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

U.S. BANK NATIONAL ASSOCIATION, Litigation Trustee of the Idearc Inc. et al. Litigation Trust,	§	
Plaintiff,	§	
v.	§	CIVIL ACTION NO. 3:10-CV-1842-G
VERIZON COMMUNICATIONS INC., et al.,	§	
Defendants.	§	

PLAINTIFF'S REPLY IN SUPPORT OF ITS RESPONSE TO ORDER TO SHOW CAUSE

Plaintiff files its Reply in Support of its Response to Order to Show Cause as follows:

I. Introduction

To read Defendants' Joint Consolidated Response (ECF No. 651) ("the Response"), one would think that this Court's Show Cause Order (ECF No. 647) created a new rule of civil procedure, something akin to Rule 12 or Rule 56 of the Federal Rules. Defendants' Show Cause Rule of Civil Procedure requires a plaintiff to marshal all his facts and explain why those facts entitle him to have his day in court. Unlike Rules 12 or 56, the new Show Cause Rule of Civil Procedure does not require a motion, notice of the legal grounds justifying dismissal, or a fair opportunity to respond. A plaintiff can, as this Plaintiff has done here, survive a barrage of motions to dismiss and for summary judgment, and still he must overcome the Show Cause Rule to justify a trial on the merits.

Plaintiff hopes that the Court in its Show Cause Order has only done what courts often do: invite briefing to assist the Court in deciding which step to take next. If the Court shares Defendants' view of this Court's Order, Plaintiff must respectfully object. Such an order as interpreted by Defendants is contrary to the Federal Rules of Civil Procedure and contrary to due process of law. Plaintiff deserves, and due process demands, clear notice of any judicial intent to summarily dispose of claims without a trial and an opportunity to respond. *Carroll v. Fort James Corp.*, 470 F.3d 1171, 1177 (5th Cir. 2006).

As to a final judgment under Rule 52, the trial of a single fact issue could not possibly resolve all the fact issues in this lawsuit. The Court need only compare the one fact found by the Court with the 324 disputed issues of fact listed by the parties in their Joint Pre-Trial Order. (ECF No. 572, at pp. 24-90). If there are some legal grounds (as distinguished from untried facts) justifying a take nothing judgment as to untried claims, then surely Plaintiff ought in fairness be apprised of those legal grounds, be afforded an opportunity to respond, and be afforded a chance to offer evidence to negate the legal propositions. *Lindley v. City of Birmingham, Alabama*, 452 Fed. Appx. 878, 881 (11th Cir. 2011); *Carroll*, 470 F.3d at 1177.

Under Defendants' Show Cause Rule, there is no due process. In its Order, the Court said it believed its finding that Idearc was worth more than $12 billion was outcome determinative of all claims, but the Court's Order did not give any legal grounds explaining its preliminary conclusion. With the possible exception of Plaintiff's claim for constructive fraudulent transfer, the legal grounds supporting dismissal of Plaintiff's remaining claims are certainly not self-evident from the one fact found by the Court. In fairness, the Court should disclose its preliminary conclusions before Plaintiff is required to show cause why its claims should not be dismissed. *See, e.g., Lindley*, 452 Fed. Appx. at 881; *Carroll*, 470 F.3d at 1177.

Otherwise, the Show Cause Order begins to closely resemble a very one-sided guessing game that favors greatly one litigant over the other.

Nor is there any due process in adopting a show cause rule of procedure in the middle of the trial process. Time and again Plaintiff tried to offer evidence clearly relevant to the lawsuit, and time and again this Court refused to allow the evidence on the grounds that it exceeded the very narrow scope of what was being tried. *See* Tr. Vol. 2A 22:1-16; Tr. Vol. 2B 70:25-71:20; Tr. Vol. 6A 25:4-23, 27:24-28:6. The clear implication was that there would come a time when Plaintiff would get its chance in Phase Two to prove its case. The Plaintiff held back witnesses and evidence in Phase One in reliance on this Court's rulings. Surely the Court cannot change the rules of the game at halftime. *See Knapp v. McFarland*, 457 F.2d 881, 886-887 (2nd Cir.), *cert. denied*, 409 U.S. 850 (1972).

In Defendants' 25 page Response, they attempt to fill the void in the Show Cause Order by offering up a number of so called legal propositions that they believe justify entry of a final judgment. Many of these propositions are simply off the wall. Some deal not with legal propositions but with untried affirmative defenses like waiver and laches. These defenses were not set for trial, were not in the pre-trial order, and drip with fact issues. Plaintiff does not know if this Court will adopt the Defendants' points of law as this Court's Conclusions, but regardless, Plaintiff has only 10 pages under the local rules to respond. *See* Local Rule 7.2(c). If the Court plans on adopting any of the Defendants' propositions of law, Plaintiff should have more than 10 pages to show cause why its claims deserve a trial.

