

SECURITIES AND FIDUCIARY DUTY CASES IN TEXAS

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

- Securities Fraud Class Actions – The Fifth Circuit reversed the dismissal of the *Six Flags* securities litigation, holding that the trial court overly discounted the allegations based on confidential witness statements. The Court reaffirmed that confidential witness allegations must be discounted but ruled that a single confidential witness with a “unique and significant corporate title,” who alleges facts in “convincing detail,” and is in a position to know facts firsthand requires only “minimal discounting.” Reviewing alleged misrepresentations that defendants claimed were forward-looking statements protected by the PSLRA safe harbor, the court found that some of the statements that referred to the current progress of construction projects were “mixed present/future” statements that were not protected by the safe harbor. As to other forward-looking statements that were not accompanied by any meaningful cautionary language, the Court found that plaintiffs adequately alleged “actual knowledge” of falsity. In the *Nobilis Health Corp.* securities litigation, the Fifth Circuit affirmed the denial of plaintiff’s motion for judgment under Rule 60(b). The trial court previously granted defendants’ motion to dismiss, which was affirmed in a prior appeal. While the appeal was pending, Plaintiff filed a motion for judgment under Rule 60(b), claiming that allegations in a related complaint filed by a third party demonstrated scienter. These allegations, the Court held, were insufficient.

The magistrate judge in the *Concho Resources* securities litigation recommended denial of the motion to dismiss, finding that plaintiffs adequately alleged that defendants made false statements regarding the company’s transition to “large scale development” or “manufacturing mode” in the Permian Basin. The Court in the *First Cash Holdings* securities litigation granted defendants’ motion to dismiss, finding that although plaintiffs pled some false statements regarding their auditors’ failure to focus on compliance with the Military Lending Act, plaintiffs failed to adequately allege scienter or loss causation. Because plaintiffs failed to allege motive to commit fraud, they were required to demonstrate a higher level of scienter, namely severe recklessness. In the *Cassava Sciences* securities litigation, the Court denied plaintiffs’ motion to lift the PSLRA discovery stay in order to obtain documents that the company had produced to the SEC in connection with an

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SEC civil action that was in the midst of settling. The Court found that plaintiffs failed to demonstrate any prejudice, other than the delay in obtaining discovery that is inherent in the automatic stay.

- SEC Enforcement Actions – The Fifth Circuit affirmed disgorgement awards in two SEC enforcement actions where the awards approximated defendants’ unjust enrichment after deducting legitimate business expenses and reiterated that trial courts are not required to hold evidentiary hearings at the remedy phase where the defendant has consented to liability and disgorgement. *See SEC v. Voight* and *SEC v. Team Resources, Inc.* In *SEC v. Reliable One Resources*, the district court rejected the SEC’s argument that it was not required to show irreparable harm in order to obtain a TRO but found that the SEC’s showing of harm to the investing public was sufficient to support a TRO. In *SEC v. Stack*, the court entered an award of disgorgement, civil penalties, and an industry bar after defendant had consented to liability.
- Other Cases – In a case arising from the Stanford Financial receivership proceeding, the district court held that Texas law does not recognize a claim for aiding and abetting breach of fiduciary duty. *Turk v. Pershing LLC*. Texas does, however, recognize a claim for “knowing participation in breach of fiduciary duty.” The court found that there was sufficient evidence to create a material fact issue whether Stanford Financial’s clearing broker, Pershing LLC, knowingly participated in Stanford Financial’s breach of fiduciary duty and aided and abetted Stanford Financial’s TSA violations where Pershing provided additional services beyond merely acting as a clearing broker, and Pershing personnel noted the risks of doing business with Stanford Financial. In a 2-1 decision, the Fourteenth Court of Appeals affirmed the dismissal of a shareholder derivative case on demand futility grounds because plaintiff failed to adequately allege how the director defendant personally benefitted from the acts that plaintiff claimed were improper. *Condon v. Kadakia*.

For convenience, the cases summarized below are hyperlinked to Westlaw.

CASE SUMMARIES

I. FEDERAL CASES

A. Fifth Circuit

1. *Oklahoma Firefighters’ Pension and Ret. Sys. v. Six Flags Enter. Corp.*, 58 F.4th 195 (5th Cir. 2023)

A Fifth Circuit panel of Judges Southwick, Haynes, and Higginson issued an important decision on confidential witness (“CW”) allegations and corporate statements regarding progress on construction projects. The Court reaffirmed that CW allegations must be discounted but ruled that a single confidential witness with a “unique and significant corporate title,” who alleges facts in “convincing detail,” and is in a position to know facts firsthand requires only “minimal discounting.”

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The Court reversed the district court's dismissal of a putative securities fraud class action against Six Flags and two of its executive officers alleging misstatements and omissions concerning construction progress on theme parks in China, ruling:

- Alleged statements from a CW described as the Director of International Construction and Project Management who oversaw the parks' construction process in China and made regular reports whose contents were shared with top management and the Six Flags board should not have been "generally discounted."
- Statements about construction "progressing nicely towards their anticipated opening dates" with "ongoing building" and "no delays" were mixed present/future statements that did not qualify for the safe harbor.
- The alleged misstatements and omissions satisfied the PSLRA's pleading requirements in light of specific allegations by the CWs that Six Flags' licensee in China had not yet commissioned fundamental blueprints, was unable to pay vendors constructing roller coasters, and rides and had made no progress on one site scheduled to open in 19 months.

Factual Allegations

Six Flags entered into a partnership with Riverside Investment Group, a Chinese real estate developer, to develop 11 Six-Flags branded theme parks in China scheduled to open between 2019 and 2021. The parks were projected to contribute at least \$60 million to Six Flags' annual EBITDA. Throughout 2018, Six Flags maintained publicly that the parks were "progressing nicely towards their anticipated opening dates." On the April and July earnings calls, the CEO cautioned that international deals sometimes take a long time, and that international contribution has been "lumpy historically, and what makes it lumpy is opening dates," but the parks' openings remained on-time.

In 2019, Six Flags began speaking more cautiously about the parks but continued to assure investors there was "ongoing building" and "no delays" of the opening timelines. In February 2019, Six Flags admitted that due to "macroeconomic events" affecting Riverside's ability to finance the parks, the openings would be delayed 6-12 months. In connection with the year-end audit, Six Flags disclosed a negative revenue adjustment of \$15 million for the fourth quarter of 2018 and had failed to reach its target EBITDA of \$600 million for fiscal year 2018. The officer Defendants also failed to earn large equity bonuses based on the missed EBITDA target. Despite this setback, throughout 2019 Six Flags said construction was "progressing," that Riverside continued to pay and was "fully committed to developing and opening these parks," and denied any material change in the opening timelines. By October, Six Flags had changed its tune on the timing of park openings and cautioned that it was unrealistic to think the timelines would hold.

In January 2020, Six Flags disclosed that Riverside had defaulted on its payment obligations. One month later, Six Flags terminated its agreements with Riverside. It also disclosed an expected negative \$1 million revenue adjustment and aggregate one-time charges of approximately \$10 million.

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Judicial Analysis

Confidential Witness Allegations. Before addressing the specific allegations in the complaint, the Court reviewed the district court’s decision to generally discount the allegations of an anonymous witness (FE1) and significantly discount his allegations about Riverside’s financial health. In a portion of the opinion likely to be quoted frequently in the future, the Court stated: “Discount does not mean unfettered discretion to discard. The degree of discounting depends on the circumstances involved.” *Id.* at 208. FE1 was described as Six Flags International’s Director of International Construction and Project Management during the relevant period with responsibility for overseeing the construction of the China parks and reporting on their progress. FE1’s significant role, combined with adequate details about the project, and at least some corroborating evidence was sufficient for the Court to rule that his allegations about the project should be discounted only minimally (not generally).¹ Instead of significantly discounting FE1’s allegations about Riverside’s financial health, they should have been minimally discounted because his role at the Company, attendance at meetings about Riverside’s ability to pay, and contemporaneous letters to Six Flags’ Senior VP for HR demonstrated that he had personal, relevant, and perhaps comprehensive knowledge about Riverside’s financial health. *Id.* The Court stated: “[W]e consider the significance of FE1’s reported role in the project to substitute for numbers.” *Id.*

Forward-Looking Statements. Defendants argued that all the alleged misrepresentations were forward-looking statements protected by the PSLRA safe harbor. The Court analyzed each statement to determine whether it was forward-looking and, if so, whether it (1) was accompanied by meaningful cautionary language, (2) was immaterial, or (3) plaintiff failed to plead that the statement “was made with actual knowledge that [it] was false or misleading.” *Id.* at 201 (quoting 15 U.S.C. sec. 78u-5(c)(1)(A)-(B)).

The Court grouped Plaintiff’s allegations into two time periods: 2018 and 2019. Although some 2018 statements concerning three new parks expected to open in 2020 and 2021 were purely forward-looking because they were a “concrete plan with no commentary about present construction progress,” the remainder of the 2018 statements about construction underway and opening timelines were not purely forward-looking and, therefore, ineligible for safe-harbor protection. The Court found they were “mixed present/future” statements because the crux of the fraud claim was that Six Flags misled investors about present construction progress.

