

SECURITIES AND FIDUCIARY DUTY CASES IN TEXAS

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This quarterly newsletter summarizes recent federal and state court decisions and other developments of interest to practitioners litigating securities and fiduciary duty claims in Texas.

Court rulings, hyperlinked to Westlaw, and other notable events include:

- SEC Enforcement Actions – Two decisions are likely to impact future SEC enforcement actions. In *Axon Enterprise, Inc. v. FTC*, the Supreme Court held in a 9-0 decision that constitutional challenges to SEC administrative enforcement actions may be filed directly in federal district courts without first objecting in the ALJ proceedings. In *SEC v. Barton*, the Fifth Circuit clarified what the SEC must establish to impose a receivership when no injunction prohibiting asset disposal is in place; it also confirmed that the SEC must trace ill-gotten gains to specific entities before placing them in receivership but can move for a temporary freeze before tracing is complete.
- Securities Fraud and RICO Cases – In *Slack Technologies, LLC v. Pirani*, a unanimous Supreme Court confirmed that when registered and unregistered shares are sold contemporaneously, a plaintiff in a §11 case must still plead and prove the securities he purchased were traceable to an allegedly misleading registration statement. In *Yegiazaryan v. Smagin*, the Supreme Court rejected a bright-line rule barring foreign plaintiffs from pursuing civil RICO claims if their injuries arose in the United States. Finally, Texas federal district courts denied motions to dismiss in three recent cases: *Alta Mesa* (denying motion to dismiss opt-out cases); *Cassava Sciences* (denying motions to dismiss putative class case); and *Concho Resources* (denying motion to dismiss claims against all but two individual defendants).
- Texas-Specific Rulings – In *Abdullah v. Paxton*, the Fifth Circuit ruled that a participant in two Texas retirement plans lacked standing to challenge state legislation requiring the plans to divest from pro-BDS companies. In *Munro v. Jagpal*, the Dallas Court of Appeals reinstated a dispute over majority ownership of a cannabis company that had been dismissed on *forum non conveniens* grounds.
- New Texas Business Courts – A new Texas law creates specialized business courts with appointed judges and concurrent jurisdiction over shareholder derivative litigation, securities class actions filed in state courts, and certain high-dollar commercial disputes. The new law is expected to face legal challenges but will otherwise take effect on September 1, 2024.

CASE SUMMARIES

I. FEDERAL CASES

A. United States Supreme Court

1. ***Axon Enterprise, Inc.*, 143 S. Ct. 890 (Apr. 14, 2023)**

The U.S. Supreme Court unanimously held that federal district courts can hear collateral constitutional challenges to administrative enforcement actions brought by the Securities and Exchange Commission (SEC) and the Federal Trade Commission (FTC) before there is a final agency adjudication on the merits. The Court affirmed the Fifth Circuit’s decision in *Cochran v. SEC*, 20 F.4th 194 (5th Cir. 2021), which held that challenges to the constitutionality of the appointment of ALJs can be heard by federal district courts prior to the SEC’s adjudication on the merits. The case has been remanded to the district court to consider Cochran’s arguments that because SEC ALJs enjoy multiple layers of “for-cause” removal protection, they are unconstitutionally insulated from the President’s Article II removal power. However, the Fifth Circuit has already held that the SEC’s use of ALJs is unconstitutional. *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022). The Supreme Court granted the SEC’s petition for a writ of certiorari on June 30, 2023, and will consider the issue next term. *SEC v. Jarkesy*, 2023 WL 4278448 (June 30, 2023). The *Axon* and *Jarkesy* opinions mark a trend of recent decisions that will likely continue to pressure the SEC into filing claims in federal district courts rather than in house.

2. ***Slack Technologies, LLC v. Pirani*, 143 S. Ct. 1433, 2023 WL 3742580 (June 1, 2023)**

As markets adopt new methods for raising capital, long-standing interpretations of the federal securities laws can be subjected to “new” challenges. Slack Technologies, LLC (Slack), a company with a platform for instant messaging, chose to forgo an IPO and instead embarked on a direct listing of shares on the NYSE. It filed a registration statement for the direct listing of shares but also allowed holders of unregistered securities to sell them as well. After the Company’s stock price dropped, plaintiff later filed a putative class action under § 11 of the 1933 Act. The defendants moved to dismiss because the plaintiff did not trace his shares to the registration statement. In a short and unanimous opinion, the Supreme Court upheld the long-standing view that § 11 requires a plaintiff to plead and prove the securities he purchased were traceable to an allegedly misleading registration statement.

Background

In 2019, Slack sold shares to the public through a direct listing on the NYSE.¹ As part of that process, 118 million *registered* shares were offered, and another 165 million *unregistered* shares were also sold. Plaintiff Fiyaz Pirani purchased 30,000 shares on the day Slack went public and another 220,000 shares over the next several months. When Slack’s stock price dropped after the offering, Pirani filed a class-action lawsuit alleging that the registration statement was false and misleading in violation of §§ 11 and 12 of the 1933 Act, but he did not make any claim under §10 of the 1934 Act. Slack moved

¹ In a “direct listing,” a company sells shares directly to the public on an exchange without creating new shares, using underwriters, or entering into lockup agreements. The SEC approved this new sales process at the request of the NYSE for companies that met certain requirements including a reliable market valuation of at least \$250 million. *See* Proposal to Amend Section 102.01B of the NYSE Listing Manual, SEC Rel. No. 34-82627, 83 Fed. Reg. 5650 (2018).

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to dismiss the action because Pirani failed to trace his shares to the allegedly misleading registration statement.

The district court denied the motion to dismiss but certified the issue for interlocutory appeal. A divided panel of the Ninth Circuit then affirmed with the dissent noting the long line of lower court cases holding that § 11 applies only to shares purchased pursuant to a registration statement. *See id.* at *5 n.2 (citing cases from the 1st, 5th, 8th, 10th, and 11th Circuits). The Supreme Court granted certiorari to address the Circuit split.

Court Analysis

Justice Gorsuch began the Court's opinion by noting that the provisions of the 1933 Act are "narrower" than the provisions of the 1934 Act. The 1933 Act is primarily concerned with the regulation of new offerings of securities and imposes strict liability on companies whose registration statements contain material misstatements or misleading omissions. The 1934 Act "sweeps more broadly" and is primarily concerned with ongoing disclosures, but it requires a plaintiff to prove material misstatements or omissions were made with scienter. *Id.* at *2-3.

With this backdrop, the Court analyzed the text of § 11(a) of the 1933 Act which provides:

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission), may, either at law or in equity, in any court of competent jurisdiction, sue [certain enumerated parties].

