

SECURITIES AND FIDUCIARY DUTY CASES IN TEXAS

OCTOBER– DECEMBER 2021

This quarterly newsletter summarizes recent federal and state court decisions of interest to practitioners litigating securities and fiduciary duty claims in Texas. Decisions of particular interest this quarter include:

- The Fifth Circuit affirmed the authority of the SEC to seek disgorgement so long as it is for the benefit of investors (*SEC v. Blackburn*);
- The Fifth Circuit held that district courts have jurisdiction to hear constitutional challenges to administrative law judges prior to entry of a final order in SEC enforcement proceedings (*Cochran v. SEC*);
- After motions to dismiss were denied and discovery began, Magistrate Judge Edison required plaintiffs to disclose the names of confidential witnesses (CWs) cited in the complaint and to produce documents provided by the CWs (*Edwards v. McDermott Int'l, Inc.*); and
- Judge Lindsay found that the PSLRA did not pre-empt RICO claims asserted in a real estate financing fraud case (*Megatel Homes, LLC v. Moayedi*).

I. FEDERAL CASES

A. Fifth Circuit

1. [SEC v. Blackburn, 2021 WL 4737431 \(5th Cir. 2021\).](#)

In *SEC v. Liu*, the Supreme Court upheld the SEC’s authority to seek disgorgement under the Exchange Act (15 U.S.C. § 78u(d)(5)), but only so long as the disgorgement was “for the benefit of investors.” *Liu v. SEC*, 140 S. Ct. 1936, 1949 (2020).¹ On October 12, 2021, the Fifth Circuit was the first court of appeals to decide whether an SEC disgorgement award met the “for the benefit of investors” requirement. In affirming the disgorgement award, the Fifth Circuit provided a roadmap for how the SEC may comply with *Liu* in future cases by identifying specific victims to whom disgorgement funds will be disbursed.

Facts and Procedural History. The SEC sued a “penny stock” company and several

¹ Before its ruling in *Liu*, the Supreme Court held in *Kokesh v. SEC*, 137 S.Ct. 1635 (2017) that when disgorgement is effectively used to redress public wrongs and as general deterrence, it should be considered a “penalty” and subject to the five-year statute of limitations. This set the stage for further argument in *Liu* challenging the scope of disgorgement remedies imposed by the SEC.

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individuals for selling unregistered securities and deceiving investors. The district court granted summary judgment to the SEC and entered a disgorgement order. The Fifth Circuit affirmed the liability ruling and concluded that the disgorgement order complied with *Liu* because the district court “individually assessed each defendant’s gain” and properly concluded that the SEC “created a process for the return of disgorged funds” to identified victims. *Id.* at *4.

Treaty Energy Corporation (Treaty) was a small oil and gas company whose shares traded over the counter as “penny stocks.” Treaty was formed and controlled by Ronald Blackburn who owned 86.4% of Treaty’s stock. Before forming Treaty, Blackburn was convicted of four federal tax felonies and paid over \$1 million to settle claims that he misappropriated funds from a gravel pit company. Given his past, Blackburn recruited people with cleaner records to serve as Treaty’s officers.

The SEC alleged that Treaty, Blackburn, and several corporate officers (1) failed to register millions of shares of Treaty stock they sold; (2) misrepresented drilling results by issuing a press release claiming the Company had “struck oil” in Belize – a statement called “false and misleading” by the Belize government; and (3) deceived investors by hiding Blackburn’s involvement with the Company and not identifying him in its 10-K. The district court granted partial summary judgment to the SEC and ordered disgorgement of the defendants’ profits. The Company and one defendant settled, and the remaining defendants appealed.

Material Omissions. On appeal, defendants challenged both the liability ruling and the disgorgement remedy. Treaty’s COO, who prepared the Company’s 10-K, argued there was no evidence he knew of Blackburn’s criminal history when he omitted Blackburn’s name from the 10-K. The Court stated that Blackburn’s criminal history was not the only material information omitted from the 10-K:

Investors make decisions about whether to invest their money in a company, in part, based on the company’s leadership. Even though Blackburn was not an officer of Treaty, there is “little doubt that a reasonable investor would have wanted to know the true identity” of who was leading the company. Disclosure of Blackburn’s key role with Treaty might have mattered to investors for a number of reasons, including but not limited to his criminal convictions, the lawsuit he settled for misappropriating over a million dollars from another company, or just his general reputation – good, bad, or nonexistent—in the oil-and-gas industry.