As to the 2018 statements that were forward-looking, the Court found that they were not accompanied by meaningful cautionary language. The CEO’s statement that international deals took time, that international contribution was lumpy historically, and that opening dates make it lumpy were not meaningful cautionary language because the comments were not connected to the forward-looking statements at issue and failed to address the actual risk at issue: whether the parks might be significantly delayed or fail to open. Because these forward-looking statements were not accompanied by meaningful cautionary language, the Court went on to analyze whether Plaintiff’s adequately pleaded they were made with actual knowledge of their falsity. As discussed below, the Court found Plaintiff adequately plead actual knowledge.

¹ The Court noted this was consistent its own precedent and that of other circuits. *Id.* at *5 & n.11 (citing cases from the Third and Fourth Circuits).

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None of the 2019 statements were eligible for safe-harbor protection because the future deadlines were accompanied by reassurances about present progress towards those deadlines.

Falsity. The Court determined that Plaintiff met its burden to allege numerous facts demonstrating inadequate construction that showed why Defendants' 2018 reassurances that construction was progressing towards anticipated opening dates were misleading, even if still theoretically possible. The CW's job responsibilities were tied to the understanding of the required time to build a theme park, and his knowledge of Riverside's failure to pay vendors, pay for construction drawings, or meaningfully begin construction, supported the conclusion that the parks would not open on schedule.

The Court concluded that the complaint adequately alleged that Six Flags' statements about Riverside's financial condition in February, April, and July 2019 contained actionable omissions about its partner's true financial state. The CW again provided ample allegations of Riverside's distress, including employee terminations, underpayment of workers, construction stoppage, and lack of funds to finance the project. In the context of investors' expectations about the meaning of progress, these omissions rendered Six Flags' statements false.

In October 2019, Six Flags' language changed when it revealed that it expected changes in the timing of park openings going forward and that it was "unrealistic" to think the timelines would hold. Thus, the Court found those statements did not satisfy the pleading standard.

Scienter. For the 2018 statements that were forward-looking (but not accompanied by meaningful cautionary language), the Fifth Circuit held for the first time (and in agreement with several other circuits) that plaintiff must meet the more demanding standard of "actual knowledge:" liability arises only upon proof of knowing falsity (as opposed to recklessness, which is sufficient for statements of present fact).² Discussing motive, the Fifth Circuit cited *Barrie v. Invoice-Brite, Inc.*, 397 F.3d 249, 261-64 (5th Cir. 2005), but drew a different conclusion than the district court in favor of Plaintiff. Plaintiffs alleged that Defendants were motivated to receive equity awards of 600% and 300% of their base salaries, and that those awards would have been reached if not for the downward revenue adjustment in February 2019. This supported an inference of motive to hide the true nature of the parks' construction progress. Other relevant allegations supported scienter, such as the weekly internal reports the CW prepared for senior executives and directly relayed to the board of directors, and "master reports" containing information about the lack of construction progress prepared for the CEO.

For the 2019 statements that were not forward-looking, the Court determined that the totality of Plaintiff's allegations supporting the inference of scienter was at least as cogent and compelling as any opposing inference. Additional circumstantial allegations, including the CW's August 2019 letter to the Human Resources VP about the disastrous state of the parks, his regular reports prepared for senior management, and his allegations that construction was non-existent,

² The Court cited decisions requiring actual knowledge for forward-looking statement liability from the Second, Third, and Sixth Circuits. *Id.* at *10 (citing *Slayton v. Am. Exp. Co.*, 604 F.3d 758, 773 (2d Cir. 2010), *Institutional Invs. Grp. v. Avaya, Inc.*, 564 F.3d 242, 262 (3d Cir. 2009), and *Miller v. Champion Enters., Inc.*, 346 F.3d 660, 672 (6th Cir. 2003)).

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buttressed Plaintiff's allegations of motive and core operations theory such that when taken together, Plaintiff alleged a strong inference of scienter.

Accounting Allegations. The Court noted that standing alone, Plaintiff's allegation that Six Flags improperly recognized revenue on the China parks in its financial statements and misstated the company's compliance with GAAP might not satisfy the pleading requirements. When considered with Plaintiff's allegations that Six Flags knowingly made false and misleading statements about construction progress and opening dates, however, it was not unreasonable to infer that Six Flags also may have overstated revenue based on the projected opening dates. Despite lacking knowledge about the exact amounts of the overstatement, Plaintiff adequately alleged how the adjustments were improper in terms of reasonable accounting practices and how those adjustments were incorporated into the financial statements. The Court again cited *Barrie* in holding that because the crux of the accounting claims depended on whether the projected park opening dates were realistic, it was inappropriate for the district court to dismiss the case.

2. *Yang v. Nobilis Health Corp.*, 2023 WL 2473302 (5th Cir. Mar. 13, 2023)

In this latest appeal from a putative securities fraud class action, the Fifth Circuit upheld the district court's denial of a motion for judgment under Rule 60(b) based on alleged evidence from a third-party complaint. The plaintiff, Zhang Yang, sued Nobilis Health Care Corporation and various officers for failing to write down accounts receivable they allegedly knew were uncollectible. The district court dismissed for failure to allege a strong inference of scienter, and the Fifth Circuit previously affirmed that ruling. *Yang v. Nobilis Health Corp.*, 2021 WL 3619683 (5th Cir. Aug. 13, 2021). However, before the Fifth Circuit's opinion issued, the plaintiff also filed a motion in district court requesting relief from judgment under Rule 60(b) based on alleged concessions and statements made in other proceedings. Specifically, Yang argued that the following additional evidence supported his motion:

1. In a separate complaint, *BBVA USA v. Fleming* (N.D. Tex.), a third party alleged that Nobilis acted with scienter when allegedly misrepresenting its finances and its ability to collect on its account receivables; and
2. In the underlying action filed by Yang, Nobilis made "improper factual attacks" on his confidential witnesses.

The district court did not rule on Yang's Rule 60(b) motion until eight months after the Fifth Circuit affirmed the ruling on the motion to dismiss. The district court denied the motion on two grounds. First, it lacked jurisdiction because "the case [was] no longer on appeal ... [and] the Fifth Circuit never ordered [the district court] to indicate whether it would be inclined to grant or deny the Rule 60(b) motion." Alternatively, if the district court did have jurisdiction, Yang offered no evidence to support his claim that Nobilis made improper factual attacks on confidential witness account.

Addressing the jurisdictional question first, the Fifth Circuit noted that when an appeal is initiated, it divests the district court of jurisdiction "except to take action in aid of the appeal." *Id.* at *2. But once the appeal is resolved, the district court reassumes jurisdiction. *Id.* A district court that reassumes jurisdiction following an appellate court's mandate is not required to obtain leave

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to consider post-judgment motions. *Id.* Thus, the Court ruled it was an abuse of discretion for the district court to decline to address Yang’s Rule 60(b) motion on jurisdictional grounds.

The Fifth Circuit then turned to the substantive arguments. It agreed with the district court that Yang could not rely on allegations in the BBVA complaint as new evidence to prove scienter. While some third-party pleadings might be admissible for a limited purpose (e.g., SEC investigative findings admissible under the public records exception in a related proceeding, or third-party pleadings used to determine an insurance company’s duty to indemnify), the BBVA complaint merely set forth alleged statements by Nobilis. The Court rejected Yang’s second substantive argument on procedural grounds, noting in a footnote that he failed to point to “improper factual attacks” on confidential witness accounts in his primary brief on appeal. *Id.* at *3 n.4.

3. *SEC v. Voight*, 2023 WL 1778178 (5th Cir. Feb. 6, 2023)

In a short per curiam opinion, the Court affirmed an award of disgorgement in an SEC enforcement action after the defendant consented to liability for conducting Ponzi schemes that defrauded investors of tens of millions of dollars. Relying on *Liu v. SEC*, 140 S.Ct. 1936 (2020) and *SEC v. Hallam*, 42 F.4th 316 (5th Cir. 2022), the Court found that the disgorgement award was proper because it “reasonably approximated Voight’s unjust enrichment.” Further, under *Hallam*, the district court was not required to hold an evidentiary hearing on the SEC’s remedy motion, especially where Voight failed to identify any evidence that would have contradicted the SEC’s fraud examiner’s declaration.

4. *SEC v. Team Resources Inc.*, 2023 WL 1434277 (5th Cir. Feb. 1, 2023)

In another short per curiam opinion, the Court affirmed an award of disgorgement and a civil penalty in an SEC enforcement action after the defendant consented to liability for defrauding 475 investors of more than \$33 million. In its initial decision, the district court previously ordered disgorgement of \$15,508,280 and imposed a civil penalty in the same amount. The Fifth Circuit remanded that decision in light of *Liu v. SEC*, 140 S.Ct. 1936 (2020) because the district court failed to deduct legitimate business expenses from the disgorgement amount. On remand, the district court lowered the disgorgement amount to \$2,410,630 after deducting expenses. The district court did not reconsider the civil penalty amount because it was outside the scope of the remand.

On appeal, the Fifth Circuit affirmed the disgorgement award and held that defendants were not entitled to an evidentiary hearing on the SEC’s remedy motion under *SEC v. Hallam*, 42 F.4th 316 (5th Cir. 2022). Moreover, defendants waived the right to challenge the civil penalty amount because they did not challenge it in their initial appeal. Finally, by filing to raise the argument to the district court, defendants waived their argument that the civil penalty was an excessive fine in violation of the Eighth Amendment because it was more than six times the disgorgement award.

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B. District Courts

1. Securities Class Actions

(a) *In re Concho Resources Inc.*, 2023 WL 2297425 (S.D. Tex. February 23, 2023) (Sheldon, M.J.)

