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# 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:

- Securities Fraud Cases – The Fifth Circuit affirmed the dismissal of securities fraud claims based on the five-year statute of repose and pleading deficiencies in *Burback v. Brock*.

  District courts primarily wrestled with motions for class certification after the Supreme Court's decision in *Goldman Sachs* confirmed that defendants have the opportunity to rebut the presumption of class-wide reliance by showing lack of price impact. In *Ramirez v. Exxon Mobil Corp.*, Judge Kinkeade ruled that defendants rebutted the price impact of six out of seven corrective disclosures and that plaintiffs had not adequately supported their "proxy cost of carbon" claim on the seventh. In *Delaware County Employees Retirement System v. Cabot Oil & Gas Corp.*, Judge Rosenthal evaluated a "battle of the experts" over price impact and whether there was mismatch between alleged misstatements and corrective disclosures. In *Edwards v. McDermott Int'l, Inc.*, Magistrate Judge Edison recommended denial of class certification because the plaintiff painted its derivative damages claim with a disclosure coating, improperly basing her direct claim on derivative damages under §14(a).

  In *Linenweber v. Southwest Airlines Co.*, Judge Kinkeade granted defendants' motion to dismiss securities fraud class action claims based on inactionable puffery and allegations the Court ruled were neither false nor misleading.

- SEC Enforcement Actions – In *SEC v. Bowen*, Judge Scholer granted a motion to dismiss §10(b) claims against one defendant arising out of the sale of working interests in Oklahoma wells. While the Court did not rule on defendant's *Janus* argument that he was not a "maker" of any false statements, it ruled the SEC had not adequately pleaded claims with sufficient particularity. The Court granted the SEC leave to file an amended complaint.

- Shareholder Derivative Cases – In *Sobel on Behal of SolarWinds Corp. v. Thompson*, Judge Pitman granted a motion to dismiss on *forum non conveniens* grounds based on an exclusive forum provision in the Company's certificate of incorporation requiring derivative litigation to be filed in the Delaware Court of Chancery. Although the Fifth Circuit has not yet ruled on this issue, Judge Pitman followed the majority of Circuit Courts upholding such provisions even when the plaintiff asserts federal claims under the Exchange Act. In stockholder derivative litigation against Tesla's directors based on toxic workplace allegations, (*In re Tesla, Inc. Stockholder Derivative Litigaiton*) Judge Ezra adopted the magistrate's recommendation to dismiss

derivative claims for failure to establish that at least half of the directors faced a substantial likelihood of liability or were not independent from Elon Musk.

- Other – In a dispute between an investment manager and the general manager of a real estate loan fund, Judge Pitman denied defendants' motion for summary judgment on fraud, conversion, and breach of contract claims after analyzing whether provisions in various agreements precluded reliance on alleged misrepresentations. Magistrate Judge Hightower stayed a putative class action against defendants who engaged in an alleged Ponzi scheme until a criminal action against the central defendants was resolved to protect their Fifth Amendment rights.

## CASE SUMMARIES

# I. FEDERAL CASES

## A. Fifth Circuit

### 1. *Burback v. Brock*, 2023 WL 4532803 (5th Cir. July 13, 2023) (per curiam)

A Fifth Circuit panel of Judges King, Smith, and Elrod affirmed the dismissal of securities fraud, state-law fraud, and other claims based on two alleged schemes to defraud investors: the Note Scheme and the Stock Scheme. The Court affirmed the ruling that the Note Scheme claims were barred by the five-year statute of repose and related state statutes of limitation, and it rejected plaintiffs' argument that these statutes were tolled because defendants "lulled" plaintiffs into accepting their prior misrepresentations. The Court also affirmed the ruling that the Stock Scheme allegations failed to satisfy the heightened pleading standards for fraud and rejected the argument that the district court failed to consider an SEC filing that bolstered plaintiffs' claims.

The original and amended complaints alleged that defendants made false representations to investors to persuade them to purchase promissory notes in Four Oceans Global, LLC ("Global") and stock in Sharing Services, Inc. ("Sharing Services").[1] Defendant Jordan Brock and defendant-below Robert Oblon allegedly misled investors beginning in March or April 2015 about the legitimacy of Global's business (the "Note Scheme") and persuaded them to purchase promissory notes from Global in September 2015. The investors never received any return on this investment. By March 2016, it became apparent to plaintiffs that Global was a failure, but they did not make any claim. In June 2018, Brock allegedly persuaded the investors to convert their interests in Global into an equity investment in Sharing Services and then a third company that Sharing Services was supposed to acquire. The investors never received stock in either company, and the defendants allegedly used the funds for personal gain or to make Ponzi-like payments to other investors. By June 2019, Brock informed the investors that the proposed acquisition would not occur and that all their investments in both the Note Scheme and the Stock Scheme were lost.

In December 2020, the plaintiffs filed an 11-count complaint alleged federal securities fraud, state law securities fraud, breaches of fiduciary duty, and other claims. The district court granted

[1] The original complaint was filed in December 2020, more than five years after the promissory note was executed in September 2015. For additional factual background, see discussion of the district court's decisions in FH Newsletter 3Q21, at 17-18, and FH Newsletter 3Q22, at 12-14.

defendants' motions to dismiss —dismissing the federal securities fraud claim on the Note Scheme with prejudice as barred by the statute of repose, and dismissing all other claims without prejudice. Plaintiffs then filed an eight-count amended complaint, which the federal district court dismissed on limitations and for failure to satisfy the heightened pleading standards for fraud.

Statute of Repose

After outlining the elements for securities fraud claims and the heightened pleading standards under the PSLRA, and addressing a procedural question about plaintiffs' right to appeal the district court's initial dismissal order, the Court turned to the statute of repose:

> Claims arising under the Exchange Act involving "fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws … may be brought not later than the earlier of (1) [two] years after the discovery of the facts constituting the violation; or (2) [five] years after such violation." *Id.* at *4 (quoting 28 U.S.C.§ 1658(b)).