Id. at *3 (citations omitted).

Scienter. The summary judgment evidence showed that Blackburn maintained significant control over the company, and the COO was “fully aware of Blackburn’s wide-ranging management of Treaty.” *Id.* Among other things, the 10-K repeatedly referred to Blackburn’s role but used “major shareholder,” “affiliate,” and “related party” instead of Blackburn’s name – showing that the disclosure was, at the very least, reckless. While acknowledging summary judgment on a question of intent was uncommon, the Court found it “appropriate when the undisputed evidence removes any doubt on the issue.” *Id.* at *4.

Propriety of Disgorgement Remedy. Defendants also challenged the district court’s disgorgement order based on the Supreme Court’s *Liu* decision. In *Liu*, the defendants argued that the SEC lacked authority to obtain disgorgement because the remedy was omitted from a list of

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the SEC's statutory powers in administrative proceedings. *See* 15 U.S.C. § 78u(d)(5). Further, they claimed the disgorgement remedy should be reduced by millions of dollars in purported business expenses. The Supreme Court sided with the SEC on the first argument, ruling that equity practice has long recognized the ability of courts to strip wrongdoers of their ill-gotten gains and that the statute granting equitable powers in administrative proceedings was of no consequence given that history. However, the Supreme Court sided with the defendants on the second question, identifying three ways in which the disgorgement order at issue might be in "considerable tension with equity practices": (1) by ordering funds deposited into the Treasury rather than awarded to victims; (2) by imposing joint-and-several liability for disgorgement awards; and (3) by not deducting legitimate expenses from fraud proceeds. The Court remanded the case for further proceedings to address those issues.

The Fifth Circuit described its ruling in *Blackburn* as the first opportunity since *Liu* for a court of appeals to address whether a disgorgement award was "awarded for victims." *Blackburn*, at *1. It began by quoting the language of the Exchange Act authorizing the SEC to seek "equitable relief" that "may be appropriate or necessary for the benefit of investors." *Id.* at *4. It then described *Liu*'s ruling allowing the SEC to seek disgorgement as an equitable remedy consistent with its longstanding practice in securities cases. *Id.* at *4 (citing *Liu*, 140 S. Ct. at 1940). The Court recognized that disgorgement must be subject to certain limits to ensure it was not a penalty:

Two things keep a remedy aimed at unjust enrichment from becoming punitive: Disgorgement cannot exceed the defendants' "net profits" and must "be awarded for victims."

Id. at *4 (citing *Liu*, 140 S. Ct. at 1940). It found the district court order satisfied these requirements. First, the disgorgement amounts were the profits each defendant received individually from its securities fraud and were not imposed jointly and severally. Second, funds recovered will not go to the Treasury but to the SEC as a *de facto* trustee to be disbursed to identified victims under a process created by the SEC subject to supervision and approval by the district court. *Id.* at *4.

The Court was careful not to overstep the legal and factual bounds of its decision. First, it noted that Congress amended the Exchange Act after the *Liu* decision to authorize disgorgement in future cases and eliminated the "for the benefit of investors" language. *Id.* at *4 n.4. While the SEC argued this provision could be applied retroactively, the Court did "not address this argument [because] the scheme set up by the district court is sufficient under the 'equitable relief' provision the district court applied." *Id.* Second, the Fifth Circuit expressly noted that its decision did not address question left open in *Liu*, namely "[W]hether disgorgement is 'awarded for victims' when the money is put into a Treasury fund that helps 'pay whistleblowers and to fund the activities of the Inspector General.'" *Id.* at *5. It also contrasted the *Blackburn* awards made to specific victims with cases involving insider trading "which injures the market as a whole rather than individual market participants." *Id.* at *4. Thus, the Court left open how it would (1) treat the Congressional amendment to the Exchange Act and (2) analyze disgorgement in cases without identifiable victims, such as insider trading cases. Although not specifically identified by the Court, FCPA enforcement actions might also be considered cases without identifiable victims.