Magistrate Judge Sheldon issued a Memorandum and Recommendation to deny Defendants' motion to dismiss this securities fraud class action complaint. The Court found the allegations were sufficient to state a claim against Defendants for violations of the Securities Exchange Act of 1934. Defendants filed objections to the recommendation, and briefing is underway.

Allegations

Plaintiffs' allegations stem from Defendant Concho Resources Inc.'s transition to "large-scale development" or "manufacturing mode" in the Permian Basin. Plaintiffs alleged that Concho's production was at an "inflection point," which Concho claimed would allow it to maintain its established efficiencies, returns, and risk management in its historically well-managed portfolio. In February 2018, Concho announced 7-well, 8-well, 10-well, and 13-well large-scale developments that showed "strong performance" and "outstanding results," which would serve as an empirical point for moving forward with larger projects in the North and South Delaware Basin. Defendant Timothy A. Leach, Concho's CEO, assured investors that Concho's prior efforts had "validated well spacing, lateral placement, and completion design," which allowed them to "give guidance [and] forecast the things that [they were] aware of at the time they give the guidance."

In May 2018, Concho announced six multi-zone "Key Projects" planned for 2018 and 2019, including a 6-well project, an 8-well project, three 10-well projects, and a 23-well project. The 23-well project was called the "Dominator."

In May 2019, Defendant Leach stated that he saw "strong early production out of our latest projects, including the Dominator."

On July 31, 2019, Concho released its financial results for the second quarter of 2019 and advised that it reduced its active rig count and reduced production targets for the remainder of the year. It also announced, however, that it would not make a parallel reduction in its capital budget. Concho blamed the Dominator and its too-tight well spacing for the disparity between its financial projections and financial results. The following day, Concho announced it would immediately change its trajectory to wider spaced wells to reign in the costs of transitioning to manufacturing mode and to stay on budget.

On October 19, 2020, ConocoPhillips and Concho announced an agreement to combine the two companies.

Defendants Leach, Jack F. Harper, C. William Giraud, E. Joseph Wright, and Brenda R. Schroer were members of Concho's upper management during the class period. Plaintiffs allege Defendants made misstatements and omissions amounting to securities fraud under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by:

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- declaring the transition to large-scale development as a success and touting its benefits despite having no basis to know it would work as intended;
- falsely stating that “manufacturing mode” was the product of gradual learning and verified techniques despite being experimental;
- issuing non-risk adjusted production forecasts despite internal understanding that such forecasts were inaccurate and overstated; and
- stating that large-scale development projects with higher risk exposure were balanced by projects with lower risk exposure, when in reality exposure was company-wide.

PSLRA Safe Harbor Does Not Apply

Defendants argued that many of the alleged misstatements were inactionable because they were forward-looking statements accompanied by meaningful cautionary language. Plaintiffs contended that any forward-looking statement regarding financial projections and future performance referenced the present strength of large-scale development and the present transition to manufacturing mode such that it would not be protected by the PSLRA safe harbor. Plaintiffs also argued that the PSLRA safe harbor did not apply to material omissions of fact. Finally, Plaintiffs argued that even if the statements were considered forward-looking, the blanket warnings submitted in Concho’s SEC filings were inadequate.

The Court agreed with Plaintiffs. Without reciting them, the Court concluded that Defendants’ statements containing forward-looking statements relied on present and historical facts. Defendants tied increased production to increased financial forecasts based on the purported data they gradually collected over a significant amount of time. Further, the Court concluded that Defendants omitted material information regarding the risk assumptions that inflated financial forecasts, including the lack of data supporting the too-tightly spaced wells and the ability to offset the risk incurred by the transition and thus the ability to weather the failure of transitioning to manufacturing mode. After reviewing Defendants’ cautionary language and drawing inferences in Plaintiffs’ favor, the Court concluded the language was insufficient to give meaningful warnings about Defendants’ statements. Accordingly, the Court denied safe harbor protection. 2023 WL 2297425, at *14.

Opinion Statements & Puffery

Defendants next argued that several alleged misstatements were inactionable opinions. The Court rejected this argument, concluding that Plaintiffs identified particular facts going to the basis of the Defendants’ opinion statements that were omitted that rendered the opinion statements misleading to a reasonable person reading them fairly and in context. Plaintiffs alleged that both large-scale development and appropriate well-spacing were not methodically data-driven. Instead they were driven by a desire to figure out how closely wells could be spaced together and how many wells could be placed on a pad by any means possible. Concho’s statements that manufacturing mode was gradually built and supported by a technological basis, that projections were built on data reflective of the technique’s risk, and that the transition was an early success were, therefore, misleading.

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The Court concluded that Plaintiffs alleged facts showing Defendants knew their gamble “was far riskier and subject to far greater undisclosed costs, write-downs, and/or risks than publicly disclosed,” which is exactly what a reasonable investor would expect to know for such a wide-scale transition from the company’s historical way of operating. Accordingly, the Recommendation stated that Defendants’ opinion argument was without merit. *Id.* at *15.

Defendants also argued that statements about the initial Dominator results were “textbook non-actionable puffery.” The Court rejected this argument, finding the statements were made in the context of announcing projected increases in production, which influenced the financial forecasts. Further, the statements were too specific to be general corporate optimism. *Id.* at *15.

False and Misleading Statements and/or Omissions

Defendants argued that the alleged misstatements regarding Concho’s largescale development projects – including the success and benefits, technological justification, relevant production guidance, and overall concentration in Concho’s asset base – were not false and misleading. The Court disagreed, finding that the Complaint adequately alleged:

- When describing the early success of the transition to manufacturing mode, Defendants omitted the initial and ongoing cost and risk which threatened overall “production, capital efficiency, growth, asset longevity, and overall financial health.”
- Defendants abandoned proven methodologies in favor of the “manufacturing” technique despite it lacking any technical basis.
- Defendants disregarded the risks associated with large-scale development and aggressively spaced wells.
- Despite Defendants’ regular representations that risk was spread throughout the company’s portfolio of assets, there were many projects with risky well-spacing were widespread. Deviating from its historical practice, Concho lacked low risk projects to balance the increase in risk from the transition to manufacturing mode.

Defendants also argued that any alleged omission is inactionable because it would “impose a duty of self-flagellation that is foreign to federal securities laws.” The Court rejected this argument. Citing *Six Flags Ent. Corp.*, the Court concluded that a reasonable investor would have viewed the widespread risk increase, lack of a measured technological basis for the risk increase, and inflated financial forecasts without proper reflection of that risk, as significant facts to alter the total mis of information available.

Defendants also argued that Defendants Schroer and Wright should be dismissed because Plaintiffs did not allege that they made specific misstatements or omissions or plead individual scienter. Plaintiffs contended that Schroer and Wright were makers of statements because they signed Concho’s annual SEC filings. The Court agreed that Wright and Schroer made statements by signing the SEC 10-K Forms, which contained allegedly false and misleading statements.

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Scienter

Motive and Opportunity Allegations. Defendants argued that Plaintiffs failed to raise a strong inference of scienter because they didn't allege motive and opportunity to commit fraud. Plaintiffs countered that Defendants' motive for the transition to manufacturing mode was to stay relevant as "pioneers in the industry" in the "American oil and gas exploration and production renaissance." The Court found that Plaintiffs sufficiently pled circumstances constituting at least severe recklessness with respect to Defendants' overstatement of its success in large-scale manufacturing mode, assurances to investors regarding the nature of portfolio exposure, confirmation of a data-driven technological basis for the production technique, and use of the incorrect risk profile to develop financial forecasts. *Id.* at *19. The Court even stated that "Defendants' claims that the 'overtly experimental nature of Concho's progressive effort to push the boundaries' all but writes the narrative Plaintiffs allege, as opposed to the 'non-culpable gloss' they claim." *Id.* at *19.

Confidential Witnesses. Plaintiffs relied on statements by nine former employees (FEs) to allege a strong inference of scienter. The Court rejected Defendants' argument that all the FE statements must be "heavily" discounted. It generally discounted only two FEs statements. Plaintiffs particularly relied on contemporaneous facts provided by FE-1, a member of the technical staff who designed and executed the Dominator project. FE-1 stated:

- The transition to manufacturing mode was largely experimental and Defendants were willing to conceal the true nature of the risk;
- Defendants were willing to take shortcuts to prevent the permanent loss of resources, and "manufacturing mode" was one way Defendants could assure investors they would maintain their reputation as the "best value-creating engine in [the] industry."

Plaintiffs pointed to meetings where technical teams, reservoir engineers, management, and Giraud discussed the risk of transitioning to manufacturing mode. According to one FE, the executive team, especially Giraud, pushed the Dominator project from the top down.

FE-8 (a former senior geologist) explained that FE-2 (a former Concho lead reservoir engineer who oversaw simulations to ensure appropriate well density) warned Concho that based on simulations, Dominator would not work and would be "over-drilled." Concho and Giraud ignored his warning.

The Court concluded that these allegations give rise to a strong inference of scienter because the danger of misrepresentation must have been obvious. *Id.* at *20. Giraud, Harper, and Leach all touted the benefits of transitioning to manufacturing mode, but as Concho's testing had proved, the Dominator project only consisted of child wells. Accepting these allegations as true, Giraud, Harper, and Leach ignored their own data and recklessly disregarded known risks as they told investors the program was a success. *Id.* at *20.