Id. at *4 (emphasis added). The Court framed the dispute as whether the term "such security" refers to "a security issued pursuant to the allegedly misleading registration statement" or also encompasses "a security that was not issued pursuant to the allegedly misleading registration statement." *Id.*

According to dictionary definitions, the word "such" means something "already described" or "implied or intelligible from the context or circumstances." Finding no clear referent to "such security" in § 11(a), the Court looked to the broader context of the statute for clues. The statute imposes liability for misstatements or omissions in *the* registration statement and repeatedly uses the word "such" to narrow the law's focus: "such part," "such acquisition," and "such untruth or omission." All this suggests that "when it comes to 'such security,' the law speaks to a security registered under the particular registration statement alleged to contain a falsehood or misleading omission." *Id.* at *5.

Other provisions of the 1933 Act are similar. Section 5 states that unless a registration statement is in effect, it is unlawful to sell "such security." Section 6 provides that a registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered. *Id.* Section 11(e) caps damages against an underwriter with the maximum available recovery tied to the value of the registered shares. *Id.*

The Court noted that its narrow construction of § 11 was not particularly novel. It cited Judge Friendly's decision in *Barnes v. Osofsky*, 373 F.2d 269, 271 (2d Cir. 1967), which concluded that "the

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narrower reading” of § 11 is the more “natural” one. It also noted that every court of appeals to consider the issue before this action reached the same conclusion. *Id.*

The Court rejected Pirani’s arguments for a broader reading of the statute. He first argued that if Congress wanted to limit liability under § 11(a) only to securities issued pursuant to a particular registration statement, it could have borrowed language from § 5 and stated “any security with respect to which a registration statement has been filed.” The Court turned this argument on its head, noting that Congress could also have drafted § 11(a) with broader language to apply to “any security” or “any security” bearing some specified relationship to a registration statement. Pirani then argued “from policy and purpose” that a broader reading of “such security” was appropriate because it would expand liability for falsehoods and misleading omissions and better accomplish the purpose of the 1933 Act. The Court did not endorse this line of reasoning, noting that the 1933 Act was limited in scope by design and that it was equally possible Congress sought a balanced liability regime that “allows a narrow class of claims to proceed on lesser proof but requires a higher standard of proof to sustain a broader set of claims.” *Id.* at *6.

The short and unanimous opinion confirms that the current court will continue to interpret the 1933 Act narrowly, but the decision leaves some issues open for future litigation:

- The Court did not address whether Slack should have been required to register *all* the shares sold in its direct listing (Pirani did not make this argument in the lower courts, and the Supreme Court refused to consider it). *Id.* at *3 n.1.
- The Court did not address whether the scope of § 12 “follow[ed] from” its analysis of § 11 and suggested it might not: “Nor do we endorse the Ninth Circuit’s apparent belief that §11 and § 12 necessarily travel together, but instead caution that the two provisions contain distinct language that warrants careful consideration.” *Id.* at *6 n.3. Indeed, while these claims are often paired together in litigation, the text of the two provisions is organized differently.
- Because Pirani only raised claims under §§ 11 and 12 of the 1933 Act, the Court did not consider whether a direct listing of registered and unregistered shares could lead to liability under § 10 of the 1934 Act.

The Supreme Court vacated the Ninth Circuit’s legal judgment and remanded the case to determine whether Pirani’s pleadings satisfied § 11(a) once the statutory language was properly construed.

3. *Yegiazaryan v. Smagin*, __ S. Ct. __, 2023 WL 4110234 (June 22, 2023)

The Supreme Court rejected a bright-line rule barring foreign plaintiffs from pursuing civil RICO claims, and instead held that foreign plaintiffs could satisfy civil RICO’s domestic-injury requirement if their injuries arose in the United States. The Racketeer Influenced and Corrupt Organizations Act (RICO) provides a private right of action that authorizes “[a]ny person injured in his business or property by reason of” a substantive RICO violation to sue for treble damages. 18 U.S.C. § 1964(c). The Supreme Court had previously held that this private right of action extended only to domestic injuries, but it had not addressed what constitutes a “domestic” injury. *RJR Nabisco, Inc. v. European Community*, 579 U.S. 325 (2016). In *Yegiazaryan*, the Court held “[I]n assessing whether there is a domestic injury, courts should engage in a case-specific analysis that looks to the

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circumstances surrounding the injury. If those circumstances sufficiently ground the injury in the United States, such that it is clear the injury arose domestically, then the plaintiff has alleged a domestic injury.”

In 2003, Russian businessmen Ashot Yegiazaryan and Vitaly Smagin partnered on a Moscow real estate project that collapsed in 2009. Yegiazaryan subsequently fled to Beverly Hills to avoid a Russian indictment. Smagin remained in Russia and won an arbitration award against Yegiazaryan in London. Smagin then sued Yegiazaryan in California federal court to enforce the award and obtained a judgment. Yegiazaryan engaged in various fraudulent transactions to prevent Smagin from collecting on the California court’s judgment. Smagin brought a civil RICO claim against Yegiazaryan, alleging that his actions to avoid paying the California court’s judgment constituted a pattern of racketeering activities.

The district court dismissed Smagin’s civil RICO claim, holding that he failed to satisfy RICO’s domestic-injury requirement. The Ninth Circuit reversed. The Supreme Court found that Smagin had adequately alleged a domestic injury, namely his inability to collect on the California judgment.

B. Fifth Circuit

1. *Abdullah v. Paxton*, 65 F.4th 204 (5th Cir. Apr. 11, 2023)

In 2017, the Texas legislature enacted Texas Government Code § 808, prohibiting Texas governmental entities from investing in companies that boycott the country of Israel or otherwise engage in the BDS movement.² Plaintiff Haseeb Abdullah, a beneficiary of two Texas pension systems (the “Systems”), sued the Texas Attorney General and the Texas Comptroller in their official capacities and sought a declaration that the statute violated his constitutional rights under the First Amendment and the Due Process clause of the U.S. Constitution. The district court dismissed the case because Abdullah’s claims against state officials were barred by sovereign immunity and because he lacked standing under Article III. In a per curiam opinion, the Fifth Circuit affirmed the dismissal for lack of standing and did not reach the sovereign immunity issue.

To establish standing, Abdullah had the burden to demonstrate three elements: (1) an injury in fact, (2) fairly traceable to the Defendants’ actions, and (3) likely to be redressed by a favorable outcome. *Id.* at *207 (citing *Shrimpers & Fishermen of RGV v. Tex. Comm’n on Env’t Quality*, 968 F.3d 419, 424 (5th Cir. 2020) and *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560-61 (1992)). To satisfy the first requirement, Abdullah had to plead that “he has sustained or is immediately in danger of sustaining some direct injury.” *Id.* (citing *City of Los Angeles v. Lyons*, 461 U.S. 95, 101 (1983)). The injury must be “concrete and particularized,” as well as “actual or imminent.” *Id.* (citing *K.P. v. LeBlanc*, 627 F.3d 115, 122 (5th Cir. 2010)). It cannot be speculative, conjectural, or hypothetical. *Id.* (citing *Clapper v. Amnesty Int’l USA*, 568 U.S. 398, 409 (2013)).