[Securities Fraud: Scienter; Enforcement: Disgorgement]

2. [Cochran v. SEC, -- F. 4th -- 2021 WL 5876747 \(5th Cir. Dec. 13, 2021\)](#)

In a 9-7 *en banc* opinion authored by Judge Haynes, the Fifth Circuit held that federal district courts have jurisdiction to hear constitutional challenges to the appointment of SEC administrative law judges (ALJs) prior to the issuance of a final decision in SEC enforcement proceedings.

In 2018, the U.S. Supreme Court held that ALJs appointed by the SEC are “officers of the United States” who must be appointed by the President, a court of law, or a department head. *Lucia v. SEC*, 138 S.Ct. 2044, 2049 (2018). The Supreme Court did not address the question whether the fact that ALJs can only be removed for cause is unconstitutional because ALJs are insulated from the President’s Article II removal power. After *Lucia*, the SEC properly re-appointed its ALJs, but it did not address the removability issue.

In 2016, the SEC instituted enforcement proceedings against Michelle Cochran, a CPA, for failing to comply with relevant auditing standards. After the *Lucia* decision was issued, the SEC remanded all pending administrative cases for new proceedings before constitutionally appointed ALJs. After her case was reassigned, Cochran filed suit in federal district court to enjoin the SEC proceedings on the grounds that the ALJ’s protection from removal rendered the proceedings unconstitutional. The SEC argued that the district court lacked jurisdiction because Section 25 of the Securities Exchange Act of 1934 implicitly strips federal district courts of subject matter jurisdiction to hear structural constitutional claims by providing only for appellate court review of a final order of the SEC. *See* 15 U.S.C. § 78y(a)(1) (“A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.”).

The Court held that federal district courts have jurisdiction to hear structural constitutional challenges to SEC enforcement proceedings prior to entry of a final order and remanded the case to the district court to hear Cochran’s claim that the SEC enforcement proceeding are unconstitutional because the ALJs are insulated from removal by the President. As Judge Costa’s dissenting opinion noted, every court of appeals to consider the question previously ruled that federal district courts lack jurisdiction to hear such claims. 2021 WL 5876747, at *33 (citing opinions from Fourth, Eleventh, Second and D.C. Circuit Court of Appeals). The concurring opinion by Judge Oldham, on the other hand, emphasizes both the statutory text of Section 78y and his belief that federal courts must provide a check on administrative bureaucracy.

[Enforcement: ALJ Appointment]

B. District Courts

1. [SEC v. Stack, 2021 WL 4777588 \(W.D. Tex. 2021\) \(Yeakel, M.J.\)](#)

On October 13, 2021, Magistrate Judge Lee Yeakel recommended denial of a motion to dismiss filed by an individual defendant in a Section 5 civil enforcement action that alleged the sale of unregistered securities. William Stack was the CEO, President, Treasurer, Secretary, and Director of Preston Corp, a Nevada shell corporation that purportedly specialized in financing gold

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mining operations. The Company raised \$330,000 from investors but never commenced operations because it failed to obtain necessary financing.

Like *SEC v. Blackburn*, discussed below, the case involved an undisclosed control person. The SEC alleged that William Marshall (a recidivist securities law violator) persuaded Stack (an attorney with no mining experience) to be the front man for Preston Corp. According to the complaint, Stack was broke, had filed for bankruptcy five times, and needed the job. In an email to Marshall, Stack stated:

There are extremely high risks sitting in the CEO chair. I have two former clients sitting in prison right now as proof of that fact.

I am CEO of Preston and I have no idea what is ever being done. [Individual-2] says that everything is ‘done’ and that things are ‘starting’ But it’s always next week.... You guys put me in as CEO to stand as a buffer between you and the market. I get that. I agreed to stand there, accepting the risks inherent in the job. And now I’ve got a [state securities regulator’s] inquiry with my name (not yours, not [Individual-2]’s, not [a sales agent’s], no one else’s) name right there in the crosshairs.

Id. at *8.

Not surprisingly, given the email evidence, the Magistrate Judge recommended that Stack’s motion to dismiss the Rule 10b-5 claims for failure to allege scienter with particularity be denied. The Court also refused to dismiss the Section 5 claim against Stack because his intent was irrelevant. Further, the SEC made a *prima facie* case that Stack was a necessary participant and substantial factor in the sale of unregistered securities since he was the sole officer and director, approved the PPM and subscription agreements, and signed and issued the unregistered shares. *Id.* at *9.