*Id.* at *4. The complaint alleged that plaintiffs executed the note purchase agreements in September 2015, more than five years before they filed the original complaint in December 2020. Accordingly, their federal securities claims involving the Note Scheme were barred by the statute of repose. The state-law fraud claims were barred by Texas' four-year statute of limitations, and plaintiffs failed to identify any previously unknown facts relating to the Note Scheme that would support state-law tolling. *Id.* at *8.

Plaintiffs countered that Brock engaged in post-sale "lulling activities" that tolled the statute of repose, but the Fifth Circuit rejected the argument because "we fail to see how those actions (and other post September-2015 statements or conduct) were connected to the execution of the note purchase agreements." The pleadings did not "sufficiently allege a connection between these post-sale actions and the original sale," and plaintiffs' allegations are "conclusory" and "inadequate." *Id.* at *5. Plaintiffs cited *United States v. Kelley*, 551 F.3d 171 (2d Cir. 2009), which affirmed the admission of account statements produced two to four years after the alleged fraudulent purchase of securities, but the Court found it inapposite because they were admitted for a different purpose than lulling, i.e., "to demonstrate [the defendant's] intent to defraud his clients and the scope of schemes he employed." *Id.* at *7 (quoting *Kelley*, 551 F.3d at 172, 175-76)).

Pleading Deficiencies

With regard to the Stock Scheme, the district court ruled that the amended complaint did not contain non-conclusory allegations demonstrating that any of Brock's statements were false when made and that plaintiffs had failed to allege a strong inference of scienter by Brock. The Fifth Circuit affirmed, noting that the allegations about Brock's position at the companies, receipt of shares for his executive position, and other benefits were not sufficient to raise an inference of scienter. These allegations were rooted in Brock's roles with the companies, and "[s]cienter in a particular case may not be footed solely on motives universal to corporate executives." *Id.* at *7 (quoting *Ind. Elec. Workers' Pension Tr. Fund IBEW v. Shaw Grp., Inc.* 537 F.3d 527, 544 (5th Cir. 2008)).

Consideration of SEC Filing

Finally, the plaintiffs asserted that the district court failed to consider a Form 10-Q issued by Sharing Services attached to their amended complaint. The 10-Q included two passages that plaintiffs claimed were a "public acknowledgement of fraud." The first disclosed that Sharing Services "became aware of an unliquidated amount of potential liability arising from a series of cash advance loan transactions ... entered into by eight different lending sources and related party entity that was controlled by a former Company officer." The plaintiffs claimed the officer was Brock or Oblon. The second disclosed a potential liability arising from the acts of a company consultant, the company spokesperson at the time, who "solicited investment funds from various persons" relating to the formation and capitalization of two legal entities affiliated with the consultant. The plaintiffs claimed this excerpt referred to Oblon.

The Court found no error, noting that the quoted passages did not mention any fraudulent activity and did not, on their face, refer to the Note Scheme or the Stock Scheme. Given the vagueness of the disclosures and the lack of connection to the allegations in the complaint, there was no need for the district court to have considered them at all.

## B. District Courts

### 1. Securities Class Actions

#### (a) *Ramirez v. Exxon Mobil Corp.*, 2023 WL 5415315 (N.D. Tex. Aug. 21, 2023) (Kinkeade, J.)

In this securities fraud class action against ExxonMobil (the "Company"), the Court partially granted and partially denied plaintiff's motion for class certification, concluding that defendants had rebutted the price impact of several alleged misstatements to defeat the presumption of classwide reliance in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). Plaintiffs sought to certify a class over a three-year period based on alleged misstatements about the Company's assets in Canada and the Rocky Mountains, as well as the proxy cost of carbon used for impairment and proved reserve calculations. The Court refused to certify a class based on the proxy-cost-of-carbon claim and narrowed the remaining claims to a class period of eight months.

Factual Background

Plaintiff alleged that beginning in 2014 the Company and certain officers made misrepresentations about the Company's (1) Canadian oil sands assets; (2) Rocky Mountain Dry Gas ("RMDG") assets; and (3) the proxy costs of carbon used to value these assets. According to the plaintiff, when oil and gas prices dropped significantly from 2014 to 2016, the Company (1) failed to write down its proved reserves or take impairments on these assets as quickly as its competitors and (2) falsely portrayed the Company as immune from market forces. In addition, despite the Company's public announcement in March 2014 that it would use a proxy cost of carbon to calculate asset values, the Company did not do so or improperly lowered the proxy cost of carbon in its reserve and impairment calculations. As a result, the Company did not reduce proved reserves or take impairments on its Canadian or Rocky Mountain assets until January 2017, thereby rendering its 2015 10-K and 2016 10-Q reports false and misleading.

According to plaintiff, the truth was revealed in a series of seven partial corrective disclosures, including:

1. A November 9, 2015 article in *The Guardian* about the New York Attorney General investigation of ExxonMobil's climate change disclosures ("*The Guardian* Article");

2. A January 20, 2016 article in the L.A. Times about the California Attorney General investigation into whether ExxonMobil misrepresented the risks to its business because of climate change ("*L.A. Times* Article");

3. The Company's July 29, 2016 2Q16 earnings announcement ("2Q16 Earnings Announcement") disclosing a significant miss of expectations in the Company's Upstream operations;

4. An August 10, 2016 Washington Post editorial by Senators Elizabeth Warren and Sheldon Whitehouse about alleged harassment of state investigators by energy companies ("WaPo Editorial");

5. The Company's October 28, 2016 3Q16 earnings announcement ("3Q16 Earnings Announcement) noting a potential reduction in oil sand and North American reserves;

6. A January 18, 2017 UBS analyst report that downgraded the Company to "sell" based on potential reserve adjustments ("UBS Downgrade"); and

7. The Company's January 31, 2017 4Q16 earnings release ("4Q16 Earnings Announcement") announcing a $2 billion impairment of certain Canadian oil sands assets and the anticipated reduction of other Canadian oil sand reserves in the coming weeks.