The Court determined that Abdullah did not plead an injury-in-fact because he failed to allege either (1) a realistic risk that § 808 would cause him to suffer future economic harm, or (2) a violation of his own personal rights under the First or Fourteenth Amendment.

² The BDS movement seeks to put economic pressure on Israel to improve its treatment of Palestinians through boycotts, divestments, and sanctions. *Id.* at *207 n.2.

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Future Economic Injury

Abdullah conceded that he had not yet sustained any monetary injury caused by § 808 but argued the statute was likely to have an adverse effect on the overall financial health of the state pension systems because the Systems' managers would base their divestment decisions on the statute rather than free market considerations. The Court disagreed.

First, § 808's divestment requirement is not absolute. The statute allows managers to invest in pro-BDS companies if divesting would be inconsistent with their fiduciary responsibilities, would cause the Systems to suffer a loss in the hypothetical value of all assets under management, or would cause a deviation in the benchmark value of the portfolios. *Id.* (citing Tex. Gov't Code §§ 808.005, 808.056(a)(1), and 808.056(a)(2)).

Second, Abdullah could not establish that the outcome of the litigation was likely to affect his future benefit payments. He was a participant in defined-benefit plans which calculate future benefits based on factors independent of the fund's market performance such as the employee's start date, years of service, salary, and contributions.

Third, the Court stated that "[t]he only way Abdullah could demonstrate he will 'actually' suffer future economic harm is if he plausibly alleged that, as a result of § 808's constraints, the Systems will not be able to pay out his benefits *at all* when he reaches retirement." *Id.* at *208 (citing *Thole v. U.S. Bank N.A.*, 140 S. Ct. 1615, 1621 (2020)). Noting that Abdullah alleged the Systems were underfunded, the Court labeled his future economic harm allegation as speculative because it ignored Texas' ability to support the funds through taxes, fees, and assessments.

Constitutional Injuries

While constitutional issues were the primary reason for Abdullah's claims, the Court's discussion of them was limited to just three paragraphs. It acknowledged that violations of constitutional rights may, in some instances, satisfy the injury-in-fact requirement and agreed that Abdullah "certainly has a property interest in his future payments from the Systems." *Id.* Nonetheless, a plaintiff must do more than make a claim based on constitutional violations; he must establish a violation of his own personal rights. *Id.* at *208 (citing *Valley Forge Christian Coll. V. Ants. United for Separation of Church & State, Inc.*, 454 U.S. 464, 474-75 (1982)).

To allege a Due Process violation, the plaintiff must allege he will suffer an injury to a vested property interest. *Id.* at *208 (citing *Bryan v. City of Madison*, 213 F.3d 267, 274-75 (5th Cir. 2000)). Based on the analysis of defined-benefit plans above, the Court ruled that Abdullah failed to plead that § 808 posed any credible threat to his future payments.

The Court then quickly dispensed with Abdullah's First Amendment claim, noting that he did not allege § 808 infringed on *his* ability to speak or exercise *his* religious beliefs. And, foreshadowing future BDS challenges, the Court added that Abdullah could not assert arguments based on others' rights, such as the companies on the divestment list. *Id.*

2. *SEC v. Barton*, ___ F.4th ___, 2023 WL 4231605 (5th Cir. June 28, 2023)

In this appeal from an SEC enforcement action the Fifth Circuit clarified the tests and procedural hurdles that must be met before imposing a receivership over entities and assets. First,

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unless an injunctive order has already been issued prohibiting defendants from disposing of assets, a district court cannot impose a receivership unless it finds: (1) a clear necessity to protect the defrauded investors' interest in property; (2) legal and less drastic equitable remedies are inadequate; and (3) the benefits of receivership outweigh the burdens on the affected parties. *Id.* at *4 (citing *Netsphere, Inc. v. Baron*, 703 F.3d 296, 305 (5th Cir. 2012)). Second, unless a motion to freeze asset transfers has already been entered, a district court lacks jurisdiction to impose a receivership over entities unless their assets are traceable to an underlying claim or controversy before the Court. *Id.* at *5.

The SEC alleged that defendant Barton partnered with a Chinese national and a Texas-based home builder to offer and sell investment loans to Chinese investors. The defendants raised \$26.3 million from more than 100 Chinese investors to purchase and develop separate parcels of land, but only \$2.6 million was used for land purchases. The rest of the funds were commingled and used for unrelated purposes, including improper payment of the defendants' personal expenses. The SEC sued and, without first moving for a preliminary injunction, sought to appoint a receiver over various entities, including those that Barton directly or indirectly controlled. The district court granted the receivership and later supplemented its order to include 126 Barton-controlled entities by name. Barton appealed.

The Propriety of Receivership: Which Test Applies?

The central dispute on appeal was which test for receivership the district court should have applied: (a) *SEC v. First Finan. Group of Texas*, 645 F.2d 429, 438 (5th Cir. 1981), which only requires a *prima facie* showing of fraud and mismanagement; or (b) *Netsphere*, 703 F.3d at 305, which requires a court to find (1) a clear necessity to protect the defrauded investors' interest in property; (2) legal and less drastic equitable remedies are inadequate; and (3) the benefits of receivership outweigh the burdens on the affected parties, before imposing a receivership. The Fifth Circuit ruled the *Netsphere* multi-factor test was applicable because receivership is an extraordinary remedy and no preliminary injunction had yet been ordered.

The Fifth Circuit clarified that the *First Financial* test was applicable in cases where the district court had already granted injunctive relief preventing defendants from disposing of assets. In those situations, a *prima facie* showing of fraud and mismanagement would be sufficient because receivership is "proper as an adjunct" to the injunctive relief already granted and viewed as part of the district court's equitable powers to enforce its own orders. *Id.* at *3. Since the district court in this case had not entered any injunction against the disposition of assets, the *Netsphere* test applied, and a stronger showing was required to impose a receivership.

The Receivership's Jurisdiction

Barton also argued that the district court erred by placing multiple entities he controlled in receivership without any showing that they received or benefited from ill-gotten investor funds. The SEC acknowledged that it had not submitted evidence tracing ill-gotten funds to specific entities but argued that its allegation about extensive commingling of funds was sufficient to impose receivership on those entities. Again, the Fifth Circuit disagreed, noting that *Netsphere* held that the district court did not have jurisdiction over property that is not the subject of the underlying litigation. *Id.* at *5. The Court acknowledged its ruling might have been different if the SEC had sought an injunction freezing asset transfers while it traced the funds and determined which entities should be placed in receivership. *Id.*

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Ultimately, the Court’s opinion provides a roadmap for the various tests and procedural hurdles the SEC must satisfy to appoint a receiver for entities and specific assets. While the Court vacated the district court’s order appointing the receiver, it gave the SEC a second chance to get it right by delaying its order until 90 days after the appellate mandate issued. *Id.* at *6.