II. Solvency Is Not Dispositive: An Example

Entry of a judgment on a partial finding is only appropriate with respect to a "dispositive" finding of fact. FED. R. CIV. P. 52(c) advisory committee notes. This Court's finding of Idearc's

solvency on November 17, 2006, is not outcome determinative—and in fact—not even relevant to many of Plaintiff's claims. It is not feasible to go count by count to explain why in just 10 pages. So Plaintiff will use as an example the counts for breach of fiduciary duty and promoter liability and focus just on Plaintiff's contention that Defendants schemed to strip assets from Idearc and load Idearc with debt in furtherance of torts and crimes. *See* paragraphs 8 and 9 of the Joint Pretrial Order, at page 4. (ECF No. 572).

"Delaware does not charter law breakers." *Hampshire Group, Ltd. v. Kuttner*, C.A. No. 3607-VCS, 2010 Del. Ch. LEXIS 144, at *111 n.258 (Del. Ch. July 12, 2010). A director or officer who intentionally causes a Delaware corporation to violate the law breaches the duty of loyalty. *See id.*; *Ryan v. Gifford*, 918 A.2d 341, 357-58 (Del. Ch. 2007). "A failure to act in good faith may be shown, for instance, where the fiduciary . . . acts with the intent to violate applicable positive law . . . ." *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006); *see also Desimone v. Barrows*, 924 A.2d 908, 934 (Del. Ch. 2007) ("[I]t is utterly inconsistent with one's duty of fidelity to the corporation to consciously cause the corporation to act unlawfully."); *Metro Commc'n Corp. BVI v. Advanced MobileComm Techs.*, Inc., 854 A.2d 121, 131 (Del. Ch. 2004) ("Under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity."); *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey."). Directors "have no authority knowingly to cause the corporation to become a rogue, exposing the corporation to penalties from criminal and civil regulators." *Desimone*, 924 A.2d at 934.

The Court has yet to determine whether Verizon and Diercksen treated the spin transaction as a tax free one knowing that it failed to qualify as such, and then later falsified corporate documents to make it appear that the transaction qualified for tax free treatment when it did not. As the Court knows, the spin at issue was entirely tax driven. The lynchpin of the spin was a "shall" opinion by Skadden that there would be no taxable gain through the spin. *See* Ex. A-1 (November 17, 2006 Tax Opinion), App. at 1-15;[1] *see* PX 901 (November 1, 2006 Amendment No. 6 to Idearc Form 10), at p. 4. The Court has the expert report of David Schizer, Dean of Columbia Law School, detailing red flags about the tax treatment that this Court will eventually need to consider. His expert report and rebuttal report consist of 56 pages. *See* ECF No. 340-1 (initial report), ECF No. 461, Exhibit B (rebuttal report). This testimony was never heard by this Court. Rather than consume pages here, Plaintiff prays that the Court pause now, read the reports and gain an understanding of the enormity of the multi-billion dollar tax scheme that Dean Schizer found so "troubling." *See* Ex. A-4 (Schizer deposition 11:21-24), App. at 33. Once the Court does this, the Court will see that solvency is not dispositive of the breach of duty claim. If Verizon, a promoter and a fiduciary, profited through an illegal and potentially criminal tax scheme, it cannot keep those profits—even if Idearc somehow benefitted from the scheme.

In terms of the tax scheme, there is much more than what is contained in Dean Schizer's report. To achieve tax free treatment, Verizon had to own before the spin at least 80 percent of all the common stock of Idearc. *See* IRC §§ 355, 368(c) (2006). The truth is that Verizon never owned any shares of Idearc before the spin, much less 80 percent. No shares were ever issued by Idearc.

[1] All references to "App." in this brief are to *Supplemental Appendix In Support of Plaintiff's Response to Order to Show Cause*, filed contemporaneously with this brief.

The stipulated minute book before the Court establishes that no shares were ever issued. (PX 2018). Only a quorum of the board could issue stock to Verizon, and the minute book shows no quorum ever existed. *See generally* Motion for Judgment (ECF No. 649) and Reply in support filed March 15, 2013. Even if this Court should hold that Diercksen alone could constitute a "quorum" of a two person board under Delaware law, there is no board resolution by Diercksen setting a price for the stock. *See* PX 2018 (Resolution) at p. 42. Under Delaware law, only the board may issue stock, and the board must set a price for the stock it issues. *See* 8 Del. Code §§ 152 and 153(a).

Defendants argue in their Response that Verizon purchased the stock for services. This is totally at odds with Verizon's sworn position before the IRS. Verizon told the IRS that it purchased stock in VDDC for cash shortly after VDDC was formed. *See* PX 659 at p. 5[2].