Legal Standards

The Court summarized the requirements for class certification in this securities fraud case. It concluded the numerosity, commonality, typicality, and adequacy requirements of Rule 23(a) were met and then turned to the predominance and superiority requirements of Rule 23(b). It concluded there were no individualized questions that predominated as to materiality, falsity, scienter, and damages, but "[r]eliance is different." *Id.* at *10. While plaintiff established enough to invoke the class-wide presumption of reliance in *Basic (i.e.,* that the alleged misrepresentations were publicly known, that the stock traded in an efficient market, and that the plaintiff traded the stock between the time misrepresentations were made and the truth was revealed), it is a rebuttable presumption. Applying the Supreme Court's instruction in *Goldman Sachs*, the defendant has the opportunity to rebut the presumption of class-wide reliance by offering evidence that the alleged misrepresentations had no price impact. *Id.* at *11 (citing *Goldman Sachs*, 141 S. Ct. at 1963). The Court's task is to "assess all the evidence of price impact – direct and indirect – and determine whether it is more likely than not that the alleged misrepresentations had a price impact." *Id.* (quoting *Goldman Sachs*, 141 S. Ct. at 1963). Before analyzing the price impact of specific corrective disclosures, the Court addressed two minor issues involving the expert event studies presented by the parties.

First, in reviewing the analyses of price impact conducted by plaintiff's expert (Professor Frank C. Torchio) and defendants' expert (Dr. Allen Ferrell), the Court noted they disagreed about the proper window period to be used. Both experts applied an "inflation-maintenance" theory of price impact that focuses on the back-end price drop after corrective disclosures to measure the amount of inflation in the stock price. Both experts agreed that price impact required a statistically significant price movement. But they disagreed about the time period in which such statistically significant price movement might occur. Plaintiff's expert used a two-day window period to look for statistically significant price movements at the time of corrective disclosures. Defendants' expert used a shorter period, arguing that a two-day window might be acceptable for a thinly traded stock but not for a widely traded stock like ExxonMobil.[2] The Court noted that the Supreme Court had not yet adopted "any particular theory of how quickly and completely publicly available information is reflected in the market price" but a sister court had rejected a two-day window in another case. *Id.* at *14 (quoting *Basic*, 485 U.S. at 248 n.28, and citing *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton III)*, 309 F.R.D. 251, 268-69 (N.D. Tex. 2015)). The Court agreed with Defendants' expert that a window shorter than two days should apply, which was only relevant to a single corrective disclosure on January 31, 2017 (4Q16 earnings announcement).

Second, the Court noted that Defendants' expert had also analyzed the price movements of ExxonMobil stock shortly after each of the alleged misrepresentations were made. He found no statistically significant *positive* price movements after the alleged misrepresentations; defendants argued that fact was sufficient to rebut the *Basic* presumption. The Court disagreed, noting that the inflation-maintenance theory accounted for the possibility that misrepresentations merely maintained the stock price. It also noted this theory was widely accepted by the federal judiciary. *Id.* at *13. With these issues resolved, the Court evaluated the evidence of price impact for the seven corrective disclosures.

Analysis of Price Impact of Corrective Disclosures

The Court summarized the respective positions of the expert witnesses. *Id.* at *12-13. Plaintiff's expert only analyzed the reaction of ExxonMobil's stock price to the three earnings announcements (2Q16 Earnings Announcement, 3Q16 Earnings Announcement, and 4Q16 Earnings Announcement) and found a statistically significant negative price movement over a two-day window after each of these. Defendants' expert analyzed the price reaction to all seven "corrective disclosures" and found a statistically significant negative price movement over shorter windows (close-to-close or close-to-open periods) for two of those identified by Plaintiff's expert (2Q16 Earnings Announcement and 3Q16 Earnings Announcement). Defendants' expert also found two other corrective disclosures with statistically significant negative price movements (*L.A. Times* Article and UBS Downgrade).

[2] Defendants' expert used two windows to examine price movements. If the statements were made during the trading day, he used a close-to-close window, looking at the market closing price before any statement was made and the closing price at the end of the day the statement was made. If the statements were made before the trading day, he used a close-to-open window, looking at the market closing price before any statement was made and the opening price after the statement was made. *Id.* at *13-14.

The Court then analyzed each corrective disclosure, concluding that the defendants had rebutted the presumption for the following disclosures:

- *The Guardian* Article;
- *L.A. Times* Article;[3]
- 2Q16 Earnings Announcement;[4]
- The WaPo Editorial;
- The UBS Downgrade; and
- 4Q16 Earnings Announcement.

The Court found defendants had not rebutted the presumption of reliance for the 3Q16 Earnings Announcement and rejected the defense argument that all the de-booking and impairment information disclosed in that announcement was discoverable before it was announced. Quoting the Fifth Circuit's ruling in *Amedisys*, the Court reasoned that it was plausible this complex economic data was understandable only through expert analysis and was not so widely known that it became an integral part of the total mix of information. *Id.* at *19.

Finally, the Court noted that even though defendants had not rebutted the presumption for the 3Q16 Earnings Announcement, that did not mean plaintiffs had adequately supported their claim that defendants misled the market about ExxonMobil's use of the proxy cost of carbon. Plaintiff argued that if ExxonMobil had incorporated the publicly stated carbon proxy cost in its internal numbers, it would have realized its reserves were less profitable and de-booked them earlier. The Court was not persuaded by this "linkage" theory since (1) none of the corrective disclosures cited by plaintiff pertained to the Company's proxy costs of carbon; (2) no market analysts suggested such a linkage except one that only mentioned the AG investigations in passing; and (3) an Affirmation by a witness in the NYAG investigation (Oleske) that was filed on June 2, 2017 did not produce a statistically significant negative change in ExxonMobil's stock price.

### (b) *Delaware County Employees Retirement Sys. v. Cabot Oil & Gas Corp.*, 2023 WL 6300569 (S.D. Tex. Sept. 27, 2023) (Rosenthal, J.)