C. District Courts

1. Securities Class Actions

(a) *In re Alta Mesa Resources, Inc. Sec. Litig.*, 2023 WL 3873307 (S.D. Tex. June 7, 2023) (Hanks, J.)

Alta Mesa was formed as the result of a de-SPAC acquisition of upstream and midstream companies in Oklahoma’s STACK shale play in early 2018. Less than two months after the merger was completed, the Company announced a \$3.1 billion write down that constituted over 80% of its value. Twenty months later, the Company filed for bankruptcy, but the securities litigation filed before the bankruptcy continued. In April 2021, the district court denied motions to dismiss the securities class action.³ In its latest opinion, the Court denied motions to dismiss opt-out claims filed by two groups of plaintiffs. While it did not expand on the reasons why the original plaintiffs’ and the opt-out plaintiffs’ pleadings were sufficient under the PSLRA, the Court’s opinion did address issues unique to the opt-out claims, including whether they were barred by SLUSA, by statutes of limitation, or by Texas state law concerning claims by mere “holders” of securities.

Defendants argued that state-law fraud claims filed by 13 opt-out plaintiffs were barred by the Securities Litigation Uniform Standards Act (SLUSA). They argued that when the opt-out cases were consolidated with the class action, it created a group of lawsuits with more than 50 persons. The Court disagreed, citing decisions from the *Enron* and *WorldCom* cases that distinguished the number of persons in the consolidated cases from the number of persons bringing state law claims. “Regardless of how many members comprise the class, only 13 plaintiffs in the consolidated action have pled claims under Texas state law. Weighty authority instructs that the fact that fewer than 50 plaintiffs in this consolidated lawsuit have led claims under Texas state law renders SLUSA’s preclusion provisions inapplicable.” *Id.* at *4.

Defendants also moved to dismiss because the opt-out plaintiffs made state-law claims on behalf of defendants who “held” Alta Mesa securities during the class period but presumably did not purchase or sell securities. The defendants cited the Texas Supreme Court’s decision in *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 930 (Tex. 2010) which ruled that holder claims are not recognized in Texas. Again, the district court disagreed, stating that the Supreme Court of Texas “left open the prospect that holder claims involving specific, direct communications are actionable under Texas law,” though it “declined to permit a holder claim in the absence of any direct communication.” The Court did not say or analyze in the opinion whether the opt-out complaints alleged such specific, direct communications.

³ See 1Q21 Newsletter, at 12-14. The class action plaintiffs alleged that defendants inflated reserve and financial projections by using non-standard drilling techniques that departed from industry standards and falsely assured investors that the Company’s problems were temporary. In its short opinion denying motions to dismiss, the Court stated: “Under the circumstances, the enormity of the write-down over such a short period of time is enough for these defendants to proceed.” *Camelot Event Driven Fund v. Alta Mesa Res., Inc.*, 2021 WL 1416025, at *10 (S.D. Tex. Apr. 14, 2021).

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The defendants then argued that the opt-out plaintiffs' federal law claims under Sections 14(a), 20(a), and 18 of the Exchange Act were time-barred. Plaintiffs responded that they were governed by the five-year statute of repose, *see* 28 U.S.C. § 1658(b), or extended by the class-action tolling doctrine, *see American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974). The district court sided with the plaintiffs, noting that (1) the Fifth Circuit in *Blaz v. Belfer*, 368 F.3d 501, 503-04 (5th Cir. 2004), ruled that the statute of repose applicable to Section 18 claims "has been extended to five years"; (2) Plaintiffs claimed their Section 14(a) claims were subject to the statute of repose because they alleged fraud, not mere negligence; and (3) *American Pipe* tolling was appropriate because the individual claims had "a common factual basis and legal nexus with the class claims." *Id.* at *4-6.

Finally, some of the defendants moved to dismiss because the opt-out plaintiffs' pleadings were insufficient. The Court dispensed of this argument, declining to reconsider its prior ruling on motions to dismiss the class action and referring to "the reasons stated in its prior opinion." *See Camelot Event Driven Fund v. Alta Mesa Res., Inc.*, 2021 WL 1416025, at *10 (S.D. Tex. Apr. 14, 2021).

(b) *In re Concho Resources Inc. Sec. Litig.*, 2023 WL 4146278 (S.D. Tex. June 23, 2023) (Hanan, J.)

As we previously reported,⁴ Magistrate Judge Sheldon recommended that Defendants' motion to dismiss this putative securities fraud class action complaint be denied, concluding that Plaintiffs' allegations were sufficient to state claims against all defendants. On June 23, 2023, District Judge Andrew Hanan adopted the Magistrate Judge's Memorandum and Recommendation ("M&R") to deny motions to dismiss this putative securities fraud class action with two exceptions. While the M&R recommended denying *all* defendants' motions to dismiss, the district court granted motions filed by two defendants, Joseph Wright (COO) and Brenda Schroer (Treasurer). The allegations against them were not sufficiently particularized and did not "amount to a scintilla of scienter." *Id.* at 1.

The complaint, as described by the plaintiffs, was based on the "Reckless Gamble Theory." Concho Resources and its former officers allegedly oversold the probable success of the Company's new drilling program ("manufacturing mode"), undersold the risks involved, and gambled on an unproven pattern of well spacing. *Id.* at *1. While the complaint alleged that adverse information about the drilling program and proved reserves was directly shared with most individual defendants, it did not allege how Wright and Schroer learned the same adverse information. As the M&R stated: "Plaintiffs rely on factual allegations of surrounding circumstances to conclude Schroer and Wright knew or were severely reckless in not knowing of fraudulent statements about large-scale development and proved reserves in the Form 10-K." The district court described the allegations as stacked assumptions not supported by any factual contentions. Other than alleging the two individuals signed certain SEC filings, the complaint pleaded no facts to support the contention that these two individuals "(1) knew anything about the risks inherent in well-spacing; (2) knew anything untoward was about to or even would occur; or (3) were trying to mislead or hide the true facts from investors." *Id.*

As an example, the Court highlighted Plaintiffs' allegation that "According to FE-1, there were weekly Tuesday meetings amongst the executives, including Defendants Giraud, Leach, and Schroer and that Dominator [an area with densely spaced wells] was likely discussed during these meetings." While plaintiffs pleaded facts to support the existence of weekly Tuesday meetings and who attended

⁴ For a detailed summary of the allegations in the complaint and the arguments in support of dismissal, please see our prior summary of the Memorandum & Recommendation. 1Q23 Newsletter, at 8-12.

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them, the allegations about what was actually discussed was merely speculation. Further, plaintiffs did not allege that Wright even attended the executive or technical group meetings. Overall, the allegations of scienter on the part of Wright and Schroer were “practically nonexistent.” *Id.*

The district court adopted the M&R and overruled the objections of other defendants, but it sustained Wright’s and Schroer’s objections to the M&R and dismissed them from the case.