[*Exchange Act; Securities Fraud; Section 5; Control Person*]

2. [*Crutchfield v. Match Group, Inc.*, 2021 WL 5480682, \(N.D. Tex. Nov. 19, 2021\) \(Scholer, J.\)](#)

As previously reported in our 1Q21 newsletter, plaintiffs filed suit against Match Group, Inc. (the “Company”) and two of its officers alleging violations of Rule 10(b) and 20(a) of the Exchange Act. The Company operates dating and matchmaking websites, including Match.com, Tinder, and others. Plaintiffs alleged that the Company’s subscriber base and revenue growth were driven by fraudulent scammers and bots that represented a “significant” percentage of its accounts on certain websites (15-20% according to confidential witnesses). The Court granted Defendants’ motion to dismiss but allowed plaintiffs to file an amended complaint. *Crutchfield v. Match Group, Inc.*, 529 F.Supp.3d 570 (N.D. Tex. 2021).

Plaintiffs filed a 164-page amended complaint. In a four-paragraph opinion, the Court found the amended complaint rectified the pleading deficiencies the Court identified in the initial complaint and denied Defendants’ motion to dismiss the amended complaint.

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[*Exchange Act; Securities Fraud*]

3. [*Edwards v. McDermott Int'l, Inc.*, 2021 WL 5121853 \(S.D. Tex. Nov. 4, 2021\) \(Edison, M.J.\) and unreported Order, Civ. Action No. 4:18-cv-04330 \(S.D. Tex. Nov. 2, 2021\) \(Edison, M.J.\)](#)

As previously reported in our 2Q21 newsletter, Judge Hanks denied motions to dismiss shareholder complaints that asserted Section 10(b) and 14(a) claims against McDermott International, Inc., its acquisition target Chicago Bridge & Iron, and certain of their directors and officers. These cases were referred to Magistrate Judge Edison who recently addressed several interesting pre-trial issues:

- The Court required Plaintiffs to (1) disclose the names of confidential witnesses cited in the complaint and (2) produce copies of all documents they received from those confidential witnesses. Judge Edison noted the “predominant view of district courts across this great nation is that the names of CWs/FEs referenced in a complaint are not protected work product.” *Id.* at *3 (citations omitted). In addition, the work-product doctrine does not protect documents that third parties or former employees voluntarily give to Plaintiffs’ counsel. “Simply put, there is nothing about those documents – many of which were probably Defendants’ business records – that reflects the mental processes of Plaintiffs’ counsel. If the work-product doctrine did apply in such a situation, Plaintiffs could insulate from production any and all documents it obtained from any witnesses or sources in a case.” 2021 WL 5121853 at *4.
- The Court granted Plaintiffs’ request to file a supplemental complaint but rejected the request by Lead Plaintiff (Nova Scotia) and its counsel (Pomerantz) to add another class representative (Pontiac) and additional class counsel (Robbins Geller) to help with the supplemental claim. Defendants opposed the request, noting that Nova Scotia had previously argued Pontiac was disqualified from being a class representative because of a disabling conflict. Defendants speculated that “Pomerantz and Robbins Geller are attempting to circumvent the PSLRA’s carefully crafted, congressionally mandated procedures and Judge Bennett’s order appointing a lead plaintiff and lead counsel by having one competitor withdraw from the contest for appointment, only to have the other secure the appointment and cut its competitor back into the case.” Defendants’ Opposition Brief, at 10-11 (Docket No. 207, filed Oct. 20, 2021). The Court resolved the dispute promptly – and without discovery as Nova Scotia suggested in the alternative – ruling it had “already appointed lead plaintiff and lead counsel. I view the effort to add another named plaintiff and another named counsel as an affront to the procedure for the selection of lead plaintiff and lead counsel as set forth in the Private Securities Litigation Reform Act of 1995.” *Edwards v. McDermott Int'l, Inc.*, Case 4:18-cv-04330, Order dated Nov. 2, 2021 (S.D. Tex.), available on PACER.