In any event, there is no evidence of stock for services, and the board resolution does not authorize issuance of stock for services. *See* 8 Del. Code, § 152. The board never set a price for the stock and, therefore, never valued the services to be received as consideration for the stock. *See* 8 Del. Code § 153(a). Moreover, Defendants know that Idearc paid Verizon cash (not stock) for all the services supposedly benefitting it in the spin. *See* Ex. A-2 (invoice sent by Verizon to Idearc for spin-related fees, including attorney and auditor fees), App. at 17; Ex. A-5 (Deposition testimony of John Fitzgerald 31:8-34:19 describing Exhibit A-2), App. at 43-46.

In addition to violating the "positive" law of the country, there is evidence of documents being manufactured. Creating false corporate records to facilitate a baseless tax benefit potentially has criminal implications. *See, e.g., U.S. v. Rosengarten*, 857 F.2d 76, 78-80 (2nd Cir.), *cert.* denied, 488 U.S. 1011 (1989). This Court excluded from trial in Phase One PX 1944,

[2] The facts recited in the PLR are based on statements made under penalty of perjury. *See* PX 659 at p. 4. For further discussion, *see* Plaintiff's Reply filed March 15 in support of its Motion for Judgment at pp. 4-5.

a work sheet by Fulbright showing that stock certificates and a "Secretary's Certificate" were created on the eve of the spin on November 15 and 16, 2006. One stock certificate was backdated to June 22, 2006 (PX 2018 at p. 54), possibly to bring Verizon's "ownership" of Idearc into compliance with the Private Letter Ruling ("PLR") and the Skadden Opinion. *See* "Assumption" in first paragraph of page one of Skadden Opinion, Ex. A-1 (November 17, 2006 Tax Opinion), App. at 2; and compare with the first paragraph of page 5 of the PLR[3], PX 659 (Sept. 29, 2006 Private Letter Ruling), at p. 5. PX 1944 shows how Verizon's lawyer, Bill Mundy, who acted as counsel for the Yellow Pages business pre-spin, created a "Secretary's Certificate" for Idearc just before the spin attesting to Verizon's 100 percent ownership of all the common stock of Idearc. *See* PX 2018 (Secretary's Certificate) at p. 48. Mundy was not Idearc's secretary. Nor did the minute book support any share ownership, as he falsely said in the Certificate. *See* blank stock transfer pages of the minute book (PX 2018), and *see generally* Plaintiffs' Motion for Judgment (ECF No. 649) and Reply in Support filed March 15, 2013.

Verizon also argues defenses of waiver and laches. Neither waiver nor laches is in the pre-trial order. (ECF No. 572). Waiver requires a knowing abandonment, but Idearc never had a fully constituted board that could waive anything. *See* Motion for Judgment (ECF No. 649) and Reply in support filed March 15, 2013. Besides, Mundy, Verizon's lawyer who signed the false stock certificate and false Secretary's Certificate to benefit Verizon, continued on as Idearc's General Counsel until he retired in March, 2008, shortly before the bankruptcy. *See* Ex. A-3 (Deposition testimony of William Mundy 329:22-330:5), App. at 23-24. Kathy Harless, Verizon's employee who signed and backdated the false stock certificate, continued on as an Idearc employee until the first quarter of 2008. Tr. Vol. 5B 16:16-24. Fulbright, who helped

[3] The PLR recites that payment for the shares was "for nominal cash contribution." Compare this to what Verizon is now telling this Court, that the Idearc stock was purchased for "services." Which story is true, the one told to the IRS or the one now being told to this Court?

create the backdated stock certificates and Mundy's Certificate, was Idearc's counsel continuously from the spin through the date when bankruptcy was filed. *See* Voluntary Petition, *In re Idearc Inc.*, No. 09-31828 (Bankr. N.D. Tex. March 31, 2009), ECF No. 1 (bankruptcy petition signed by Fulbright & Jaworski, LLP as attorneys for Idearc). Assuming that the New Board was a lawfully appointed board (but *see* Motion for Judgment (ECF No. 649)), that their knowledge was corporate knowledge, and that they were charged with knowledge of the contents of the minute book, who was going to tell the disinterested members of the New Board that share certificate No. 1 in the minute book was manufactured and backdated? *See* PX 2018 at p. 54. Who was going to tell the New Board that Mundy's Secretary Certificate was false? *Id*. at p. 48.