In this securities fraud class action, plaintiffs moved to certify a class of persons or entities who purchased common stock of Cabot Oil & Gas Corp. ("Cabot" or the "Company") between

[3] The Court noted that Defendants' expert had observed a statistically significant negative price movement using a close-to-close window but not when using a close-to-open window. Since the article appeared before the market opened, the Court used the close-to-open window for its analysis. "If the use of a close-to-open window is ever appropriate, it would probably be for something like the alleged January 20, 2016 Corrective Disclosure—a short, easily digestible article issued hours before the market opened, discussing another investigation very similar to the one discussed in *The Guardian* and *The New York Times* articles mentioned above." *Id.* at *16.

[4] Despite both experts finding a statistically significant negative price movement after this announcement, the Court found it was likely not attributable to disclosures about the Canadian oil sands. Analyst reports focused on the Canadian wildfires and civil disturbance in Nigeria which collectively caused a decrease in production of 100,000 barrels per day. In addition, ExxonMobil's 70% joint venturer in the Kearl oil sands project, Imperial, disclosed the performance of those assets on the same day and did not experience any statistically significant negative price movement in its stock.

February 22, 2016 and June 12, 2020.[5] Defendants opposed class certification on the ground that no class-wide presumption of reliance was warranted so class certification was improper under Rule 23(b)(3). Both sides presented testimony from expert witnesses about the price impact of the alleged misrepresentations. The Court's opinion focuses on their testimony in this post-*Goldman* "battle of the experts." The Court certified the class after rejecting defense arguments that (1) the drop in Cabot's stock price was statistically insignificant when corrective disclosures were made, and (2) there was a mismatch between the alleged misstatements and the corrective disclosures.

Factual Allegations Relevant to Class Certification

Cabot is an oil and gas company that uses hydraulic fracturing, or fracking, in its well operations. Most of Cabot's production comes from the Marcellus Shale underneath Susquehanna County, Pennsylvania. Sometime after 2006, the residents of Dimock Township in Susquehanna County began to notice sediment and "effervescence" in their drinking water, and some experienced tunnel vision, nausea, and "body blotches." After a residential water well near a Cabot drilling site exploded, the Pennsylvania Department of Environmental Protection ("Pennsylvania EPA") began to investigate. The investigation concluded that methane gas was migrating from Cabot's drilling sites into the Dimock aquifer. In 2010, the Pennsylvania EPA and Cabot then entered into a consent order ("Consent Order") in 2010 requiring Cabot to cease drilling in a 9-mile square area, remediate Dimmock's drinking water and Cabot's wells, and comply with all applicable environmental laws and regulations going forward.

The securities fraud complaint alleged that Cabot did not remediate and continued to violate environmental laws. Between January 2011 and March 2020, the Pennsylvania EPA cited Cabot for 781 violations. In February 2020, a Pennsylvania grand jury recommended that criminal charges be brought against Cabot for knowingly contaminating residential water supplies in Susquehanna County. On June 15, 2020, the Pennsylvania AG filed charges against Cabot on June 15, 2020 (the "Presentment of Charges") for (1) knowingly discharging industrial waste at wells near Dimock Township and in other locations through June 11, 2018 and (2) failing to comply with the Consent Order based on Cabot's conduct from December 15, 2010 to January 9, 2020. Following the Presentment of Charges, Cabot's stock price dropped by 3%.

In addition to the Presentment of Charges, the Court focused on three categories of statements relevant to the class certification ruling:

*Category 1* – alleged misstatements in 10-Ks and 10-Qs in 2015 and 2016 where Cabot stated it was under investigation, believed the source of methane had been remediated, and had received a proposed consent order that would result in a civil penalty of $100,000 to $300,000;

*Category 2* – alleged misstatements in Cabot's 2016 10-K filed February 27, 2017, confirming its belief that the source of methane had been remediated and notifying investors that it had entered into the Consent Order and agreed to pay a monetary penalty of $300,0000; and

[5] On August 10, 2022, the Court denied motions to dismiss all claims against the Company, the CEO, and the CFO, but dismissed claims against Cabot's SVP and Regional Manager Phil Stalnaker because he was not a "maker" of any alleged misstatements. *See* FH Newsletter 3Q22, at 6-8.

*Category 3* – alleged misstatements[6] made in a press release at 6:38 am on July 26, 2019 and in a 10-Q filed at 11:42 am the same day. The press release ("Guidance Update") shared positive news that the Company was adjusting its production guidance due in large part to a unique opportunity to acquire acreage adjacent to an eight-well pad that would increase lateral drilling lengths, resulting in increased capital spending in 2019 but greater production anticipated in 2020. The 10-Q disclosed negative news that Cabot had received two additional proposed consent orders from the Pennsylvania EPA relating to gas migration allegations in other wells in Susquehanna County. Cabot's stock price declined 12% the day they were made.

Legal Standards Applicable to Class Certification

Under Rule 23, plaintiffs seeking class certification must satisfy four elements (numerosity, commonality, typicality, and adequacy of representation) and show that the class action falls within one of three categories under Rule 23(b), including (1) "questions of law or fact common to class members predominate over any questions affecting only individual members" and (2) a class action is superior to other methods for adjudicating the controversy. As in many securities cases, to establish predominance, the plaintiffs invoked the presumption of reliance established in *Basic Inc. v. Levinson*, 485 U.S. 224, 248 (1988), that requires courts to presume that a stock trading in an efficient market incorporates all material public information. Defendants sought to rebut the *Basic* presumption by presenting evidence that the alleged misrepresentations had no impact on the Company's stock price.

"When a plaintiff's theory is that the defendant's misrepresentations or omissions kept its stock artificially inflated, price impact may be shown on the back end." *Cabot*, at *7 (citing *Goldman Sachs Group Inc. v. Ark. Teacher Ret. Sys.*, 141 S.Ct. 1951, 1961 (2021)). Front-end price impact may be inferred when a corrective disclosure shows that the defendant's previous statements were untrue or that the defendant failed to disclose the truth, and the stock price falls after the truth is revealed. *Id.* A corrective disclosure need not "precisely mirror" the misrepresentation so long as they are "related" or "relevant" to one another. *Id.* (citations omitted).If there is a mismatch between the corrective disclosure and the misrepresentations or omissions, however, the inference of price impact is weaker.