[*Exchange Act; Securities Fraud*]

4. [*Greenlaw v. Klimek*, 2021 WL 6112784 \(E.D. Tex. Dec. 27, 2021\) \(Jordan, J.\)](#)

We previously reported on Texas state court litigation filed by United Development Funding, L.P. (UDF) against Kyle Bass and Hayman Capital alleging a “short and distort” scheme to sell UDF stock short then drive down the company’s stock price by making false and misleading statements. Not satisfied with their state court claims, UDF and four executives sued an Assistant United States Attorney and two FBI special agents who met with Bass for violating their constitutional rights. According to the complaint, the federal officials met with Bass and representatives of his hedge fund, repeated Bass’ false and misleading statements in a search warrant application, and raided UDF’s headquarters. The district court promptly dismissed the action for failure to allege a *Bivens* cause of action against the federal officials.

Fifty years ago, in *Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388, 397 (1971), the Supreme Court recognized an implied right of action for damages against federal officials who entered a person’s home without a search warrant, handcuffed him in front of his family, and strip searched him. While *Bivens* remains good law, the Supreme Court now disfavors expanding the *Bivens* framework and leaves to Congress “whether, and the extent to which, monetary and other liabilities should be imposed upon individual officers and employees of the federal government based on constitutional torts.” *Hernandez v. Mesa*, 140 S. Ct. 735, 742 (2020). Accordingly, before determining whether a putative *Bivens* action may proceed, courts consider (1) whether the claim involves a new context or a new category of defendants and, if so, (2) whether any special factors counsel hesitation against extending *Bivens* to include them. *Id.* at 743. Applying this two-step analysis, the district court determined that plaintiffs’ Fourth and Fifth Amendment claims were not actionable under *Bivens*.

UDF and its executives could not have been optimistic about their chances for success in this lawsuit. In addition to overcoming the hurdle of the *Bivens* framework, they would have had to overcome claims of qualified immunity, statute of limitations, and other defenses. Of course, there may have been other reasons for filing a public lawsuit blaming Kyle Bass and his hedge fund for UDF’s misfortunes. When the news of the FBI raid of UDF headquarters became public, UDF shareholders allegedly lost \$500 million and Kyle Bass gained \$60 million from his short position.

[*Bivens* Actions]

5. [*Megatel Homes, LLC v. Moayedi* \(N.D. Tex.\) \(Lindsay, J.\)](#)

In another case involving UDF, Megatel Homes, LLC and its affiliates (Megatel) sued Mehrdad Moayedi (Moayedi), United Development Funding, L.P. and its affiliates (UDF), and UDF’s founders and principals for RICO violations (18 U.S.C. § 1962), common law fraud, statutory fraud (TEX. BUS & COMM. CODE § 27.01), and aiding and abetting fraud. Moayedi and the UDF defendants filed separate motions to dismiss the complaint. The Court granted portions of the motions with leave to replead. Megatel filed an amended complaint on November 29, 2021. Defendants filed motions to dismiss the amended complaint on January 12, 2022. The UDF defendants are facing a criminal trial and recently moved to stay the case pending the outcome their criminal case. Details on the Court’s rulings are below.

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Moayeddi founded the land development company Centurion American Custom Homes and its affiliates (Centurion). UDF is an investment fund that finances residential development projects, and Centurion was one of UDF's largest borrowers. Centurion frequently hired Megatel as a builder on its projects. Megatel alleged that when UDF and Centurion faced financial difficulties, they conspired to defraud Megatel into real estate transactions (purchasing land in Centurion's developments) designed to allow Centurion to stay afloat and to allow UDF to continue writing loans and attract new investors.

- a) [*Megatel Homes, LLC v. Moayeddi*, 2021 WL 5325919 \(N.D. Tex. Nov. 16, 2021\)](#)

Moayeddi argued that the Complaint failed to: (1) satisfy RICO's "racketeering" requirement; (2) satisfy the "pattern" requirement; (3) adequately allege a RICO "enterprise;" (4) allege a substantive RICO violation; (5) satisfy RICO's injury and proximate cause requirements; (6) satisfy RICO's conspiracy requirement; and (7) adequately plead common law or statutory fraud. He also argued that Plaintiffs' RICO claims are barred by the statute of limitations and fraud claims are barred by the economic loss rule. Applying the heightened pleading standard under Rule 9(b), the Court found that the Complaint adequately alleged predicate acts of mail fraud (18 U.S.C. § 1341) but failed to plead wire fraud (18 U.S.C. § 1343) and interstate transportation of stolen property (18 U.S.C. § 2314) with sufficient particularity. The court found the Complaint adequately alleged a pattern of racketeering, the existence of a RICO enterprise, and injury and causation. In addition to the substantive RICO claims, the Court also found the Complaint adequately alleged a conspiracy to commit RICO violations.