(c) *In re Cassava Sciences, Inc. Sec. Litig.*, 2023 WL 3442087 (W.D. Tex. May 11, 2023) (Ezra, J.)

Judge Ezra granted in part but mostly denied motions to dismiss this putative securities fraud class action against Cassava Sciences Inc., (Cassava), its Chairman, President, and CEO Remi Barbier (Barbier), Senior Vice President of Neuroscience Dr. Lindsay Burns (Dr. Burns), COO and Chief Medical Officer Dr. Nadav Friedmann (Dr. Friedmann), and CFO Eric Schoen (Shoen). Plaintiffs alleged claims under §§ 10(b) and 20(a) of the Exchange Act.

Cassava was founded by Barbier in March 2019 as a successor to Pain Therapeutics, Inc., a company whose single drug candidate, a painkiller named Remoxy, failed to obtain FDA approval. Once rebranded as Cassava, the Company announced that it would focus its efforts and resources on “advancing its drug and diagnostic assets in Alzheimer’s disease.” 2023 WL 3442087, *1. To that end, Cassava developed a drug candidate called simufilam during research conducted at the Company between 2008 and 2018 under the direction of Dr. Hoau-Yan Wang (Dr. Wang), who was an Associate Medical Professor at the City University of New York School of Medicine and Cassava consultant. Simulflam was intended to restore a protein called filamin A that Cassava’s scientists claimed was misshapen in the brains of Alzheimer’s patients. Dr. Burns and Dr. Wang published their research on filamin A and simufilam in several peer-reviewed scientific journals.

In July 2017, Cassava announced that the FDA approved its Investigational New Drug application to study simufilam in patients with Alzheimer’s disease. In September 2019, and after it successfully completed its Phase 1 and Phase 2a clinical studies, Cassava launched a placebo-controlled, blind trial called Phase 2b. In May 2020, Cassava announced that the Phase 2b study “did not meet its primary endpoint” because it failed to show that simufilam lowered certain biomarkers of Alzheimer’s disease. *Id.* at *2.

Later that summer, Cassava’s Board of Directors approved a cash incentive bonus plan that tied executive bonuses to increases in Cassava’s stock price. In September 2020, just a few months after it announced the failed Phase 2b study, Cassava issued a press release regarding the “final results” of the Phase 2b study. The Company sent all samples to “outside labs for bioanalysis” to measure the biomarkers and “an academic lab generated final results.” According to the Company, the “initial bioanalysis by a different lab showed highly anomalous data. With its validity in question, the initial bioanalysis serves no useful purpose.” *Id.* But the “final results” showed that simufilam “significantly improved an entire panel of validated biomarkers of Alzheimer’s disease.” *Id.*

Cassava failed to disclose that Dr. Wang’s lab conducted the reanalysis, and that it contained highly anomalous results. Instead, Barbier stated on a conference call with investors that an “academic lab” performed the reanalysis. In October 2020, Cassava reached the first valuation milestone under the new cash bonus plan. One month later, the Company sold 9,375,000 shares of common stock for \$75 million.

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In early 2021, Cassava's stock increased again after it reported results from another trial that indicated simufilam may renew cognitive function in Alzheimer's patients. Later that year, Dr. Burns and Dr. Wang, along with others, authored a poster on the Phase 2b trial that was presented at the Alzheimer's Association International Conference. The poster included a key plasma biomarker data point that had been inserted into the placebo group instead of the control group. By late July 2021, Cassava's stock price reached \$146 per share.

By the end of the summer of 2021, a Citizen Petition was filed with the FDA raising "grave concerns about the quality and integrity of the laboratory-based studies" involving simufilam and noting that all of the foundational research supporting simufilam came from journal articles with two common co-authors: Dr. Burns and Dr. Wang. *Id.* at 3. The Petition also alleged that the Phase 2b poster showed "signs of data anomalies or manipulation", and some experiments conducted by Drs. Burns and Wang presented data that bore "hallmarks of manipulation." *Id.* The Petition also noted that Cassava or Pain Therapeutics had funded Dr. Wang's lab for over fifteen years. The authors of the petition, after reviewing Cassava's pre-clinical research, noted that some images of Cassava's tests looked like they had been tweaked by a program such as Photoshop. *Id.*

On August 25, 2021, Cassava issued a public statement before the market opened to respond to the Citizen Petition. It described the claims raised as "false and misleading," and insisted as fact that "Cassava Sciences' plasma p-tau data from Alzheimer's patients was generated by Quanterix, an independent company, and presented to the Alzheimer's Association International Conference." *Id.* Quanterix then issued a statement to clarify its role in performing sample testing and clarified that it did not interpret the test results or prepare the data to be presented to the Conference. *Id.* On that same day, an expert in identifying manipulation in biomedical images posted online that she reviewed the photos included in the Citizen Petition and "agreed with most of the concerns." *Id.* at 4. The expert also stated that at least five other articles from Dr. Wang's lab appeared to show image concerns.

Cassava's stock price plummeted from its \$146 per share peak, and it continued to fall throughout November 2021, when Cassava disclosed it was under investigation by the SEC and National Institutes of Health, and when a third and fourth supplement to the Citizen Petition was filed alleging faults in Dr. Wang's experiments and "irrefutable evidence of data manipulation/fabrication." *Id.* Although the FDA denied the Citizen Petition solely on the grounds that its requests were not the appropriate subject of that type of action, Barbier immediately issued a statement that the allegations raised were false. Nevertheless, Cassava's stock price fell again after the New York Times published an article in which nine experts said they did not trust Cassava's methods, results, or premise underlying simufilam's supposed effectiveness, and again after the Department of Justice opened a criminal probe into the Company's research results.

While the litigation was pending, Dr. Friedmann passed away. Because no motion for substitution was filed after ninety days had passed since notice of death, the Court granted the Defendants' motion to dismiss as to the claims against Dr. Friedmann only. For the reasons discussed below, the Court denied the Motion to Dismiss as to all other Defendants.

Puzzle Pleading. The Court quickly rejected the Defendants' argument that the Plaintiffs violated basic pleading rules by "puzzle pleading," which requires a court to "wade through a complaint and pick out properly pleaded segments." *Id.* at 6. The reader could logically connect the

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bolded and italicized statements in the Complaint to the reasons Plaintiffs alleged they were false and misleading without undue effort.

Misstatements and Omissions. Defendants argued that the misstatements or omissions alleged by Plaintiffs were not actionable either because: (1) there was no duty to disclose; (2) they were not supported by particularized allegations of fact; or (3) they were true. According to Plaintiffs, Defendants failed to disclose that:

- The Phase 2a study and 2b reanalysis “suffered from highly anomalous baseline measurements;”
- Defendants “intentionally removed unfavorable data” from Cassava’s presentation of the Phase 2b results;
- The Phase 2b reanalysis was conducted by Dr. Wang’s lab;
- Quanterix did not interpret the test results or prepare the data for the Phase 2b reanalysis;
- The missing data point from the AAIC poster reflected a 150% increase rather than a 38% increase.