According to Plaintiffs, Giraud directed FE-1 to apply historic risk profile numbers to Dominator rather than the significantly higher risk profile numbers recommended by FE-1 and his

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team. The true risk profile was available but not applied. The Court concluded that this supports a strong inference that Giraud, at the least recklessly, but more likely knowingly, used the incorrect risk profile to develop financial forecasts to mislead the public. *Id.* at *20.

Importance of Manufacturing Mode to the Company. Plaintiffs relied on the importance of manufacturing mode to the Company and the Individual Defendants' involvement in daily operations to support a strong inference of scienter. Plaintiffs alleged that Leach, Harper, and Giraud repeatedly told investors that the transition to manufacturing mode was a key driver of Concho's successful financial performance.

Plaintiffs alleged facts showing the importance of manufacturing mode to Concho's overall vitality – specifically, that the failure of Dominator to work as advertised hurt the company's financial performance. The Court, therefore, found a strong inference of scienter for Leach, Harper, Giraud, Wright, and Schroer. *Id.* at *21. Given the importance of manufacturing mode's success, it was reasonable to assume that Wright and Schroer familiarized themselves with the financial condition and associated risk of shifting to manufacturing mode. The Court found strong circumstantial evidence of conscious misbehavior or recklessness on the part of Schroer and Wright in signing the Form 10K. *Id.* at *21.

Weighing Competing Inferences. The Court analyzed Defendants' competing inferences to determine if they were more compelling. Citing *Spitzberg*, the Court noted a tie favors a plaintiff on a motion to dismiss. Individual Defendants argued their conduct amounted to “hubris or overconfidence” rather than scienter. Defendants' willingness to bet the move to manufacturing mode would work, despite information to the contrary, was an extreme departure from the standards of ordinary care such that the danger of misleading investors was so obvious that Defendants must have known.

Defendants also argued that they disclosed the fact that they were learning as they went and disclosed the risky nature of their experiment. The Court rejected this argument, stating that the risk of learning as you go is only mitigated when the process is gradual. Plaintiffs' allegations showed that Defendants ignored unfavorable data they collected in favor of a riskier and, hopefully, higher payout. Recognizing that additional evidence may later support or refute Plaintiffs' factual allegations, the Court concluded that Plaintiffs' contention at the motion to dismiss stage was “at least as compelling as any opposing inference one could draw.” (citing *Spitzberg*, 758 F.3d at 684).

Concluding that Plaintiffs sufficiently alleged false statements and facts giving rise to a strong inference of scienter, the Court recommended that Defendants' motion to dismiss be denied. *Id.* at *23.

(b) *Genesee County Emp. Ret. Sys. v. FirstCash Holdings, Inc.*, 2023 WL 2752846 (N.D. Tex. Mar. 31, 2023) (Pittman, J.)

Judge Pittman granted defendant FirstCash Holdings, Inc.'s motion to dismiss plaintiff's claims under Sections 10(b) and 20(A) of the Securities Exchange Act based on a detailed, thorough analysis of the confidential witness allegations in the complaint.

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FirstCash is an international pawnbroker and financial lender in the United States. Its revenue is heavily driven by short-term pawn loans, whose terms often include short maturity dates and high interest rates. These loans are subject to local, state, and federal regulation, including the Military Lending Act (MLA), amended in 2015. The amended MLA prevents pawn lenders such as FirstCash from charging annual percentage rates in excess of 36% to active-duty members of the military or their dependents. The MLA provides a safe harbor for lenders who use its optional database when conducting transactions.

In 2016, FirstCash merged with its competitor Cash America. At the time of the merger, Cash America was subject to a 2013 consent order with the Consumer Financial Protection Bureau (CFPB). The consent order required compliance with the MLA and, after the merger, applied to FirstCash. In its SEC filings, FirstCash touted its operations and controls, including a proprietary point-of-sale system, audit teams, and employee training programs. These filings also described a stable and state-centric regulatory environment for pawn shops. The 10-K reports also discussed FirstCash's risks associated with the MLA, 2013 consent order, and other regulations.

In November 2021, the CFPB sued FirstCash, alleging that it violated the 2013 consent order and MLA by making 3,600 pawn loans to active-duty military members between June 2017 and May 2021. FirstCash denied the allegations and filed a motion for judgment on the pleadings. It also filed an 8-K denying all wrongdoing. The CFPB litigation was stayed because the Fifth Circuit separately held that the CFPB's self-funding structure violated the Appropriations Clause and underlying separation of powers in the Constitution.

While the CFPB litigation remains stayed, plaintiff sued FirstCash under Sections 10(b) and 20(A) of the Securities Exchange Act, alleging that the statements in the SEC reporting were materially misleading or omitted information that inflated the stock price, causing a drop when the CFPB filed suit. In its motion to dismiss, FirstCash argued that plaintiff failed to plead allegations sufficient to support the required elements of: (1) misrepresentation or omission ("falsity"); (2) scienter; and (3) loss causation.

Discounting of Confidential Witnesses

Because plaintiff's claims rested upon the testimony of five confidential witnesses (CWs), the district court painstakingly applied three levels of functional discount to the allegations: slight, moderate, and heavy. Moderately discounted allegations were considered with caution and reduced weight, and heavily discounted allegations were given little to no weight at all. Slightly discounted allegations were given substantial weight, perhaps not even a discount at all. In the *Six Flags* case, the Fifth Circuit applied a "slight discount" that merited adoption of everything the CW said, even statements about the financial health of a company for whom the CW did not work.

After applying these "indefinite adjectives" to show how much discount applied to each CWs statement based on job description, individual responsibilities, and allegations made, the district court created a chart summarizing each statement to which it gave substantial weight, reduced weight, and no weight. *Id.* at *7. The process of applying these discounts put courts into "the position of a landlocked shrimp consumer – it's always good to get a discount, but at a certain

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point, heavily discounted shrimp at the local market in Rising Star, Texas becomes too suspicious to warrant a purchase.” *Id.* at *3.

Falsity

The Court grouped the alleged misrepresentations into three categories: operations and training, regulatory environment, and financial performance.

There was no misrepresentation or omission in FirstCash’s failure to use the external, optional MLA database or its failure to notify investors that it did not use the database because corporations have no duty to disclose a fact about an optional practice merely because a reasonable investor might like to know that fact.

Reviewing the statements regarding the regulatory environment, the Court took judicial notice of the totality of the contents of FirstCash’s 10-Ks, which were referenced in the complaint, and found that the 10-Ks repeatedly referenced the company’s exposure to the MLA and the CFPB’s regulatory power. Those statements were not buried or hidden; rather, they were clearly stated in the “Risk Factors” section. The Court rejected plaintiff’s allegation that the FirstCash 8-K’s should have disclosed the risk factors because such inclusion “would transform routine disclosures into a corporate rite of confession.” FirstCash’s claims of a “stable regulatory environment” and “no significant regulatory change for the last 25 years” were mere puffery and non-actionable opinion statements because they were subjective, and dependent upon context, industry, and company.

However, the Court found that the allegation that FirstCash’s field auditors did not focus on MLA compliance sufficiently plead a material misstatement. *Id.* at *10. A reasonable investor might have found the auditor’s lack of attention to the MLA impactful on an investment decision given FirstCash’s representations about its audit teams in its SEC reporting. FirstCash’s representations regarding its employee training were also materially misleading because, taken as a whole, the CWs’ allegations about training, specifically one CW’s claim that he received no training, did not match FirstCash’s descriptions of “robust consumer and corporate compliance programs” and “extensive training” in “regulatory compliance.” Finally, while noting “many gaps and problems” with plaintiff’s allegation that FirstCash’s revenues were misstated because they included the 3,600 pawn loans that allegedly violated the MLA, the Court found that the allegation was likely sufficient to support an inference that a reasonable investor would have considered misstated earnings a relevant factor in an investment decision. *Id.* at *14.

Scienter

Plaintiff failed to allege any motive in support of an inference of scienter. Without any allegation of motive, the plaintiff was required to meet the higher burden of demonstrating “severe recklessness.” This requires “an extreme departure from the standards of ordinary care,” that presented “a danger of misleading buyers or sellers which is either known to the defendant or so obvious that the defendant must have been aware of it.” *Id.* at *15. The Court noted that what constitutes a properly plead motive is unclear in the Fifth Circuit after *Six Flags*, where an executive bonus plan tied to EBITDA was considered adequate motive for scienter. Judge Pittman

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stated the *Six Flags* holding was “perplexing” because “none of the components that make up EBITDA have any relation to the share price or performance of a publicly traded stock,” leaving district courts with “a rather awkward question: does the motive for scienter have to make logical sense or must district courts adopt completely nonsensical scienter assertions?” *Id.* at *15, fn. 53. The plaintiff’s lack of motive allegation relieved the court of having to choose between two bad options: (1) assume the Fifth Circuit was honestly mistaken in *Six Flags*, or (2) adopt a new motive standard that went directly against the heightened pleading standards of the PSLRA. Judge Pittman’s critique of the *Six Flags* opinion is notable because it was his order that was reversed by the Fifth Circuit in that case.