The Court found that the Complaint failed to plead statutory and common law fraud with sufficient particularity.

Finally, the Court found that the RICO claims were not time-barred on their face because "When a pattern of RICO activity causes a continuing series of separate injuries, the 'separate accrual' rule allows a civil RICO claim to accrue for each injury when the plaintiff discovers, or should have discovered, that injury." 2021 WL at 5325919, at *10 (quoting *Love v. National Med. Enterprises*, 230 F.3d 765, 773 (5th Cir. 2000)). Because Megatel alleged injuries that occurred within two years of filing the Complaint, the claims were not barred by RICO's four-year statute of limitations.

- b) [*Megatel Homes, LLC v. Moayeddi*, 2021 WL 5360509 \(N.D. Tex. Nov. 16, 2021\)](#)

The UDF defendants filed a motion to dismiss asserting the same arguments as Moayeddi, as well as arguing that the RICO claims were barred by the Private Securities Litigation Reform Act (PSLRA) and that Texas does not recognize a cause of action for aiding and abetting common law fraud. For the same reasons noted above, the Court found that the Complaint adequately alleged RICO violations based on predicate acts of mail fraud, but not wire fraud or interstate transportation of stolen property. The Court found that the PSLRA did not bar Plaintiffs' RICO claims. The Court held that Texas does not recognize a cause of action for aiding and abetting common law fraud and dismissed this claim with prejudice.

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Section 107 of the PSLRA ““bar[s] civil RICO claims based on ‘any conduct that would have been actionable as fraud in the purchase or sale of securities.’” 18 U.S.C. § 1964(c). The Court found that the Complaint alleged that the UDF defendants “facilitated Mr. Moayed’s racketeering activity and agreed to his commission of the alleged predicate acts” and that this would not be actionable as securities fraud even though Plaintiffs also alleged that UDF operated as a Ponzi scheme. The Court, therefore, held that Plaintiffs’ RICO claims against the UDF defendants were not barred by the PSLRA. 2021 WL 5360509, at *4.

[RICO]

II. STATE COURT CASES

A. Texas Appellate Courts

1. [*In re Ubican Global, Inc.*, 2021 WL 4533281 \(Tex. App. – Houston \[1st Dist.\] Oct. 5, 2021\) \(Radack, J.\)](#)

On October 5, 2021, Chief Justice Sherry Radack overturned a district court ruling allowing a corporate shareholder to intervene in breach of fiduciary duty litigation filed by a company against a former director and several former employees. The underlying litigation alleged that the group colluded to usurp corporate business opportunities in Texas, whereas the intervention asserted fraudulent inducement claims arising from a separate transaction. The First Court of Appeals granted mandamus and ordered the district court to strike the intervention.

Ubican is a health and wellness company that sells CBD and hemp products worldwide. In August 2019, Ubican entered into an exclusive licensing agreement with Invenda Group AG (“Invenda”), to sell its products through vending machines. One of Ubican’s directors, Todd Colter, and several of its employees worked in Texas to solicit investors and develop Ubican’s business. According to the petition, in late 2019 and early 2020, Colter and the Ubican employees colluded to steal Ubican’s business by providing Invenda with confidential strategic and financial information about Ubican that allowed Invenda to increase its financial demands, terminate the exclusive licensing agreement, and enter into a new licensing arrangement with Invenda Media Solutions, LLC (“IMS”), a company formed by Colter and the former employees. In response, Ubican filed litigating against Colter and the former employees alleging breach of the fiduciary duty of loyalty, tortious interference, conspiracy, libel, and unjust enrichment.

After Ubican filed its lawsuit, a company in which Colter was a principal called Justified Hemp Investments, LLC (“JHI”) filed a petition in intervention. JHI asserted claims against a Ubican entity and its officers for securities fraud based on a \$2 million investment it made in Ubican in 2019. Although the Subscription Agreement between JHI and Ubican was governed by Delaware law and included a forum selection clause requiring disputes to be filed in Delaware, JHI claimed that it was entitled to join the Texas litigation because Ubican had filed the action against Colter. Ubican moved to strike the petition in intervention and sought mandamus when the district court denied the motion.