Id. at *7. The Court concluded that a reasonable investor could certainly have viewed these omissions, in particular the omission regarding Dr. Wang’s lab, as significantly altering the total mix of information available. Further, and although the Court agreed that “an investigation is not a violation,” the evidence of government investigations into Cassava was not the only evidence relied upon by Plaintiffs to support their claims of data manipulation. The Complaint detailed specific instances of photographic evidence of manipulation and described the responses of scientific journals and experts who reviewed Cassava’s research. The stock price drops that accompanied each revelation further supported the materiality of Cassava’s alleged omissions. The Court also dismissed the Defendants’ argument that the allegations of data manipulation were never adopted by persons with personal knowledge of the underlying facts, noting that other federal district courts in Tennessee, New York and California have permitted plaintiffs to rely on short-seller reports to allege falsity at the motion to dismiss stage. *Id.* at *8. Finally, Defendants’ arguments that some of its statements were not actionable because of their literal truth failed because the ability of a statement to provide accurate information, rather than its literal truth, is the benchmark by which public statements are measured in securities fraud cases.

Scienter. The Court found sufficient allegations to support an inference of scienter in the Company’s selective reporting, including that Defendants did not divulge that the “outside lab” for the reanalysis was in fact Dr. Wang’s lab, and that the Phase 2b “final results” contained anomalous data. *Id.* at *9. The Court found further support for scienter in the scientific community’s reaction to the disclosure of Cassava’s manipulation of data and in the Company’s quick and unequivocal denial of the Citizen Petition’s claims. As to motive, the Court found that the “circumstance and structure” of the Company’s new cash bonus plan that tied executive bonuses to short-term increases in Cassava’s stock price suggested that Defendants had motive to inflate the stock price. Pumping stock price further enabled Defendants to raise capital to develop simufilam, which could be probative of

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scienter. Interestingly, and without much explanation as to relevance, the Court noted that Barbier earned nearly \$27 million in salary, bonuses, and stock options as CEO of Cassava's predecessor, Pain Therapeutics, even though the stock price of Pain Therapeutics lost 98% of its value. *Id.* at *9.

Group Pleading. The Court found that to varying degrees, the Plaintiffs adequately alleged scienter as to each Defendant. As to Barbier and Dr. Burns, the circumstances indicated that Cassava was a small company with eight or nine employees in 2019 and eleven in 2020. Simufilam was Cassava's primary drug candidate, and the Company had no other revenue. Barbier and Dr. Burns, who are married, authored Cassava's paper on the allegedly manipulated 2a study results. Although the allegations regarding Schoen (the CFO) were weaker because of his lack of involvement with scientific research, the Court still found that Schoen's participation in the cash bonus plan, along with his failure to disclose in the press release announcing the September 2020 Form 8-K that the "outside lab" was Dr. Wang's, supported an inference of scienter. *Id.* at *11.

Loss Causation. The Court found that the Plaintiffs alleged that immediately following each partial disclosure, Cassava's stock price dropped. When viewed collectively, the partial disclosures constituted a corrective disclosure that adequately pleads loss causation because they "gradually informed the market of the relevant truth." *Id.* at *12.

II. STATE COURT CASES

A. Texas Appellate Courts

1. *Munro v. Jagpal*, 2023 WL 3914554 (Tex. App.—Dallas June 9, 2023)

The Fifth Court of Appeals in Dallas reversed the trial court's dismissal of this action on forum non conveniens grounds and remanded the case to the trial court for further proceedings. The appellees filed their original petition in Collin County, litigated the case there for three years, and only then sought dismissal based on forum non conveniens. The Court of Appeals refused to allow the appellees to "turn the doctrine on its head" and ruled that appellees waived any reliance on the forum non conveniens doctrine by "substantially invok[ing] the judicial process to appellants' detriment when they chose the forum." *Id.* at *7.

The underlying dispute focused on who owned a majority interest in a Nevada holding company (Intrinsic) that held shares of Cannabis Science, Inc. Appellants claimed James Munro owned 100% of Intrinsic whereas Appellees claimed Munro held their shares of Intrinsic in trust. When Munro, a Canadian resident, attempted to sell Intrinsic's shares of Cannabis Science with the help of a Colorado-based consultant and a Collin County, Texas-based transfer agent, Appellees demanded the transfer agent cease from transferring any of the Cannabis Science shares. Appellees then sued Munro, the consultant, and the transfer agent in Collin County, Texas alleging claims of fraud, breach of contract, breach of fiduciary duty, conspiracy to defraud, conversion, tortious interference, and aiding and abetting. Appellees claimed that Munro "schemed to take over Intrinsic and lock out his trust beneficiaries." *Id.* at *1. Munro, allegedly working through his wife, caused Intrinsic to enter into an agreement with the Colorado consultant for services paid by the transfer of 21,400,000 shares of Cannabis Science stock. Munro delivered the stock to the Texas transfer agent, who issued the shares to the Colorado consultant in early March 2017. Appellees also filed an application for temporary restraining order and a request for temporary injunction, which the trial court granted.

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Appellants learned of the Texas litigation at the time of filing and launched legal proceedings in British Columbia. They filed special appearances in the Texas litigation, and after the trial court signed the temporary injunction, they filed an answer and request for disclosure under the Texas Rules of Civil Procedure. In March 2019, appellants filed their second amended answer and counterclaims, asserting causes of action for slander of title, tortious interference with existing contracts, tortious interference with prospective business relations, conversion, intentional infliction of emotional distress, breach of fiduciary duty, violation of Nevada law, violation of Chapter 12 of the civil practice and remedies code, and declaratory relief.

In April 2019, appellants filed a motion for traditional and no-evidence partial summary judgment, which the trial court granted on June 7, 2019. Specifically, the trial court ordered that Munro was the sole owner of Intrinsic, he was the ninety-six percent owner of Intrinsic Venture Corp. (and that his wife owned the other four percent), and that appellees were liable to Munro for slander of title. The court dismissed with prejudice the appellees' claims for fraud, breach of contract, breach of fiduciary duty, conspiracy, conversion, and permanent injunction. The court also dissolved the March 2017 temporary injunction.

In July 2020, one of the appellees filed a motion to set aside interlocutory orders and dismiss the case based on forum non conveniens, arguing that because Munro retained possession of the stock certifications once held by the Texas transfer agent, and the transfer agent's involvement was over, the remaining issues should be litigated in British Columbia. The trial court denied the motion to dismiss, leaving in place the order granting appellant's motion for summary judgment. In September 2020, the appellees filed a notice of nonsuit with prejudice all of its claims against the Texas transfer agent, which the trial court granted. Two months later, the appellees filed a "renewed motion to dismiss based on forum non conveniens" and argued that with the dismissal of the Texas transfer agent, the lawsuit had no connection to the state of Texas. *Id.* at *3. Appellants countered that it was "patently absurd" for the appellees, plaintiffs in the trial court, to "chose this forum, [and now] seek to dismiss this case after four years of litigation based on forum non conveniens." *Id.* The trial court disagreed and dismissed the entire case on forum non conveniens grounds. *Id.* at *4.

