N.D. Tex. 2012).
[58] *Marshall v. Kusch*, 84 S.W. 3d 781, 785.

to correct its false statements. Since Balboa specifically alleged the facts that trigger Ascentium's duty-to-disclose, it has satisfied its pleading requirements under the federal rules.

E. Balboa's Negligent Misrepresentation Claim is Properly Pled and is not Time-Barred

1. Balboa's Negligent Misrepresentation Claim is not Time-Barred

Because Ascentium's supposed statute of limitations argument is an affirmative defense,[59] Balboa has no affirmative obligation to plead facts in its Complaint necessary to defeat this defense.[60] Rather, Ascentium bears the burden to not only to plead its limitations defense, but also to negate application of the discovery rule.[61] And although Ascentium may raise a statute of limitations defense in a Rule 12(b)(6) motion to dismiss, such a motion "cannot be granted unless the limitations defense is clear on the face of the complaint."[62] In this case, no time limitations defense appears on the face of the complaint—which is evident as Ascentium improperly attempts to have this Court take judicial notice of different allegations in different Complaints to bolster the necessary factual findings necessary for its time limitation defense.

Despite Ascentium's erroneous arguments that there is sufficient factual allegations to support its time limitation defenses, it fails to address whether the discovery rule applies to extend

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[59] FED. R. CIV. P. 8(c) ("In pleading to a preceding pleading, a party shall set forth affirmatively ... statute of limitations ... and any other matter constituting an avoidance or affirmative defense.").
[60] See Rice v. Interactive Learning Sys., Inc., No. 07-CV-0725, 2007 WL 2325202, at *2 (N.D. Tex. Aug. 10, 2007) ("[T]here is no affirmative duty on the plaintiffs to plead facts in their complaint necessary to defeat a statute of limitations defense."); *Verizon Employee Benefits Comm. v. Fitzgerald*, No. 06-CV-0482, 2007 WL 2080004, at *3 (N.D. Tex. July 12, 2007) (stating that plaintiff "was not required in its complaint to anticipate and plead the discovery rule as a basis to avoid [defendant's] affirmative defense").
[61] *See Doe v. Linam*, 225 F. Supp. 2d 731, 735 (S.D. Tex. 2002) (*citing Woods v. William M. Mercer, Inc.*, 769 S.W.2d, 515, 519 n.2 (Tex. 1988)).
[62] *Rice v. Interactive Learning Sys., Inc.,* 3:07-CV-0725-G, 2007 WL 2325202, at *2 (N.D. Tex. Aug. 10, 2007) at *2 (*citing Jones v. Alcoa, Inc.*, 339 F.3d 359, 366 (5th Cir. 2003)); *see also Seghers v. El Bizri,* 513 F. Supp. 2d 694, 707 (N.D. Tex. 2007) ("[T]o grant a Rule 12(b)(6) motion to dismiss based on a statute of limitations defense, the defense must be clear on the face of the complaint.").

the time period. And to properly consider the time the statute of limitations began with the application of the discovery rule, would require a factual finding that is inappropriate for a Rule 12(b)(6) motion. Moreover, as discussed below, the discovery rule tolled the statute of limitations and the determination as to the date the statute of limitations began in the instant matter is a factual determination that should not be decided on a Rule 12(b)(6) motion since there is no evidence in Balboa's Complaint that (1) the statute of limitations expired and (2) that the discovery rule is inapplicable.

2. The Discovery Rule Tolled the Statute of Limitations

The discovery rule has been applied by Texas state and federal courts to defer accrual of a cause of action until the plaintiff knew or, exercising reasonable diligence, should have known of the facts giving rise to a cause of action.[63] The Texas Supreme Court has applied the "discovery rule" to negligent misrepresentation claims. The "discovery rule" extends the statute of limitations for a negligent misrepresentation claim until the plaintiff discovered or should have discovered the misrepresentation.[64] In *HECI Exploration Co. v. Neel*, for instance, the Texas Supreme Court engaged in a detailed discovery-rule analysis of a negligent misrepresentation claim.[65] Following suit, numerous Texas appellate courts have applied the discovery rule to negligent misrepresentation claims[66] as well as federal courts.[67] In a Southern District of Texas case—with