Court's Analysis

Defendants challenged price impact on two grounds: (1) the 3% price drop following the Presentment of Charges was statistically insignificant; and (2) there was a mismatch between (a) the alleged misstatements about environmental compliance (Categories 1 and 2) and (b) the Presentment on June 15, 2020 and (c) the corrective disclosures on July 26, 2019.

*Statistical Significance of 3% Price Drop*

The Court described this issue as a "battle of the experts," which required it to decide which side's expert is more likely correct. *Id.* at *8. In *Goldman*, the Supreme Court instructed district courts to "assess all the evidence of price impact – direct and indirect – and determine whether it is more likely than not that the alleged misrepresentations had a price impact." *Id.* (quoting *Goldman*, 141 S.

[6] According to the Complaint, the July 26, 2019 statements were both misstatements and corrective disclosures. While they misstated certain material facts, they also corrected the Company's prior misstatements about environmental compliance.

Ct. at 1963). The task requires courts to keep in mind the importance of "common sense" in evaluating expert testimony on price impact. *Id.* (citing *Goldman*, 141 S. Ct. at 1960).

According to the Court, the dispute over statistical significance centered around use of the Newey-West Methodology to account for COVID-19 market volatility. Plaintiffs' expert (Dr. Feinstein) claimed the defense expert (Allen) failed to account for this factor. Defendants' expert claimed the methodology was non-standard and yielded erroneous and unreasonable results. Comparing the two, the Court found that Plaintiffs' expert's analysis was more reliable because (1) it accounted for COVID-19 market volatility and (2) Defendants' expert's firm had endorsed the same methodology in its regression models. From a commonsense perspective, it also seemed likely to the Court that the announcement of criminal charges against Cabot would likely impact its stock price. The Court was also unpersuaded by Cabot's argument that the potential fines were small compared to Cabot's revenues because the failure to remediate known violations identified in the Presentment of Charges meant that Cabot could also face regulatory scrutiny, reputational damages, and reduced gas production.

*Mismatch*

The Court divided its analysis into two parts: (1) the potential mismatch between the Category 3 corrective disclosures on July 26, 2019 and the Category 1 and 2 statements from 2015-17, and (2) the potential mismatch between the Presentment of Charges on June 15, 2020 and the Category 1, 2, and 3 statements.

Defendants first argued there was a mismatch because the sites referenced in the July 26, 2019 disclosures[7] (Howell Wells and Jeffers Farms Pad 2 Wells), and the sites referenced in the Category 1 and 2 statements (Stalter Wells) were different. The Court disagreed because it was "not facially apparent from these documents that the distinct violations concerned different well sites." *Id.* at *11. Both the 2Q19 Form 10-Q dated July 26, 2019 and the statements in Categories 1 and 2 referred only to "several wells owned and operated by us in Susquehanna, Pennsylvania," and this generic description did not on its face create a mismatch.[8]

Defendants next argued there was a mismatch because Cabot was not charged with violations relating to the Stalter Wells (Categories 1 and 2) and the time period of violations in the Presentment of Charges (through June 11, 2018) did not match the "appropriate remediation efforts" referenced in Category 3 (through July 26, 2019). The Court quickly dispensed with both arguments. First, the generic description of "wells in Susquehanna County" in the Category 1 and 2 statements meant that a reasonable observer could infer the charges against Cabot corrected its misrepresentations from

[7] The Court's Opinion repeatedly refers to the "2Q10 Form 10-Q," but the factual description of the Category 3 statements refers to a Form 10-Q dated July 26, 2019. Given the context, we assume the Opinion is referring to the 2Q19 Form 10-Q.

[8] The Court agreed there was a mismatch between the Guidance Update issued on July 26, 2019 and the Category 1 and 2 statements, but found it was immaterial "unless Cabot can show the July 26, 2019, price drop was caused by the Guidance Update and not by the 2Q[19] Form 10-Q." *Id.* at *11. The defendants' expert argued the price dropped after the Guidance Update was issued at 6:38 am, but the plaintiffs pointed out that the price dropped another 3% after the Form 10-Q was issued at 11:42 a.m. *Id.* at 12. The defendants also argued that none of the 18 market analysts mentioned the notices of violation disclosed in the Form 10-Q, but the Court found the record "inadequate to conclude that the Form 10-Q did not at least contribute to the price drop." *Id.*

2015 and 2016. Second, the Presentment of Charges "through June 11, 2018" at least corrected Cabot's prior representation that it performed "appropriate remediation efforts" between the Spring of 2017 and July 26, 2019. *Id.*

Based on its analysis of the expert testimony and its comparison of the disclosures, the Court found there was probative evidence of statistical significance and insufficient evidence of a mismatch between the disclosures to rebut the *Basic* presumption. Accordingly, it certified the class consisting of persons or entities who purchased Cabot common stock between February 22, 2016 and June 12, 2020.

### (c) *Edwards v. McDermott Int'l, Inc.*, 2023 WL 5916598 (S.D. Tex. Sept. 11, 2023) (Edison, M.J.)

In the latest *McDermott* ruling, Magistrate Judge Edison recommended denial of class certification for the plaintiff asserting §14(a) claims relating to the merger of McDermott and CB&I.[9] The magistrate judge focused on the plaintiff's claims for damages under § 14(a) and considered whether she stated a direct or a derivative claim. Applying Delaware law, the magistrate judge concluded that the plaintiff alleged a direct claim but sought damages that were only proper in a derivative action or a securities fraud action under § 10(b). "Delaware law does not permit Plaintiff to paint its derivative damages claim with a disclosure coating." Because the plaintiffs sought derivative action damages on behalf of the class but had not satisfied the procedural requirements for bringing a derivative action under Rule 23.1, the magistrate judge concluded the plaintiff lacked standing to seek these damages and recommended denial of class certification. The magistrate judge also noted that if its recommendation on class certification were adopted, it "means that Plaintiff's claims must be dismissed for lack of standing …." *Id.* at *11 n.11.