The Court of Appeals took up appellees' waiver argument, ruling that appellants' intentional decision to file suit in Collin County was inconsistent with their forum non conveniens argument. *Id.* at *7. "[A]llowing the plaintiff-appellees to use forum non conveniens—the point of which is to protect defendants from plaintiffs' vexatious forum choices—to dismiss defendant-appellants' counterclaims would be to turn the doctrine on its head." *Id.* The Court of Appeals reversed the order of dismissal and remanded the case to the trial court for further proceedings.

III. TEXAS LEGISLATION

Texas' New Business Court: Progress or Power Grab?

On June 9, 2023, Governor Abbott signed into law two pieces of legislation, HB 19 and SB 1045. Together, they establish (1) a new statewide business court ("Business Court"), and (2) a new appellate court ("15th Court of Appeals") that will hear appeals from the Business Court and appeals

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in other matters.⁵ This note focuses on the potential impact the two new laws will have on business cases in Texas.

The Business Court is expected to “streamline resolution of business disputes,” “giv[e] businesses confidence in Texas’ legal system,” and “encourage[e] businesses] to incorporate and headquarter in Texas.” H.B. 19 Committee Report (Substituted). It will have concurrent jurisdiction over several types of cases, including (a) shareholder derivative actions; (b) securities claims filed against publicly traded companies and against other defendants when the amount in controversy is \$5 million or more; and (c) claims relating to “qualified transactions” if they are valued at \$10 million or more. Notably, defendants have the right to remove cases to the Business Court and its 16 new judges will be appointed to two-year renewable terms by the Governor with the advice and consent of the Texas Senate.

Governor Abbott, Republican legislators, and members of the business community have long supported the creation of a specialized business court in Texas, but the legislation was sharply criticized by an unlikely trio of legal organizations: the Texas Trial Lawyers Association, ABOTA, and the Texas Association of Defense Counsel. They argued the new court was unconstitutional because it would be composed of appointed (rather than elected) judges and attached a detailed analysis by UT Law Professor Stephen Vladeck detailing the legislation’s constitutional problems. The legal organizations also argued that the need for the Court was not supported by statistical data, that it would be costly, and that it should have been preceded by a pilot program like those adopted by other states. After the legislation was signed into law, a flurry of law firm memos began to identify additional potential problems with the new law. With the understanding that the constitutionality of the Business Court will likely be challenged, below is a brief outline of the legislation that created it.

Original Jurisdiction

The Business Court has concurrent jurisdiction with district courts over several types of cases depending on the parties involved and the amounts in controversy.

- Actions in which the amount in controversy is \$5 million or more if based on:
 - Derivative claims;
 - Governance of the organization’s internal affairs;
 - Securities or trade regulation claims under state or federal law against an organization, controlling person, underwriter, or auditor;
 - Claims by an organization or its owner against an owner, manager, or controlling person alleging an act or omission in the person’s capacity as an owner, manager, or controlling person;
 - Claims seeking to hold an owner or governing person of an organization liable for an obligation of the organization [e.g., veil-piercing] other than under a written contract signed by the person; or
 - Claims arising under the Business Organizations Code.

⁵ The 15th Court of Appeals will have exclusive intermediate appellate jurisdiction over matters brought by or against the state or a board, commission, department, office, or other agency in the executive branch of the state government . . . or against an officer or employee of [such group].” Tex. Gov’t Code §22.220(d). It will also have “exclusive jurisdiction over an appeal from an order or judgment of the business court or an original proceeding related to an action or order of the business court.” Tex. Gov’t Code § 25A.007.

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- Actions against a publicly traded company
 - No amount in controversy requirement, but
 - Must be based on one or more of the claims referenced above.

- Actions in which the amount in controversy exceeds \$10 million if based on:
 - A “qualified” transaction (defined as any transaction other than a loan by bank, credit union, or savings & loan);
 - Contract or commercial transaction where the parties agree to jurisdiction of the Business Court; or
 - Violation of the Finance Code or the Business & Commerce Code if brought by an organization (other than a bank, credit union, or S&L) so long as it does not involve an insurance contract.

Supplemental Jurisdiction

The Court has supplemental jurisdiction over other claims related to a case or controversy *only if* all parties and the judge agree (otherwise, the other claims may be filed in another court of original jurisdiction). Specifically, unless the parties and judge agree, the Court does not have original jurisdiction of claims by or against a governmental entity; foreclosure proceedings; antitrust or DTPA claims; estate claims; Family Code claims; Insurance Code claims; Mechanics and Materialmen’s liens; trust claims; claims relating to the production or sale of farm products; consumer transactions; or claims relating to duties and obligations under an insurance policy.

Finally, certain claims are expressly excluded from the Court’s original and supplemental jurisdiction. Thus, even if all parties and the judge agree to hear them, the Business Court does not have jurisdiction to hear claims for bodily injury or death, legal malpractice, or medical liability (CPRC Ch. 74).

Venue, Removal, and Transfers

The plaintiff must plead facts establishing venue in a county of a specific division of the Business Court (same as judicial administrative divisions) so the Business Court can assign the case to that venue. Once jurisdiction and venue are established, the Business Court judge shall declare the county in which any jury trial will be held (consistent with CPRC 15.002 and other rules applicable to district courts). If the Business Court does not have jurisdiction, it may, at the option of the party filing the action, transfer the case to a district court or dismiss without prejudice. If the Business Court has jurisdiction but venue is improper, it may transfer to the proper Business Court division.

Notably, any case filed in a district court or a county court at law with proper venue that is within the jurisdiction of the Business Court may be removed to the Business Court. The process for removal is the same as in district courts but not subject to the statutes or rules governing the due order of pleading. Removal of a case to the Business Court does not waive a defect in venue or constitute an appearance to determine personal jurisdiction.

The presiding judge in the court where an action is filed may also request a case be transferred to the Business Court after a hearing on the request if she finds the transfer will facilitate fair and efficient administration of justice.

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Appeals

As noted above, on the same date that HB 19 was signed into law, Governor Abbott signed SB 1045 which creates a 5-member specialized intermediate appellate court with exclusive intermediate appellate jurisdiction over appeals from the Business Court. The Governor will initially appoint justices to the new appellate court, but they will thereafter be elected on a statewide basis.⁶

Powers

Business Court judges shall have the same powers as district court judges, including the ability to grant injunctions and declaratory relief.

Judicial Qualifications and Appointments

- Qualifications
 - U.S. citizen at least 35 years old;
 - 5-year resident of the division of the Court to which she is appointed; and
 - Texas-licensed attorney with 10 years of experience in complex civil business litigation, business transaction law, or as a civil judge.