Next, Defendants claim that Delaware law does not include vacancies when counting a quorum, and even though the bylaws required a two person board, Diercksen constituted a quorum. From this they argue stock was issued by a board to Verizon. The law on which Defendants rely does not involve the failure of an incorporator to perfect incorporation by failing to elect an initial board under Section 107. Defendants' authority instead deals with vacancies in newly created directorships following an increase in the number of directors by a lawful board of a duly incorporated company. Moreover, the bylaws at issue here are very specific and very different than the one at issue in Defendants' authority. *See* discussion of *Belle Isle* in Plaintiff's Reply in Support of its Motion for Judgment filed March 15, 2013. Finally, even if Diercksen was a quorum, the Resolution sets no price for the stock. Thus it was ineffective under the law. *See* 8 Del. C. §§ 152, 153(a).

The Defendants say that this Court has already ruled as a matter of law without a trial that Verizon had to own all the Idearc stock, reasoning that someone had to own the stock. *See* this Court's Memorandum Opinion and Order regarding motions for summary judgment (ECF

No. 523), at 26-27. First, a court may not make fact findings contrary to the parties duly filed and binding stipulation. *See Gander v. Livoti*, 250 F.3d 606, 609 (8th Cir. 2001). Here, the Stipulated Minute Book proves no stock was ever lawfully issued. PX 2018; *see also* Motion for Judgment (ECF No. 649) at pp. 10, 17-21. Second, this Court's ruling was simply an advisory opinion and was not relevant to any relief granted to any movant for summary judgment. Third, rulings on motions for summary judgment can only dispose of fact issues before trial when that particular relief is clearly sought and a court makes perfectly clear that it is making such a finding. *See CIVIX-DDI, LLC v. Hotels.com, L.P.*, 2012 WL 6591684 at *9 (N.D. Ill. 2012) (concluding that Rule 56(g) does not bind parties to facts established for purposes of summary judgment since a party may dispute only a few facts in order to defeat a summary judgment motion, and as a result, that party should not run the risk that other facts will be taken as established for trial or other purposes). This is not the case at bar. Fourth, this finding of fact is simply not in accord with Delaware law. *See* Motion for Judgment. (ECF No. 649). Fifth, the fact finding (if it is one) that Verizon owned all of Idearc's stock is irrelevant because it assumes facts not in evidence—that stock was ever issued in the first place. The Court did not expressly find that stock was ever issued, by what act it was issued, and or through what lawful board resolution it was issued. Once it is determined that a lawful board issued stock for a price, then one can determine ownership of shares under Article 8 of the Uniform Commercial Code. *See* 6 Del Code §§ 8-104, 8-301.

III. Prior Legal Pronouncements and Safe Harbors

Prior legal pronouncements are not law of the case, and are not insulated from review by this or any other court on some theory that to revisit the issue is a request for reconsideration. *See, e.g., U.S. v. Palmer*, 122 F.3d 215, 220 (5th Cir. 1997) (law of the case does not preclude a

district court from reconsidering rulings on interlocutory orders such as summary judgment rulings). Take for example Count 8. The Plaintiff is not asking the Court now to reconsider its order denying Plaintiff's motion for summary judgment. To the contrary, the Plaintiff is asking for its day in court for the very reason that the Court did not grant the summary judgment. After trial on the merits, if the Court decides to apply the law the way it saw the law earlier in motion practice, that is obviously the Court's prerogative. But, Count 8 was not disposed of by summary judgment.

Defendants also rely on the safe harbor provided by Section 550 of the Bankruptcy Code. It is interesting how Defendants feel Plaintiff is bound by this Court's prior rulings, but they are not. This Court has already ruled that §550 is inapplicable to the $7.1 billion of debt obligations which were delivered to Verizon. (ECF No. 469). Since both §550 and §546(e) only apply to transfers, not obligations, and this Court has ruled that the $7.1 billion of debt obligations in question do not constitute transfers, the unlawful dividend claim of the Plaintiff relating to the $7.1 billion cannot possibly be preempted by §550. Provisions of the Bankruptcy Code do not preempt all state law. *Butner v. U.S.*, 440 U.S. 48, 54-55 (1979). Additionally, this defense does not apply to Diercksen. Nor has he plead the defense.

IV. Conclusion

En somme, there is no reason to invent new rules of civil procedure. Trying to create a new rule of procedure or torturing Rule 52 to reach a result that is simply unprecedented does nothing but introduce legal and procedural uncertainty, add costs, and insure a delay in a final resolution of this controversy.

Respectfully Submitted,

/s/ Werner A. Powers

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CERTIFICATE OF SERVICE

On March 15, 2013, the undersigned electronically submitted the foregoing document with the Clerk of Court for the U.S. District Court, Northern District of Texas, using the electronic case filing system of the Court. The undersigned hereby certifies that all counsel and/or pro se parties of record have been electronically served in accordance with Federal Rule of Civil Procedure 5(b)(2).

/s/ Werner A. Powers

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