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The Court began by reviewing the law governing petitions in intervention. Texas law “authorizes a party with a justiciable interest in a pending suit to intervene in the suit as a matter of right.” T.R.C.P. 60. A person has a right to intervene “if the intervenor could have brought the same action, or any part thereof, in [its] own name, or, if the action had been brought against [it], [it] would be able to defeat recovery, or some part thereof.” *Guar. Fed. Sav. Bank v. Horshoe Operating Co.*, 793 S.W.2d 652, 657 (Tex. 1990). Once a motion to strike has been filed, the burden shifts to the intervenor to show a justiciable interest in the lawsuit. *In re Union Carbide Corp.*, 273 S.W.3d 152, 155 (Tex. 2008). A justiciable interest “must be present and not merely remote or contingent.” *Zeifman v. Michels*, 229 S.W.3d 460, 464 (Tex. App. – Austin 2007, no pet.).

The Court then analyzed the factual allegations in the petition for intervention and those set forth in the underlying litigation to determine if JHI had a justiciable interest. *Id.* at *5 (citing *Smith v. City of Garland*, 523 S.W.3d 234, 241 (Tex. App. – Dallas 2017, no pet.)). The Court concluded that the shareholder claims against Ubican involved different predicate facts, different time periods, different parties, different theories of liability, and different alleged harms than those in Ubican’s claims against Colter and its former employees. JHI was not a party to the contracts on which Ubican sued, and it would not have been entitled to recover any of the relief that Ubican seeks.

As to Ubican’s claims against its former director and employees, the Court noted:

‘[T]he right to proceed against an officer or former director of a corporation for breaching a fiduciary duty owed to the corporation belongs to the corporation itself. A corporate officer owes a fiduciary duty to the corporation, but, absent some contractual or special relationship, he does not owe a fiduciary duty to an individual shareholder. JHI is a shareholder in Ubican. ‘[A] corporate shareholder has no individual cause of action for personal damages caused solely by a wrong done to a corporation.’ Likewise, individually stockholders generally ‘have no separate and independent right of action for injuries suffered by the corporation which merely result in the depreciation of the value of their stock.’ ‘Accordingly, an action for such injury must be brought by the corporation, not individual shareholders.’

Id. at *6 (quoting *Webre v. Sneed*, 358 S.W.3d 322, 330 (Tex. App.—Houston [1st Dist.] 2011, *aff’d*, 465 S.W.3d 169 (Tex. 2015)). The Court concluded that because JHI could not have brought Ubican’s pending action in its own name, it had no right to intervene.²

In response to Ubican’s motion to strike, JHI asserted for the first time that it was intervening as a defendant not a plaintiff because its claims were “interwoven” with Ubican’s claims. The Court quickly dismissed this effort, noting that courts “rarely designate intervenors as defendants” and noting that Ubican’s petitions did not assert any claims against JHI, that there

² One wonders whether the Court would have reached the same conclusion on the petition to intervene if JHI had filed a securities fraud claim based on Ubican’s failure to disclose the risks associated with the Invenda agreement. However, if the purpose of the intervention was “delay, distraction, and complication,” as Ubican alleged, JHI’s petition in intervention may have accomplished that goal.

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was no “direct antagonism” between the companies, that JHI’s interests as a shareholder were actually aligned with Ubican’s in the underlying suit, and that JHI had not met its burden to demonstrate a justiciable interest in defending against Ubican’s suit. To the extent JHI sought to stand in the shoes of its principal, Colter, the Court stated that “the law regards [them] as separate.” *Id.* at *7-8.

Based on its analysis, the Court granted mandamus for Ubican and directed the trial court to vacate its order denying Ubican’s motion to strike the intervention. The Court did not address Ubican’s alternative argument that the trial court improperly denied its motion to dismiss JHI’s claim based on venue questions.

[*Fiduciary Duty: Intervention*]

**N. Scott Fletcher
Kenneth P. Held
January 2021**

[FH009563:1]

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808 Travis Street, Suite 1420
Houston, TX 77002

(713) 255-0422

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