The Court found that Plaintiff’s allegations were insufficient to demonstrate “severe recklessness” necessary to establish scienter. The SOX certifications signed by the individual defendants failed to support an inference of scienter because the plaintiff failed to allege that the defendants had any actual knowledge of the MLA violations. The allegations regarding statements contained in the 10-K, 10-Q and 8-Ks likewise failed to state with particularity anything besides the general job responsibilities of executives, and at bottom, were impermissible group pleading. Plaintiff failed to allege any of the “special circumstances” necessary to justify an inference of scienter based upon an officer’s position under *Diodes*. The allegations were insufficient to overcome the Fifth Circuit’s “disdain” for group pleading. *Id.* at *18. Therefore, only the CEO’s statements in the Form 8-K investor presentations could support an inference of scienter. The Court dismissed those statements as “a Russian-nesting-doll of allegations with nothing beyond the CFPB’s vague assertions to back itself up.” *Id.* at *19. Plaintiff failed to (1) estimate how much the earnings were inflated, (2) provide any standard of comparison to what the correct numbers should have been, and (3) provide any detail beyond descriptions of the CEO and CFO positions, and FirstCash never revised its financial statements.

Loss Causation

Loss causation under the PSLRA requires a plaintiff to allege a plausible causal relationship between the fraudulent statements or omissions and the drop in stock price. Generally, this is shown by alleging misrepresentations or omissions followed by the leaking out of relevant facts or related truth that correct the alleged misstatements or omissions. The plaintiff alleged that the CFPB litigation against FirstCash was the corrective disclosure required by the PSLRA. The district court refused to consider the allegations in the CFPB lawsuit a corrective disclosure, calling it a “tangle of allegations... currently stayed at the pleadings stage.” The court noted that a full disclosure may not be required, but a corrective disclosure must be verifiably true to a least some small degree.

The Court dismissed Plaintiff’s claims.

(c) *In re Cassava Sciences, Inc. Sec. Litig.*, 2023 WL 28436 (W.D. Tex. Jan. 2, 2023) (Hightower, M.J.)

In this putative securities class action against Cassava Sciences, Inc., a company that was developing a drug to treat Alzheimer’s disease, Magistrate Judge Susan Hightower denied Plaintiffs’ motion to lift the PSLRA discovery stay. Although the only documents requested were

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those already produced in government investigations and in a separate shareholder derivative action, the Court ruled that Plaintiffs failed to establish that they would be unduly prejudiced if the stay were not lifted.

To lift the automatic discovery stay under the PSLRA, Plaintiffs must prove either that the requested discovery is needed to (1) preserve evidence or (2) prevent undue prejudice. 15 U.S.C. §78u-4(b)(3)(B). Plaintiffs relied only on the undue prejudice prong which has been construed as “improper or unfair treatment amounting to something less than irreparable harm.” *Texas Pac. Land Tr. v. Oliver*, 2019 WL 3387767, at *4 (N.D. Tex. July 26, 2019). However, prejudice caused by the delay inherent in the PSLRA’s discovery stay is not “undue prejudice.” *Barrett v. Wilson*, 2011 WL 13134638 (S.D. Tex. Aug. 15, 2011).

Plaintiffs argued they would be unduly prejudiced because they would be the only major party in the several proceedings involving the same core events not to receive sets of the documents in question, and because resolution of the government investigations could potentially reduce Cassava’s limited resources to settle the action. They further argued that courts have routinely granted stays in cases involving concurrent investigations by government agencies, particularly when the cost of discovery is minimal for defendants.

The Court stressed that stays were granted in other cases only when the plaintiff met its burden to show undue prejudice by meaningfully explaining (1) how it will be prejudiced, (2) why it has a particular need for early discovery of the material, or (3) how the specific documents and deposition testimony sought will actually prevent undue prejudice. *Id.* at *3. While Plaintiffs claimed the SEC civil action against Cassava was “in the midst of settling,” they did not argue they were unable to formulate an appropriate settlement demand or had to defer settlement decisions in the current action without discovery. The Court compared Plaintiffs’ argument to that rejected in *Odyssey Healthcare* where plaintiffs claimed undue prejudice whenever the PSLRA stay prevents discovery of related government investigations:

Plaintiffs’ rationale, if accepted, would effectively result in a structural, or at least categorical, exception to the discovery stay that is neither apparent nor discernible from [the statute]. It would be possible to find “undue prejudice” based on the amorphous notion that a plaintiff who sought discovery – even one who had not yet made the PSLRA’s heightened pleading standard – is entitled to the same discovery as are other interested parties – including, presumably, those who had met the standard – provided the Plaintiffs would be prejudiced by a perceived inability to make informed decisions about litigation strategy. Neither the plain terms of the statute nor the purpose of the discovery stay lends itself to so facile a showing of undue prejudice.

In re Odyssey Healthcare, Inc., 2005 WL 1539229, at *2 (N.D. Tex. June 10, 2005). The Court also rejected Plaintiffs’ argument that Cassava had limited assets because Cassava had not filed for bankruptcy and Plaintiffs did not argue bankruptcy was imminent.

The Court concluded that “this appears to be a ‘garden variety’ case in which the only thing which has happened, apart from ordinary litigation activities, is that Defendants have produced documents to government agencies and to other non-parties in other litigation.” *Id.* at *4 (citation

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omitted). Because the Plaintiffs did not show how or why they would be unduly prejudiced without the requested discovery, the Court recommended denial of the motion.

2. SEC Enforcement Actions

(a) *SEC v. Reliable One Resources, Inc.*, 2023 WL 177687 (E.D. Tex. Jan. 9, 2023) (Barker, J.)

Judge Barker granted the SEC's motion for an ex parte TRO enjoining defendants from violating the securities laws and freezing their assets. The SEC argued that – contrary to the requirements of Federal Rule of Civil Procedure 65 – it was not required to show irreparable injury. The Court disagreed, but also held that irreparable harm to the investing public qualified as irreparable harm to the SEC. Further, the finding of future securities violations implies a significant injury to the public, but the strength of the inference depends upon the facts and circumstances of the case. Here, the Court granted the TRO because it found

a likelihood that that either (i) funds controlled by defendants that are traceable to the alleged violations of securities laws would be dissipated, concealed, or transferred by defendants and thus unrecoverable by the SEC or investors or (ii) that new investors with defendants would transfer money that has the same characteristics. And the declarations show a likelihood that defendants, were they to engage in such acts, would not have funds or assets sufficient to fully satisfy any judgment that may be ordered in this action. So the injury of dissipation, concealment, or transfer of assets traceable to securities violations would not be reparable by damages awarded only at the end of the case.

2023 WL 177687, at * 3.

(b) *SEC v. Stack*, 2023 WL 1325495 (W.D. Tex. Jan. 31, 2023) (Yeakel, J.)

Judge Yeakel granted the SEC's motions for financial relief and injunctive bars against William Stack. Stack was a licensed securities law attorney who represented individuals and entities in the over-the-counter penny stock market. He had filed for bankruptcy protection five times before he was persuaded to become the CEO, President, Treasurer, Secretary, and Director of Preston Corp, a Nevada shell corporation that purportedly specialized in financing gold mining operations. The Company raised \$330,000 from investors but never commenced operations because it failed to obtain necessary financing.

By the time the SEC's motion for financial relief and injunction bars was presented to the Court, Stack had consented to entry of an Agreed Partial Judgment and injunctive relief. Stack nonetheless argued that (1) he was he was unaware of unlawful solicitations or sales, (2) he did not materially benefit from the violations, (3) the disgorgement amount should be reduced by legitimate business expenses, and (4) he lacked the financial resources to pay any civil penalties. The Court repeatedly rejected these arguments based on Slack's admissions in the Agreed Partial Judgment, and it ordered Stack to pay disgorgement and civil penalties. In a partial victory for Stack, however, the Court rejected the SEC's request for permanent bars and only barred Stack

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for five years from (1) serving as an officer or director of a public company, (2) participating in a penny stock offering, and (3) providing legal services in connection with offer or sale of securities.

(c) *SEC v. Gandy*, 2023 WL 211005 (S.D. Tex. Jan. 17, 2023) (Bray, M.J.)

Magistrate Judge Bray granted the SEC's motion to quash defendant's notice under Rule 30(b)(6) to depose the SEC's corporate representative regarding (1) facts related to the witness declarations in this case, (2) information regarding the Wells Notice letters, (3) facts related to a document that had been submitted anonymously to the SEC, and (4) the original complaint and facts related to its genesis. Following precedent from courts in New York and Maryland, the Court held that the topics would improperly invade the work product of the SEC's investigating attorneys. Certain non-work product information could have been sought by other means (such as deposing the witnesses who submitted declarations), but defendants failed to do so.

3. Other Cases

(a) *Turk v. Pershing LLC*, 2023 WL 36080 (N.D. Tex. Jan. 3, 2023) (Godbey, J.)

In another case arising out of the Stanford receivership proceeding, Judge Godbey granted in part and denied in part motions for judgment on the pleadings and for summary judgment filed by Pershing LLC. Pershing was the custodian and clearing broker for Stanford Group Company (SGC), the Houston broker-dealer for entities controlled by R. Allen Stanford (collectively, Stanford). After the Court's prior rulings on motions to dismiss, the claims remaining against Pershing were (1) aiding and abetting violations of the Texas Securities Act (TSA); (2) aiding and abetting breach of fiduciary duty under Texas common law; (3) knowing participation in breach of fiduciary duty; and (4) civil conspiracy.

Judgment on the Pleadings

Pershing moved for judgment on the pleadings on the Intervenor's claims for aiding and abetting violations of the TSA and aiding and abetting breach of fiduciary duty. Pershing argued the TSA claims were barred by the 5-year statute of repose because the last sale alleged in the Intervenor's complaint occurred no later than 2009, yet they did not intervene until 2019. Pershing also argued that there is no cause of action for aiding and abetting breach of fiduciary duty under Texas law. The Court agreed with both arguments.