Factual Background

In December 2017, McDermott entered into a merger agreement with CB&I, an engineering and construction company. According to the § 14(a) complaint, McDermott made material misrepresentations and omissions in the proxy and proxy solicitations regarding four large CB&I construction projects (the "Focus Projects"): the Four Projects were expected to incur higher costs than publicly represented; CB&I had overstated the fair value of these projects and McDermott had improperly assumed they were worth their "carrying value"; and McDermott had failed to conduct even minimal due diligence on the Four Projects that would have revealed their true risks.

The district court denied defendants' motion to dismiss the claims in April 2021. As part of that ruling, the district court held that plaintiff "is entitled to bring, and has pled, a direct claim." *Edwards v. McDermott Int'l, Inc.*, 2021 WL 1421603, at *6 (S.D. Tex. Apr. 13, 2021). This "law of the case" was a central focus of the magistrate judge's analysis in his recommendation to deny class certification.

[9] In addition to the §14(a) litigation, McDermott and its officers were sued in securities fraud class action cases alleging violations of § 10(b). For additional factual background and discussion of these related cases, see the discussion in FH Newsletter 2Q21, at 8-12; FH Newsletter 3Q22, at 11-12.

Legal Standards

The magistrate judge initially considered whether it was bound by the district court's "law of the case" holding that plaintiff had pled a direct claim under Delaware law. Plaintiff argued the law of the case may only be modified if (1) the evidence on a subsequent trial was substantially different; (2) controlling legal authority made a contrary decision applicable to the issues; or (3) the earlier decision was clearly erroneous and would cause manifest injustice. *Id.* at *4 (quoting *McKay v. Novartis Pharm. Corp.*, 751 F.3d 694, 703 (5th Cir. 2014)). The magistrate judge rejected this argument, noting that *McKay* involved a district court's decision to overturn the decision of a multi-district litigation transferee court – a procedurally unique situation. It cited Fifth Circuit law outside of the MDL transfer context holding that "[a] court has the power to revisit prior decision of its own in any circumstance." *Id.*, at *4 (quoting *Zarrow v. City of Wichita Falls*, 614 F.3d 161, 171 (5th Cir. 2010). It further noted a district court has the ability to revisit standing issues at any time, and a successor judge has the ability to revisit prior rulings to prevent error. *Id.* at *3-4.

The magistrate judge then determined that Delaware law governed supplied the rule of whether the § 14(a) claims were direct or derivative. Defendants argued that federal common law should apply. The magistrate judge – citing *Freedman v. magicJack Vocaltec, Ltd.*, 963 F.3d 1125, 1134 (11th Cir. 2020) and rejecting an earlier S.D. Tex. opinion, *Rudolph v. Cummins*, 2007 WL 118963, at *2 n.4 (S.D. Tex. Apr. 19, 2007) – ruled that the law of the state of incorporation should be applied. As stated in *Freedman*:

> [T]he rule directing a court to look to the law of the state or place of incorporation to answer the "direct vs. derivative" question is a logical one. After all, the law of the state or place where a company is incorporated establishes the requirements that a shareholder must meet before bringing either a direct or derivative claim against a corporation.

*Id.* at *5 (quoting *Freedman*, 963 F.3d at 1133).

Under Delaware law, in evaluating whether a claim is direct or derivative, a court asks: "Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?" *Id.* at *6 (quoting *Tooley v. Donaldson, Lufkin & Jenrette, Inc.* , 845 A.2d 1031, 1035 (Del. 2004)). In addition, "[t]he stockholder's claimed injury *must be independent of any alleged injury to the corporation.*" *Id.* (quoting *Tooley*, 845 A.2d at 1039) (emphasis in *McDermott* recommendation); *see also In re J.P. Morgan Chase & Co. S'holder Litig.* , 906 A.2d 766, 769-70 (Del. 2006) ("[T]o plead a direct (non-derivative injury), a stockholder must demonstrate that the duty breached was owed to the stockholder and that she can prevail without showing an injury to the corporation."). Thus, the magistrate judge concluded: "[U]nder Delaware law, a securities plaintiff has standing to assert a direct claim against a corporation only when the plaintiff's theory of liability *and* damages are *both* direct." *Id.* at *7 (emphasis in original). While it is possible for a claim to be both derivative and direct, "[t]o the extent that the Plaintiffs seek to recover for losses suffered [by the company], those claims are derivative in nature because any recovery would benefit the entity as a whole." *Id.* (quoting *Thornton v. Bernard Techs., Inc.*, 2009 WL 426179, at *3 n.28 (Del. Ch. Feb. 20, 2009).

Analysis

Plaintiff did not contest this statement of Delaware law but argued instead that her claim for damages would not benefit the corporation as a whole because (1) the harm to shareholders was the decline in price of their shares; (2) only historical shareholders of McDermott as of the record date for the merger would be eligible to recover damages; and (3) a decline in the value of shares is not necessarily co-extensive with injury to the corporation.

The magistrate judge rejected all of these arguments. First, a drop in the price of a company's stock is not a direct injury because it is shared by all the corporation's shareholders. *Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 385 (5th Cir. 2005). Second, the restriction of the class to those who held stock on the record date did not change the fact that the stock price drop affected all shareholders equally. Third, while the *Bank of America* case cited by Plaintiff posed the same question as in this case, the court did not answer it; instead, it certified a class of both direct and derivative claims and refused to revisit the issue of plaintiffs' damages model. *McDermott* , 2023 WL 5916598, at *7-8.

The magistrate judge concluded that Delaware law "does not permit Plaintiff to paint its derivative damages claim with a disclosure coating." *Id.* at *9. To seek derivative damages, the Plaintiff was required to satisfy the procedural requirements under Rule 23.1, which she had not done. Accordingly, the Plaintiff lacked standing under Rule 23.1, and the proposed class should not be certified. *Id.* The magistrate judge further noted that if its recommendation on class certification were adopted, it also "means that Plaintiff's claims must be dismissed for lack of standing …." *Id.* at *11 n.11.