[63] *HECI Expl. Co. v. Neel*, 982 S.W.2d 881, 886 (Tex. 1998).
[64] *Id*.
[65] *Id.*
[66] *See Sabine Towing & Transp. Co. v. Holiday Ins. Agency, Inc*., 54 S.W.3d 57, 60-61 (Tex. App. —Texarkana 2001, pet. denied); *Matthiessen v. Schaefer*, 27 S.W.3d 25, 31 (Tex. App.—San Antonio 2000, pet. denied); *Hendricks v. Thornton*, 973 S.W.2d 348, 365 (Tex.App. —Beaumont 1998, pet. denied).
[67] See *AEP Energy Servs. Gas Holding Co. v. Bank of Am., N.A.*, No. 03-4973, 2004 WL 2278770, at *13 (S.D. Tex. Sept. 14, 2004) ("The court is persuaded the weight of authority in Texas holds that the discovery rule applies to a claim for negligent misrepresentation."); *In re Sunpoint Sec., Inc*., 377 B.R. 513, 551 (Bankr. E.D. Tex. 2007) ("[T]he Court concludes that the Texas legal

analogous factual allegations and in a Rule 12(b)(6) procedural posture—the court applied the discovery rule and tolled the statute of limitation of a negligent misrepresentation claim until the plaintiff should of known of the misrepresentation.[68] Specifically, the Court allowed the discovery rule to toll the statute of limitation until the documents containing the misrepresentation was publicly disseminated when it was filed with the Securities and Exchange Commission.[69]

Not surprisingly—without discussing the applicability of the discovery rule—Ascentium relies on allegations outside of the pleadings to allege the negligent misrepresentation claim is time-barred. Importantly, Ascentium attempts a slight-of-hand argument by relying on allegations made in different cases against Balboa to purportedly show that Balboa knew of MHT's scheme over two years before filing its claim against Ascentium. However, Ascentium's argument is predicated on the date of Balboa's alleged knowledge of the MHT scheme—not Balboa's knowledge of Ascentium's fraud and misrepresentations. Furthermore, Ascentium does not even attempt to pin point the date Balboa knew or should have known of Ascentium's misrepresentations. Instead, Ascentium attempts to use false allegations made in a separate case, which asserted that *Balboa* participated in the Ponzi scheme.

In any event, the reliance on allegations in separate suits is inappropriate evidence in a Rule 12(b)(6) motion. Ascentium's factual argument as to the date Balboa knew of MHT's scheme requires the Court to engage in a premature and highly fact-intensive analysis in order to determine the factual and legal implications, if any, of the allegations made against Balboa in a separate

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landscape has significantly changed in this regard since the *Kansa* decision in 1994 and that Texas law would now apply the discovery rule in negligent misrepresentation cases.").

[68] *AEP Energy Services Gas Holding Co. v. Bank of Am., N.A.*, CIV.H-03-4973, 2004 WL 2278770, at *14 (S.D. Tex. Sept. 14, 2004), report and recommendation adopted, CV H-03-4973, 2005 WL 8164018 (S.D. Tex. Apr. 6, 2005).

[69] *Id*.

claim. Lastly, even the cases relied upon by Ascentium demonstrate the prematurity of its argument. The *Levels v. Merlino* case involved a motion for summary judgment and a well-developed factual record, not a motion to dismiss filed at the outset of the case.[70] In sum, the factual determinations necessary to conclude that Balboa's negligent misrepresentation claim is time-barred requires a factual determination of when Balboa knew or should have known of Ascentium's misrepresentation—none of which are present on the face of the Complaint—which is inappropriate on a Rule 12(b)(6) motion.

3. Balboa's Negligent Misrepresentation Claim is Sufficiently Pled under Rule 8

Ascentium cites a number of cases in support of its position that the pleading requirements of Rule 9(b) apply to Balboa's negligent misrepresentation claim, but it completely disregards the two seminal cases on this issue: *American Realty Trust, Inc. v. Hamilton Land Advisors, Inc*.[71] and *American Realty Trust, Inc. v. Travelers Casualty & Surety Company of America*.[72] Relying on *American Realty v. Hamilton Land*, this Court in *American Realty v. Travelers*, rejected Ascentium's argument and stated that "[negligent misrepresentation claims] do not become subject to Rule 9(b) simply because they are based on the same operative facts as fraud claims."[73] This Court held that "[t]he Court has determined that Rule 9(b) operates to require dismissal of a negligent misrepresentation claim when (1) a plaintiff waives arguments to the contrary or (2) the inadequate fraud claim is so intertwined with the negligent misrepresentation claim that it is not possible to describe a simple redaction that removes the fraud claim while leaving behind a viable

[70] *Levels v. Merlino*, 969 F. Supp. 2d 704 (N.D. Tex. 2013).
[71] 115 F. App'x. 662 (5th Cir. 2004).
[72] 362 F. Supp. 2d 744 (N.D. Tex. 2005).
[73] *Am. Realty Trust, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 362 F. Supp. 2d 744, 749 (N.D. Tex. 2005).

negligent misrepresentation claim."[74] Additionally, the Fifth Circuit has explicitly held that a dismissal by a district court in applying Rule 9(b) to a negligent misrepresentation claim "was in error and we reverse."[75] The Fifth Circuit succinctly summarized the applicable pleading standard as follows:

> Rule 9(b) is an exception to the liberal federal court pleading requirements embodied in Rule 8(a).28 Rule 9(b)'s stringent pleading requirements should not be extended to causes of actions not enumerated therein. Accordingly, plaintiffs' negligent misrepresentation claims are only subject to the liberal pleading requirements of Rule 8(a)."[76]

While some courts have conflated the Rule 8 and 9 pleading requirements in specific circumstances, the predicate factual background in not present in Balboa's allegations. For example, Ascentium relies on the Fifth Circuit case of *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, where the Fifth Circuit stated there that "[a]lthough Rule 9(b) by its terms does not apply to negligent misrepresentation claims, this court has applied the heightened pleading requirements when the parties have not urged a separate focus on the negligent misrepresentation claims."[77] Furthermore, the Fifth Circuit in *American Realty Trust* stated that *Benchmark* "is also not applicable because in *Benchmark* the appellant failed to distinguish between its fraud claims and negligent misrepresentation claims on appeal."[78]

Here, however, Balboa's Complaint does not suffer from that infirmity. Balboa's claims for fraud and negligent misrepresentation are not so intertwined that one cannot be distinguished from the other. Instead, each claim is pleaded separately and distinctly from one another—Count 3: Fraud (against Ascentium) and Count 4: Negligent Misrepresentation (against Ascentium). If

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[74] *Id.* at 749.
[75] *Am. Realty Tr., Inc. v. Hamilton Lane Advisors, Inc.*, 115 Fed. App'x. 662, 668 (5th Cir. 2004)
[76] *Id.*
[77] *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 723 (5th Cir. 2003), opinion modified on denial of reh'g, 355 F.3d 356 (5th Cir. 2003).
[78] *Am. Realty Tr., Inc. v. Hamilton Lane Advisors, Inc.*, 115 Fed. App'x. 662, 669 (5th Cir. 2004).

the Court finds that Balboa has not pleaded fraud with the requisite particularity (which it did, as discussed above), the Court can excise Count 3 and evaluate Balboa's claim for negligent misrepresentation on its own.[79] The fact that both of these causes of action are based on the same operative facts is inconsequential.[80] As this Court has previously noted, "[t]his approach is consistent with the spirit of Rule 8(e)(2), which provides that '[w]hen two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements.'"[81]

F. Balboa Requests Leave to Amend in the Alternative

As set forth above, Balboa has pled its claims in the manner required by the Federal Rules Civil Procedure and, as a matter of both substance and procedure, has stated claims on which relief may be granted. However, should the Court disagree and grant the motion to dismiss, in whole or in part, Balboa should be allowed to amend its Complaint.

Under the Federal Rules, a dismissal under Rule 12(b)(6) should not be final, and any court purporting to dismiss a plaintiff's complaint should simultaneously grant leave to amend the complaint, pursuant to Rule 15(a).[82] Accordingly, in the event the Court is inclined to grant any aspect of Ascentium's motion, Balboa respectfully requests leave to amend its Complaint against Ascentium to the extent that the Court finds any portion of it wanting.

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[79] *Am. Realty Trust, Inc*., 362 F. Supp. 2d at 751 (The court stated that factual circumstances do not become tainted when used as the basis of insufficiently particular fraud allegations (*citing Lone Star Ladies Invest. Club v. Schlotzsky's Inc.*, 238 F.3d 363 (5th Cir. 2001)). The court should instead disregard averments of fraud by disregarding those aspects of them that go beyond what is necessary to state the remaining claims.).

[80] *Id.* at 749 ("[negligent misrepresentation] claims do not become subject to Rule 9(b) simply because they are based on the same operative facts as fraud claims.").

[81] *Id*. at 751.

[82] *See, e.g.*, *Waste Control Specialists v. Envirocare of Tex., Inc*., 199 F.3d 781, 786 (5th Cir. 2000) ("[T]he usual course of action upon granting a defendant's Rule 12(b)(6) motion to dismiss is to allow a plaintiff to amend his or her complaint.").

V. CONCLUSION

Ascentium – having discovered that it was involved in a massive Ponzi scheme – made false statements and failed to disclose material facts in an effort to enlist Balboa to unwittingly perpetuate the Ponzi scheme for Ascentium's benefit. As a result of its false statements and nondisclosures, Balboa loaned millions of dollars that Ascentium knew – based on its own experience – would most likely never be repaid. Ascentium's attempt to avoid liability for its conduct is at best disingenuous. At worst, it is shameful.

Balboa's complaint fully satisfies the pleading standards set forth in the Federal Rules of Civil Procedure; accordingly, Ascentium's motion to dismiss should be denied. In the alternative, the Court should grant Balboa leave to amend its Complaint against Ascentium to address any pleading issues identified by the Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served on all counsel of record and parties via the Court's ECF system, this 11th day of February, 2020.

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