The Court ruled the TSA claims were time barred and not subject to class action tolling. It noted that the Supreme Court recently held that class action tolling, an equitable doctrine, cannot override a statute of repose. *Id.* at *3 (citing *Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042, 2052 (2017)). In a footnote, the Court rejected Intervenor's suggestion that ANZ did not apply, reasoning that "remaining in a purported class does not satisfy the statute of repose if the court denies class certification" and "ANZ Securities requires plaintiffs to take cautionary steps within the response period." *Id.* at *3 n.2.

As to the claim for aiding and abetting breach of fiduciary duty, the Court noted that this is not a recognized cause of action in Texas. *Id.* at *3 (citing *First United Pentecostal Church of*

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Beaumont v. Parker, 514 S.W.3d 214, 224 (Tex. 2017) (the Texas Supreme Court “has not expressly decided whether Texas recognizes a cause of action for aiding and abetting.”). Moreover, the Fifth Circuit recently clarified that federal courts “exceed[] the bounds of legitimacy in fashioning novel causes of action not yet recognized by federal courts.” Nevertheless, the Court noted that the separate claim for knowing participation in breach of fiduciary duty has long been recognized in Texas and would be discussed as part of its ruling on Pershing’s motion for summary judgment on that claim.

Summary Judgment

Pershing moved for summary judgment on the following claims: aiding and abetting TSA violations (sale of unregistered securities, sale of securities by an unregistered dealer, and sale of securities through untruths or omissions); knowing participation in common law breach of fiduciary duty; and civil conspiracy.

1. Aiding and Abetting TSA Violations

Pershing first argued that some of the TSA claims did not apply to Intervenor Lynne Turk because she was a resident of Florida when she invested in Stanford International Bank Limited (SIBL) certificates of deposit (CDs). The Court dispensed of this argument based on the Texas Supreme Court’s ruling in *Citizens Insurance Co. v. Daccach*, 217 S.W.3d 430, 446 (Tex. 2007), which concluded that “the Texas Legislature intended section 12 of the [TSA] to prohibit the unregistered sale of securities from Texas, even when the purchasers are nonresidents.” Even if the operative facts of the untruth-or-omission claim were connected to Florida, not Texas, the record evidence showed that an “act in the selling process” occurred in Texas, which Texas courts have ruled is sufficient for the TSA to apply.

Pershing next argued that Intervenor failed to raise a material fact issue because there was insufficient evidence that Pershing substantially assisted Stanford. The Court stated that while the actions of clearing brokers are generally not subject to liability, they can be held liable if they perform more than mere ministerial or clerical services. The Court then cited evidence that Pershing marketed itself to Stanford as a strategic partner, offered to provide one-on-one interaction with financial advisors, and executed a clearing agreement giving it the ability to exercise professional judgment and discretion in clearing transactions. Based on this evidence, the Court ruled a reasonable jury could find that Pershing rendered substantial assistance to Stanford.

The Court noted a TSA aiding and abetting claim requires an intent to deceive or reckless disregard for the truth or the law. The Texas Supreme Court has interpreted “reckless disregard” to encompass assistance rendered “in the face of a perceived risk” that it would “facilitate untruthful or illegal activity.” *Sterling*, 168 S.W.3d at 842. The Court cited significant evidence of this perceived risk:

- Pershing’s Due Diligence Committee received information to “be careful in doing business with Stanford”;
- Pershing personnel questioned Stanford’s processes, including how they met return objectives, their sources of capital, and where the CD proceeds were invested; and

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- Pershing employees who saw these “red flags” were repeatedly rebuffed by Stanford when they sought to investigate. Pershing executives even joked that Stanford was running a Ponzi scheme and guessed he would follow Bernie Madoff.

The Court ruled this was sufficient evidence to deny summary judgment on the TSA claims.

2. Knowing Participation in Breach of Fiduciary Duty

The Court stated that a knowing participation claim requires proof that (1) a fiduciary relationship existed; (2) the third party knew of the fiduciary relationship; and (3) the third party knew it was participating in a breach of that fiduciary relationship. While Texas requires actual knowledge of the breach to show knowing participation, it can be shown through circumstantial evidence. Citing the evidence supporting Pershing’s intent to aid and abet TSA violations, the Court found sufficient evidence to raise a material fact issue on Pershing’s intent. The Court noted evidence that Pershing had a highly lucrative relationship with Stanford and SGC, recognized signs of improper activity but continued the relationship, and knew that SGC depended on referral fees.

3. Civil Conspiracy

Pershing argued that Intervenors lacked evidence of a meeting of the minds between SGC and Pershing to engage in unlawful activity. The Intervenors did not respond to this argument, so the Court granted summary judgment on this claim.

(b) *VTX Communications, LLC, et al. v. AT&T, Inc. et al.*, 2023 WL 2144154 (S.D. Tex. Feb. 21, 2023) (Alvarez, J.)

Judge Alvarez granted in part and denied in part competing summary judgment motions in this dispute among general and limited partners of three partnerships formed with AT&T in the 1980s to provide cellular service in South Texas. The dispute centered around the actions of AT&T as cellular service evolved from voice-only to data sharing, the introduction of prepaid phone service, and the granting of additional spectrum licenses. In general, the Court sided with the limited partners against AT&T and granted summary judgment to the limited partners on their claims against AT&T for breach of the fiduciary duty of loyalty.

Factual Background

In the 1980s, the FCC issued licenses for mobile cellular service through a lottery system. The Plaintiff limited partners won the lottery for their respective geographic areas and formed partnerships with what was then Cingular and now AT&T (collectively, “AT&T”). These partnerships built out the infrastructure necessary for cellular services and continued to incur costs as cellular services evolved, but the continuing business operations were the responsibility of the general partner, AT&T.

At the time the partnerships were formed, most AT&T customers had postpaid service plans. The partnerships made money by increasing the number of customers who were “homed” in their area. The partnerships also made money when non-homed customers “roamed” on the

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partnerships' networks. The industry created agreements among network providers to compensate each other when customers roamed on each other's networks.

By the early 2000s, there was evidence that AT&T began to view the partnerships as dead weight and sought to cut their distributions. Early versions of "Project Smoothie" focused on roll-up and buyout scenarios, but AT&T ultimately considered squeeze out options as well. The parties hotly disputed this evidence.

The current dispute focused on three developments that the limited partners alleged caused them damages: (1) a new methodology for sharing costs when roaming customers used data on their networks ("Data Cost Sharing Methodology"); (2) a different methodology to compensate the partnerships for use of their networks by prepaid customers of AT&T through its Cricket Wireless offering ("Cricket Arrangement"); and (3) charges imposed on the partnerships when AT&T instead of the partnerships acquired FCC new spectrum licenses in their geographic areas ("Spectrum Services Agreements").

The Limited Partners sued AT&T for breach of contract and breach of fiduciary duties. They also sued non-partner defendant Cricket and certain AT&T parent entities for breach of the duty of loyalty, conversion, and tortious interference – all of which survived motions to dismiss. Plaintiffs sought summary judgment on claims relating to the Data Cost Sharing Methodology, the Cricket Arrangement, and the Spectrum Services Agreements. Defendants moved for summary judgment on all claims, arguing that Plaintiffs' Data Cost Sharing Methodology was time-barred, that the parties' contractual agreements did not impose the same fiduciary duties as Delaware law, and that elements of various claims were not met.

Court Analysis and Rulings

The Court found that the claims were not time barred because the discovery rule applied. The Court noted there is a presumption of inherent undiscoverability in the fiduciary context until the conduct raises red flags that need to be investigated. *Id.* at *5. The Court found that AT&T failed to disclose adequately that the Data Cost Sharing Methodology supplanted the old compensation methodology and rebuffed suggestions from its employees to keep the partnerships informed of rate changes. Moreover, since the Data Cost Sharing Methodology was not industry practice when introduced, it undercut any claim that the Limited Partners should have understood the change.

The Court next reviewed in detail the provisions in the different partnership agreements, including whether traditional fiduciary duties were displaced, whether AT&T was exculpated unless guilty of willful misconduct, who had the burden of proof for exculpation and self-dealing allegations, and whether plaintiffs could recover damages or only injunctive relief.

Ultimately, the Court granted summary judgment to plaintiffs on most claims, finding that AT&T was subject to the entire fairness standard and did not deal fairly with the partnerships or pay a fair price with respect to the three claims. The Court also denied summary judgment to the AT&T non-partnership defendants but dismissed the fiduciary duty claims against Cricket entities.

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(c) *ICI Construction Inc v. Hufcor Inc.*, 2023 WL 2392738 (S.D. Tex. March 7, 2023) (Lake, J.)

Judge Lake granted the Individual Defendants' motions to dismiss fraud, fraudulent inducement, and negligent misrepresentation claims arising from a construction company's failure to perform its contractual obligations and failure to return a deposit paid by the plaintiff.

ICI Construction entered into a subcontract contract with Hufcor dated September 22, 2021 to procure and install glass-folding partitions on one of its construction projects. ICI paid Hufcor a \$103,000 deposit. ICI became concerned about Hufcor's financial condition and requested confirmation in February 2022 that Hufcor had paid the \$103,000 deposit to its glass supplier. On February 24, 2022, Hufcor's chief operations manager, Neal Berens, emailed ICI (copying Hufcor CEO Scott Dobak) a response stating that the deposit had been received and secured pricing on the project. Hufcor later went out of business without completing the project or returning the deposit. ICI sued Hufcor, along with Berens, Dobak, and Hufcor CFO Tom Gioia.