### (d) *Linenweber v. Southwest Airlines Co.*, 2023 WL 6149106 (N.D. Tex. Sept. 19, 2023) (Kinkeade, J.)

Judge Kinkeade granted Defendants' motion to dismiss this securities fraud class action filed against Southwest Airlines and its CEO, CFO and COO alleging violations Rule 10b-5 based on alleged misstatements about deficiencies in Southwest's safety and regulatory compliance practices.[10] The Court found that the alleged misrepresentations were inactionable puffery or neither false nor misleading on the facts alleged. The claims failed for the additional reason that there was no strong inference of scienter because the allegations did not suggest that the "Officer Defendants actually learned of Southwest's alleged operational deficiencies or would have benefited from concealing them more than a typical executive would benefit from concealing moderately unfavorable news about his or her business." The Court also rejected Plaintiffs' "scheme" liability claims because the only scheme alleged in the complaint consisted of making false statements, which the Court ruled were deficient. The Court granted leave to replead, but Plaintiffs didn't, and final judgment was entered.

The Alleged Misstatements

During the proposed class period, four safety and regulatory compliance issues arose for Southwest:

[10] The litigation focused on events between 2009-2015, not the highly publicized delays at the end of 2022.

- The FAA granted Southwest airworthiness certificates for 88 previously-owned aircraft unusually quickly and later discovered that some of the aircraft had maintenance or maintenance-documentation deficiencies.

- Some of Southwest's flights experienced "balance weight" issues, meaning that the aircraft in flight carried excessive weight by FAA standards.

- Southwest made unspecified changes to its pilot training program with the FAA's approval but without conducting an SMS risk assessment.

- An engine on a Southwest aircraft failed in April 2018, releasing pieces of the engine's fan assembly that broke one of the aircraft's windows and caused the death of a passenger.

Plaintiffs alleged that Southwest subsequently lobbied for more time to conduct engine inspections designed to prevent similar incidents, but Plaintiffs did not allege that Southwest's failure to prevent the April 2018 engine failure violated FAA regulations or resulted from Southwest's other safety and compliance issues.

Plaintiffs alleged the following false statements:

- Defendants purportedly touted Southwest's safety record, their commitment to safety, and their commitment to encouraging employees to report safety issues.

- Defendants allegedly asserted that the FAA independently and extensively regulated Southwest and that Southwest was dedicated to compliance with laws and regulations.

- Defendants allegedly suggested that Southwest engaged in regular and substantial maintenance of its aircraft and attributed unscheduled maintenance costs to factors other than Southwest's issues with balance weight and previously owned aircraft maintenance.

- The COO allegedly stated that Southwest's balance weight program worked well for Southwest's Hawaiian operations.

- The CEO allegedly boasted that Southwest's pilots were experienced and well trained.

- The CEO and CFO certifications required by the Sarbanes-Oxley Act (SOX) stated that they designed the Company's public disclosure controls and internal controls over financial reporting to ensure that material weaknesses are made known to them and that they disclosed any significant deficiencies or material weaknesses in Southwest's financial reporting controls.

The Court's Analysis

The Court summarized its rulings as follows:

> Defendants' alleged misstatements are not actionable because they would not mislead a prospective investor. *Police & Fire Ret. Sys. v. Plains All Am. Pipeline, L.P.*, 777 F. App'x 726, 730 (5th Cir. 2019). Some of Defendants' purported misstatements are generalized expressions of optimism that are short on factual content and difficult to

> prove true or false. Investors do not rely on such "puffery," so it does not **violate** Rule 10b-5(b). *Id.* The remainder of Defendants' purported misstatements are neither false nor misleading judged by the facts Plaintiffs' have alleged. *Masel v. Villarreal*, 924 F.3d 734, 748 (5th Cir. 2019).

2023 WL 6149106, at *5.

No Actionable Misstatements. The Court found the following statements were inactionable puffery:

- Safety was Southwest's "top priority," "number one priority," "highest priority," and "uncompromising priority."
- "We continually work to create and foster a Culture of Safety and Security that proactively identifies and manages risks"
- Southwest's history "demonstrated [its] commitment to Safety."
- Southwest's maintenance systems were either "pretty good" or "really pretty darn solid."
- The COO 's statement that he believed that Southwest focuses on providing a "safe," "reliable," "ontime," "hospitable," "efficient," and "enjoyable" operation and that Southwest's "weight balance program works well" for Southwest's Hawaiian operations;
- Press release thanking partners "who collaborated with us to safely prepare our operation" in Hawaii; and
- The CEO's statements that Southwest is the "gold standard" in hiring and training pilots and has pilots that are "well prepared," "confident of their skills," "deeply experienced and highly trained," and not in "need [of] new training."

*Id.* at 5.[11] The Court found that the CEO's statement "characterizing Southwest's safety record as 'impeccable' presents a closer question because of its strong terms and lack of aspirational language, but it is also not actionable." The Court found the statement was "vague and difficult to falsify" and did "not clearly refer to the balance weight, previously-owned aircraft maintenance, or pilot training deficiencies about which Defendants purportedly misled investors." Nor would an investor understand Mr. Kelly to deny that Southwest faced safety issues.

The Court found that other alleged misrepresentations were not – in the context they were made – false or misleading:

[11] Citing *In re Anadarko Petroleum Corp. Class Action Litig.*, 957 F. Supp. 2d 806, 820–21 (S.D. Tex. 2013) (generalized statements about prioritization of safety not actionable); *Plains All Am.*, 777 F. App'x at 731 (stated "commitment to proper systems and ... intention to comply with regulations" not actionable); *In re BP P.L.C. Sec. Litig.*, 843 F. Supp. 2d 712, 765 (S.D. Tex. 2012) (generalized statements about strengthening "safety culture" not actionable).