- Appointments.
 - Two-year terms with reappointment option;
 - Salary - \$140,000 per year with retirement benefits similar to other judges;
 - Governor makes appointments with the advice and consent of the Senate;
 - Vacancies filled by the Governor with advice and consent of the Senate; and
 - Visiting judges may be appointed by the Chief Justice of the Supreme Court.

Potential Legal Challenges

Critics of the legislation argued that the Business Court was unconstitutional, unnecessary, and undemocratic on several, interrelated grounds.⁷

Constitutionality

The Texas Constitution requires the State to be divided into judicial districts with judges elected by the qualified voters of their respective districts. Tex. Const. art. V § 7(a), (b) (district courts); Tex. Const. art. V, § 6 (intermediate appellate courts). While the Texas Constitution also authorizes the state legislature to create other courts, Tex. Const. art. V, § 1, this does not authorize the legislature to “take away and deprive the regular district courts of the jurisdiction specifically given them by the Constitution.” *Reasonover v. Reasonover*, 58 S.W.2d 817, 818 (Tex. 1993). The line that the Texas Supreme Court has drawn is between courts that are functionally equivalent to constitutional courts,

⁶ Critics of the legislation creating the 15th Court of Appeals have called it a court-packing scheme designed to “take state-involved appeals away from judges elected in more Democratic parts of the state [Austin] in favor of judges elected by all Texas voters—who haven’t chosen a Democratic candidate for statewide office since 1994.” Steve Vladeck, *The Legislature’s shameless and unconstitutional court-packing plan*, Austin American-Statesman (March 19, 2023).

⁷ On April 25, 2023, Paul Manning, Chair of the Litigation Section of the Texas State Bar, sent an email about the Business Courts Bill with a link to Professor Vladeck’s memo on the constitutionality of HB 19 and the joint letters submitted by TILA, ABOTA, and TADC. Many of the arguments and criticisms discussed above are taken from those sources. If you would like a copy, please let us know.

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which must be divided into districts and elected by voters as per the Texas Constitution, and statutory courts that are inferior to constitutional courts and may be created by the legislature.

Although HB 19 recites that the Business Court is a statutory court, it is functionally equivalent to a district court and, therefore, must conform to constitutional requirements. *See, e.g., Jordan v. Crudginton*, 231 S.W.2d 641 (Tex. 1950). The Business Court is not inferior to district courts. Its judges will have the same powers as district court judges; its statewide jurisdiction is broader than even district courts; and its jurisdiction will deprive district courts of some of their cases. Second, the Business Court. Because it is not inferior, the Business Court must be divided into districts and elected by citizens in the district. While the statute purports to divide the Business Court into districts, it remains a single court with statewide jurisdiction and its judges are not elected as the Texas Constitution requires.

Necessity

Critics of the legislation noted that the legislature did not support its creation with any statistical data. Although a December 2022 Committee report called for the creation of a pilot program, none was ever created. No data or evidence was presented to show the number of cases that would be handled by the Business Court nor the impact on district courts if those cases were removed. Many complex cases are filed in federal court, subject to mandatory arbitration, or contain forum selection clauses. Indeed, many corporations now include forum selection clauses in their charters or bylaws requiring shareholder litigation to be filed in their state of incorporation.

Nor was any data presented to support the notion that the creation of a Business Court would improve the Texas economy or its business climate. The critics pointed to statements by Governor Abbott touting Texas' perennial No. 1 ranking among CEOs and business owners from every state. Moreover, while the fiscal note accompanying the legislation states that the fiscal impact of the legislation will be zero, it specifically notes that no appropriation for the Business Court has yet been made, fees charged by the court may not be enough to support its operations, and "the fiscal impact of this bill may be greater than the amount reflected by this fiscal note." Critics pointed out the fiscal note for a similar bill in the last legislature estimated \$12 million in annual costs.

Undemocratic

Critics also challenged the fairness of the Business Court, calling it a special court created for special people. "A separate and markedly different judicial system for high-dollar business disputes would send a message to Texas citizens that their disputes are less worthy." The judicial qualifications, smaller caseloads, and other specialized treatment of these cases make that point loud and clear. There is also the risk that judges subject to appointment and reappointment by the Texas governor every two years could be subject to politicization and bias. Critics also speculated that the right to trial by jury could be impacted because the legislation states only that jury trials may be held "when required by the constitution." They encouraged further study before forming the Business Court.

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Workability

Some concerns raised in law firm memos about the new Business Courts include:

- Reduced state court shareholder actions in Texas as the plaintiffs' bar seeks to avoid filing class actions and derivative cases that might be removed to the Business Court;
- Confusion over the jurisdiction of the Business Court when forum selection clauses do not mention it and cases are filed or removed there;
- Complexities around related or parallel cases when removing claims to the Business Court, including aggregation and whether supplemental claims must be tried in a separate court if all parties do not agree to remove them;
- Potential turnover of judges every two years could risk inconsistent decisions and nullify the benefit of having the same judges on long-running business cases;
- Delayed appointments to six Business Court divisions (September 1, 2026) may impact venue decisions; and
- Parties may prefer federal courts until the Business Court is established.⁸

Conclusion

While we recognize that a specialized Texas business court may benefit our clients and our practices, we are concerned about its constitutional problems and the unprecedented gubernatorial power over Business Court judges. The Texas Constitution requires our district, appellate, and supreme court judges to be elected, but Business Court judges would be perpetually appointed. Moreover, the two-year appointment process will not assure continuity over complex business cases and runs the risk of politicizing the appointment process. In short, the new law would replace our longstanding practice of electing judges with a short-term appointment process that places enormous power in the hands of one person in this politically divided state.

If Texas wants to instill confidence in the Business Court, it would be better to add checks and balances that promote judicial independence and enable judges to manage complex cases for more than two years. While other states appoint judges to their business courts, their terms are significantly longer (14 years in New York; 12 in Delaware). Other states also use nominating commissions and other safeguards to ensure that appointments are less political. In Delaware, for example, when the governor appoints someone to the Chancery Court, he chooses from a list provided by a nominating commission, the appointment lasts for 12 years, and no more than a bare majority of seats on the Chancery Court may be held by one party.⁹

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⁸ See, e.g., Sidley Austin LLP, Welcome to Texas: Texas Governor Signs Law Creating Specialized Business Courts (June 12, 2023).

⁹ For additional information about business courts across the United States, see the following articles that were helpful for this note: Lee Applebaum, Mitchell Bach, Eric Milby & Richard L. Renck, *Through the Decades: The Development of Business Courts in the United States of America*, 75 *The Business Lawyer* 2052 (Summer 2020); Anne Tucker Nees, *Making a Case for Business Courts: A Survey of and Proposed Framework to Evaluate Business Courts*, 24 *Ga. State Univ. L. Rev.* 477 (2007).

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