The Court granted Dobak and Gioia's Rule 12(b)(2) motions to dismiss for lack of personal jurisdiction but denied Berens' Rule 12(b)(2) motion.

The Court granted Berens' Rule 12(b)(6) motion to dismiss the conversion and civil theft claims for failure to state a claim because Hufcor – not Berens personally – took possession and retained ICI's deposit. The Court dismissed the fraudulent inducement claim against Berens because the only misrepresentation ICI alleged took place February 24, 2022 – after the contract was signed – and could not have induced ICI to sign the contract. The Court dismissed the fraud and negligent misrepresentation claims because the complaint failed to allege that Berens' statements in the February 24, 2022 letter “were belied by his actual knowledge of contradictory facts.” 2023 WL 2392738, at * 17. The Court also dismissed these claims as barred by the economic loss rule. Although fraud claims are not barred by the economic loss rule where the defendant owes the plaintiff a duty separate from a contractual duty, ICI failed to allege facts supporting an inference that Berens' statements were knowingly false. Further, ICI failed to allege any damages separate from the “economic damages stemming from the loss of contractual benefits.” *Id.*, at *19.

(d) *VeroBlue Farms USA Inc. v Wulf*, 2023 WL 2481272 (N.D. Tex. Mar. 13, 2023) (Starr, J.)

Vero Blue sued its Founders (Wulf, Hall, James, and Rea) and one of its officers (Driver) for breach of fiduciary duty. Judge Starr denied the Founder defendants' motion for summary judgment for lack of evidence of damages, denied one defendant's motion for summary judgment based on mutual release, and granted in part and denied in part Vero Blue's motion for partial summary judgment on certain elements of its breach of fiduciary duty claim and denied several affirmative defenses.

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Background Facts

In 2014, the Founders and Driver formed VeroBlue Farms, a sustainable fish farm in Iowa. From its formation until July 7, 2016, the Founders and Driver were the only individuals serving as officers and directors.

In July 2016, VeroBlue received large investments from outside capital providers, and its board of directors increased to seven directors comprised of two Founders, three investor representatives, and two Founder-selected, independent board members.

In November 2016, Defendant Driver was removed as Chief Operating Officer, and in January 2017, he entered into a Restructuring Agreement with VeroBlue by which he was (1) terminated as an employee; (2) engaged as a consultant; and (3) the parties mutually released employment claims.

In June 2017, a new employee questioned a key productivity measurement and discovered that the Founders' representations about farm production might have been false. He reported his findings to the board. After VeroBlue experienced other significant performance issues, one of the investors took majority ownership and fired the remaining Founders. After their termination, VeroBlue discovered the Founders had fraudulently concealed misconduct from the board, including misappropriating funds for personal use and orchestrating schemes to force VeroBlue to make loans or investments into other companies owned by the Founders.

Analysis of Claims

Driver moved for summary judgment based on the mutual release contained in the Restructuring Agreement. Driver argued in the alternative that even after becoming aware of the alleged fraud, VeroBlue ratified the release provision. The Court denied Driver's motion because it found some evidence disputing the legitimacy of the release provision in the Restructuring Agreement based on an alleged conspiracy where defendant Wulf and Driver signed the release as a coverup for their dealings. Specifically, Wulf agreed to keep Driver on at a six-figure salary as a consultant in the same areas in which Driver was already deemed incompetent. The Court also found some evidence that VeroBlue did not have full knowledge of Driver's alleged misconduct at the time of the Restructuring Agreement and, therefore, could not have ratified the mutual release provision.

The Court also denied the Founders' motion for summary judgment for lack of proof of damages, finding genuine issues of material fact on six points:

- Damages were supported by evidence of misappropriated assets reflected in VeroBlue's financial documents;
- The equitable doctrine of *Bangor Punta* did not apply because VeroBlue's remaining shareholder acquired its shares during the alleged misconduct, not before, and therefore the shareholder could not fairly be considered the beneficiary of a windfall;

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- VeroBlue alleged a fraud by nondisclosure claim under Texas law, supported by some evidence of pre-2016 non-Founder officers and directors' reliance on fraudulent statements and post-2016 misrepresentations and concealments of important data provided to VeroBlue's independent directors by the Founders;
- As a matter of law, and regardless of solvency, the Founders owed VeroBlue fiduciary duties under Texas, Iowa, and Nevada law;
- VeroBlue made transfers at the Founders' direction and for their benefit, such that VeroBlue was a creditor and precluded summary judgment on the Founders' fraudulent transfer claim; and
- The intracorporate conspiracy doctrine did not bar VeroBlue's civil conspiracy claim because evidence showed that the Founders were acting in their personal interest, such as when defendant Wulf used misappropriated funds to rebuild his personal lake house.

The Court granted VeroBlue's motion for partial summary judgment, finding that defendants owed a fiduciary duty to VeroBlue. The Court denied VeroBlue's request for summary judgment on the affirmative defenses of reasonably equivalent value, ratification, waiver, estoppel, and business judgment rule. But the Court granted VeroBlue's summary judgment by only allowing the unclean hands defense against its equitable theories (and not against its non-equitable theories of recovery).

(e) *U.S. ex rel. Hueseman v. Professional Compounding Centers of America, Inc.*, 2023 WL 2669879 (W.D. Tex. March 27, 2023) (Rodriguez, J.)

Judge Rodriguez denied a motion to dismiss common law fraud claims filed by the federal government. Defendant Professional Compounding Centers of America, Inc. (PCCA) sold chemical ingredients to compounding pharmacies which combine, mix, or alter ingredients to create medication for individual patients. The federal government sued, alleging that PCCA and its pharmacy customers submitted false reimbursement claims to the TRICARE program, which provides healthcare coverage for military personnel. Specifically, the complaint alleged that defendants fraudulently inflated prices for its ingredients and asserted claims for common law fraud and violations of the False Claims Act.

PCCA first argued the complaint was deficient because it did not allege that PCCA made any misrepresentation to TRICARE; it only reported prices to third-party publishers. The Court quickly dispensed with that argument, noting that the law did not focus on whether an alleged misrepresentation was directly transmitted to the plaintiff but whether the defendant had reason to expect the misrepresentation would reach the plaintiff and induce reliance.

PCCA then argued that TRICARE did not justifiably rely on the alleged misrepresentations because it was aware of sufficient circumstances to put it on notice that the submitted prices did not correspond to the average price of the ingredients. The Court also rejected this argument,

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stating that unless a representation is “obviously false,” the recipient of a fraudulent misrepresentation of fact is justified in relying on its truth, even when he might have discovered the falsity of the representation had he made an investigation. *In re Mercer*, 246 F.3d 391, 417 (5th Cir. 2001). The prices PCCA submitted were not so obviously false that the Government should have known that they were false without conducting an investigation. Further, taken as true, the facts were sufficient to plausibly allege that TRICARE’s reliance was justified even under a heightened pleading standard.

The Court concluded that the Government sufficiently stated a claim for common law fraud and noted that the complaint alleged 325 examples of allegedly false and fraudulent prescription claims.

II. STATE COURT CASES

A. Texas Appellate Courts

1. *Condon v. Kadakia*, 661 S.W.3d 443 (Tex.App.—Houston [14th Dist.] 2023)

The 14th Court of Appeals affirmed the dismissal of a shareholder derivative case on demand futility grounds in a 2-1 decision, with Justices Jewell and Hassan in the majority and Justice Zimmerer filing a dissenting opinion.

Robert Condon filed a derivative action on behalf of CKC Partners, LLC (CKC), a Delaware LLC, against Alpesh Kadakia (Alpesh); his brother, Ruchir Kadakia (Ruchir); their business partner, Jeff Hodgson; Manticore Fuels, LLC (Manticore); and Gladieux Energy, LLC (Gladieux). According to the petition, Condon and Alpesh formed CKC to invest in startup opportunities. Condon sponsored a startup company called Manticore that distributed diesel fuel in the Permian Basin. The diesel fuel was supplied by Gladieux, an Indiana company owned and operated by Alpesh, Ruchir, and Hodgson. Condon allegedly brought the Manticore opportunity to CKC and provided \$500,000 for CKC to invest in Manticore.

Condon, CKC, and the other defendants allegedly signed an MOU that documented their partnership and agreement that each would own Manticore. Later, the parties agreed that Gladieux should own 100% of Manticore so that it could access Gladieux’s credit facility. Under pressure and facing the others’ threatened withdrawal from the venture, Condon and CKC “relinquished equity ownership in Manticore” to Gladieux. The entities, CKC, Manticore, and Gladieux, then executed a royalty agreement (Royalty Agreement) whereby Manticore paid CKC royalties on diesel sales, and Gladieux agreed to pay CKC in the event of a change in control. The Royalty Agreement prohibited Gladieux from competing directly with Manticore and provided that Manticore and Gladieux “shall not circumvent, avoid, or bypass CKC, directly or indirectly, to avoid payment of Commission and Fees [as defined in the agreement].”

Condon alleged that defendants began “circumventing” the Royalty Agreement by:

- Maintaining separate accounting records that enabled Alpesh to hide Gladieux’s charges and margins from CKC;

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- Altering Manticore’s pricing structure so that diesel fuel, which was subject to royalties, was deeply discounted and related services, which were not subject to royalties, were charged at higher prices;
- Shifting employees from CKC to Manticore to avoid paying CKC management fees for providing the services;
- Forming a new entity owned by Alpesh that operated under the name Core Automated Fueling Services (“Core”) and competed directly with Manticore.

Manticore paid royalties to CKC in 2018, but the amount of royalties declined in 2019 and stopped altogether by 2020. Alpesh allegedly told Condon in 2019 that Manticore was worth at least \$15 million, but he and other defendants soon after began telling Condon that Manticore could not continue as a wholly owned subsidiary of Gladieux. In November 2019, Hodgson demanded that CKC contribute \$1.2 million within three days to fund a new subsidiary of Manticore. When Condon asked for more time, he received an ultimatum to (a) fund the \$1.2 million investment by December 2, 2019; (b) accept a \$200,000 fee to terminate the Royalty Agreement with a full release; or (c) do nothing and get nothing. Alpesh did not tell Condon that he would receive an annual salary of \$600,000 to work at the new company.

Condon filed suit on December 7, 2019. The Second Amended Petition asserted the following derivative claims on behalf of CKC:

1. Breach of the Royalty Agreement against Gladieux and Manticore;
2. Breach of the CKC agreement against Alpesh for disclosing confidential information, breaching his duty of loyalty to CKC, and assigning CKC’s property – the Manticore business opportunity;
3. Breach of fiduciary duty against Alpesh for aligning with others against CKC; sharing CKC’s confidential information; and various other actions; and
4. Aiding and abetting and knowing participation in breach of fiduciary against Ruchir, Hodgson, and Gladieux.

Defendants filed special exceptions to these claims arguing, primarily, that Condon failed to make demand or plead sufficient facts to support demand futility under Delaware law. The district court granted the special exceptions and dismissed the case.

Majority Opinion

The majority opinion reviewed Delaware’s demand futility requirements under *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034 (Del. 2021). The Court stated that when alleging demand futility, a plaintiff must meet “stringent requirements of factual particularity that differ substantially from ... permissive notice pleadings.” *Zuckerberg*, 262 A.3d at 1048. Since the heightened pleading

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standard for derivative suits is substantive, not procedural, it is “not simply a technical rule of pleading.” *Condon*, 661 S.W.3d at 457 (quoting *In re Crown Castle Int’l Corp.*, 247 S.W.3d 349, 355 (Tex. App. – Houston [14th Dist.] 2008, orig. proceeding)).

Applying the facts to the law, the Court focused on whether Alpesch – the only director of CKC other than Condon – received a material personal benefit from his alleged misconduct. After describing many of Condon’s allegations as conclusory, the Court reviewed Condon’s specific allegations that Alpesch (1) caused Manticore to stop making royalty and managerial service payments to CKC; (2) obtained a \$500,000-\$600,000 salary from Manticore in 2019 and 2020; (3) set up another business (CORE) that competed against Manticore; and (4) disclosed CKC’s confidential information to Ruchir and Hodgson and assigned away CKC Partners’ financial interest in the Royalty Agreement.

As to the declining royalty payments, the Court simply stated that the petition did not contain sufficient particularity describing how Alpesch personally benefitted from that alleged breach.

As to Alpesch’s salary paid by Manticore, the Court stated that it was unclear from the allegations how Alpesch’s salary was a personal benefit flowing from the alleged misconduct. Although Condon argued that Alpesch’s \$500,000 salary from Manticore began after Manticore stopped paying CKC \$15,000 per month for managerial services, the Court noted that the Royalty Agreement did not require Manticore to pay CKC any amount for managerial services, that Manticore was not competing with CKC, and that “Manticore is entitled to have a president and is entitled to pay that president a salary.” *Id.* at 462. The Court also noted that Condon did not plead any particularized facts showing the \$500,000-\$600,000 salary was material to Alpesch. *Id.*

As to Alpesch’s creation of a competing business (CORE) to compete against Manticore, the Court stated “the petition does not explain with particularity how Alpesch—Manticore’s president and part owner—materially and personally benefitted from Manticore’s collapse. Any benefit would have had to come from CORE, and the amended petition did not allege that Alpesch was CORE’s owner, had a financial interest in CORE, or received any salary from CORE. Moreover, although Condon set forth a plausible claim that CORE competed with and harmed Manticore, Condon and CKC lack standing to complain about any injury to Manticore.

As to disclosing confidential information and assignment of financial rights, the Court did not find sufficient allegations in the petition detailing what confidential information was shared, with whom, and how Alpesch benefitted. Nor did it find sufficient allegations about what financial rights were assigned.

Dissenting Opinion

The dissent found the pleadings contained sufficient credible facts to support the notion that Alpesch received a personal benefit and met part one of the *Zuckerberg* test. It further argued that the majority conflated the Delaware pleading standards for “particularized facts” and “materiality” with the standards required to establish interested director status (i.e., a director with a self-dealing conflict) and, thereby, imposed a higher pleading burden than required under Delaware law.

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First, it noted that *Zuckerberg* did not “change the result of demand-futility analysis;” it simply blended the tests set forth in *Aronson* and *Rales* into one inquiry. *Id.* at 468 (citing *Zuckerberg*, 262 A.3d at 1058).

Second, it emphasized that the protections of the business judgment rule can only be invoked by “disinterested directors” and not tainted by self-interest. According to the dissent, the plaintiff “provided detailed factual allegations describing with sufficient particularity, [Alpesh’s] self-dealing and participation in transactions in detriment of the business and [CKC]. These pleadings raise issues of self-dealing between CKC and various other entities to which Alpesh Kadakia was associated.” *Id.* at 469.

The Court’s opinion was filed on January 19, 2023. Since that date, Condon has been granted two extensions to petition the Texas Supreme Court for review.

2. *Slack v. Shreve*, 2023 WL 2417971 (Tex.App.—Tyler Mar. 8, 2023)

The Tyler Court of Appeals reversed the trial court’s summary judgment ruling for one defendant because the court applied a three-year statute of limitations to plaintiff’s claim under Section 33(A)(2) of the Texas Securities Act (TSA).³ The Court affirmed the dismissal of other claims against the defendant because the plaintiffs did not properly brief the grounds for reversing them on appeal.

Plaintiff Marcia Slack sued multiple defendants, including Robert Charles Shreve, Jr. and Joseph Shane Jackson, in connection with her investment in an oil and gas exploration company called SunRay Resources, LLC. According to Slack, she invested \$250,000 in SunRay based on Shreve’s statement that Jackson and certain other defendants were “trustworthy people.” According to Slack, Shreve did not tell her that he would receive \$107,500 of the money she invested or that her money would be used to buy a lease from a limited liability company owned by Shreve.

Slack asserted multiple causes of action against Shreve, including claims for (1) TSA violations, (2) Texas Theft Liability Act violations, (3) common law fraud, (4) conversion, and (5) negligence. The trial court granted summary judgment for Shreve after Slack did not file a response to his motion, but Slack argued she was not provided proper notice of the motion and moved for a new trial. The trial court denied that motion, severed Slack’s claims against Shreve, and signed a final judgment that Slack take nothing from Shreve. This appeal followed.

With respect to the TSA violations, Slack raised two issues on appeal. She first argued globally that the trial court erred in dismissing all her TSA claims and next argued specifically that the trial court applied the wrong limitations period to her Section 33(A)(2) claim.

The Court of Appeals rejected Slack’s global argument because it was not sufficiently briefed but ruled in her favor on the 33(A)(2) claim. The Court noted that the statutes of limitations for misrepresentation claims under Section 33(A)(2) and for failure to register securities under

³ The Texas Legislature repealed the Texas Securities Act in 2019 and recodified it in the Texas Government Code. *See, e.g.*, TEX. GOV’T CODE ANN. §4008.052 (codifying former TSA §33(A)2). The Court cited Section 33(A)(2) in its opinion since that was the version of the statute in effect when plaintiff filed her petition.

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Section 33(A)(1) are different. While Section 33(A)(1) claims must be filed within three years from the date of purchase, Section 33(A)(2) claims may be filed up to five years from the date of purchase. Under the five-year statute, Slack's 33(A)(2) claim was timely filed. Moreover, because Shreve's summary judgment motion improperly lumped the 33(A)(2) claim with other TSA claims under the three-year statute of limitations and did not even address Shreve's misrepresentation alleged in the petition, it did not properly move for dismissal of this claim.

The Court then addressed Shreve's argument that he did not receive fair notice of Slack's claim under Section 33(A)(2). Shreve argued that the following sentence in the petition excluded him: "With the exception of Mr. Shreve, [the defendants] offered for sale oil and gas interests for SunRay Resources, LLC on their website to obtain investors." The Court rejected Shreve's argument on several grounds, noting (1) it was obligated to construe pleadings liberally in the plaintiff's favor; (2) the sentence could be read to mean that Shreve was the only defendant who did not offer an oil and gas interest for sale on SunRay's website; (3) Shreve did not raise this argument in his special exceptions, complaining only that Slack's pleadings did not describe what security was sold and how the alleged sale occurred; and (4) Slack's petition as a whole provided fair notice of the claim. Among other things, Slack's petition alleged that she was asserting claims for TSA violations against Shreve, that Shreve failed to disclose he would receive \$107,500 of the investment funds, and that Shreve was not registered to sell securities in Texas.

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