- The Court found that the "alleged misstatements about Southwest's maintenance costs are not misleading because they are accurate and do not imply that Southwest's maintenance, safety, and compliance issues did not exist."

- Plaintiffs also failed "to plead that Southwest's alleged misstatements in its safety and compliance policies misleadingly downplayed or concealed Southwest's safety and compliance issues." The statements are not misleading because Plaintiffs fail to plead that (1) Southwest's employees lacked responsibility for safety, compliance, and proactive risk management, (2) Southwest lacked compliance policies and procedures, or (3) Southwest's participation in the Required Navigation Program lacked safety benefits. In short, "[i]nvestors know that the deployment of employees and development of policies and programs to mitigate safety and compliance issues is not a guarantee that problems will not arise."

- Plaintiffs do not plausibly allege that Southwest misled investors when it referred to its "regular maintenance checks."

- Plaintiffs fail to plausibly allege that Southwest overstated the extent and quality of the FAA's regulation of the airline because Plaintiffs fail to plead facts inconsistent with Southwest's statements.

- Plaintiffs fail to show that Southwest's January 2017 commitment to "ensuring that no disciplinary action will be taken against any Employee for reporting a Safety or Security occurrence or hazards" was misleading when made because "Plaintiffs do not allege that Southwest exerted pressure on mechanics around the time of the January 2017 statement Although an FAA Office of Inspector General report detailing an investigation commenced in 2018 expressed concern about Southwest's compliance culture, Plaintiffs failed to allege that the report covered the 2017 time period.

- The Court noted that Plaintiffs took two statements out of context. First, Plaintiffs contend Southwest falsely stated in SEC filings that it performed "substantially all line maintenance on its aircraft." However, Plaintiffs do not allege that Southwest's maintenance problems were issues of "line maintenance" or plead facts showing that Southwest failed to perform "substantially all" line maintenance on its aircraft. Second, Plaintiffs alleged that the COO falsely told investors that Southwest had a "strong" operational "foundation" and that unexpected maintenance events were "behind Southwest." The Court however, reviewed the COO's "full statement" and found that it "does not misleadingly imply that Southwest was free from the maintenance issues."

- Plaintiffs failed to plausibly allege that the SOX certifications in SEC filings misleadingly concealed Southwest's "internal control deficiencies" because Plaintiffs failed to identify any internal control deficiencies at Southwest.

No Scienter. The Court found that the allegations did not give rise to a strong inference that the individual defendants made the alleged misstatements with scienter. The Court rejected Plaintiffs' allegations of "positional" scienter, finding that they "establish only that the Officer Defendants were executives with responsibilities that touched on safety and compliance, which is not a sufficient basis from which to infer scienter." *Id.* at *10. The Court also rejected Plaintiffs' "core operations" theory,

noting "The Fifth Circuit has rarely approved a "core operations" theory of scienter where the corporate defendant is as large as Southwest." *Id.* at *11 (citing *Alaska Elec. Pension Fund v. Flotek Indus., Inc.*, 915 F.3d 975, 985 (5th Cir. 2019)).

The Court also ruled that because Plaintiffs failed to "identify events putting the Officer Defendants on notice of Southwest's issues with balance weight, maintenance of previously-owned aircraft, and pilot training," the allegations failed to give rise to a strong inference that they misled investors with scienter in their SOX representations about Southwest's internal controls. The Court found the allegation that the Officer Defendants were motivated to lie because "overstating the quality of Southwest's safety and compliance practices would yield some benefit for Southwest by pleasing customers and regulators" was too generic to support scienter. Finally, the Court found that the Officer Defendants' stock sales did not give rise to a strong inference of scienter because Plaintiffs did "not state whether Defendants' sales were unusually large, suspiciously timed, made spontaneously rather than pursuant to a plan, or otherwise particularly probative of scienter" – even though the Officer Defendants sold 15.4%, 20.1% and 31.8% of their holdings respectively during the relevant time period.

No Scheme Liability. The Court ruled that Plaintiffs "fail to clearly allege that Defendants engaged in a fraudulent scheme distinct from Defendants' series of alleged misstatements." *Id.* at *14. Because the misrepresentation claims failed, the scheme allegations also failed: "After *Lorenzo*, a scheme liability claim based solely on misstatements must still meet the pleading standard for a misstatement claim." *Id.* (citing *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019)).

Finally, because there was no primary violation, Plaintiffs' control person liability claims under Section 20(a) also failed.

### 2. SEC Enforcement Actions

#### (a) *SEC v. Bowen*, 2023 WL 6166780 (N.D. Tex. Sept. 21, 2023) (Scholer, J.)

Judge Scholer granted defendant Michael Bowen's partial motion to dismiss in this securities fraud action. The SEC sued defendants Bowen, Baker, Kim, Cannon Operating Company LLC, and North Texas Minerals L.L.C. for selling unregistered securities, failing to register as brokers, and securities fraud. The underlying factual allegations relate to money raised for working interests in four Oklahoma wells.

According to the complaint, Bowen and Baker directly solicited investors and used salespeople paid on commission to find other investors. The offering documents sent to investors contained misleading statements about the actual production from prior wells and failed to disclose that Bowen had previously been sanctioned for selling unregistered securities, as well as other negative information about Baker and Kim. Despite promises in the offering materials, defendants never opened a separate account to hold investor funds but instead deposited them into Cannon's operating account where they were spent to pay the unauthorized (and undisclosed) commissions and excessive management expenses.

Bowen moved to dismiss only the securities fraud claims, arguing (1) he was not a maker of the statements under *Janus Cap. Grp., Inc. v. First Deriv. Traders*, 564 U.S. 135, 142 (2011) and (2) the SEC failed to satisfy the heightened pleading requirements for alleging fraud and scienter.

The Court considered whether *Janus* applies to enforcement actions brought by the SEC. It noted that courts are split on this issue,[12] but ruled that regardless of whether *Janus* applies to enforcement actions, the SEC had not adequately pleaded its §10(b) claims. Specifically, the SEC did not provide sufficient details about how Bowen used the misrepresentations and omissions in investor solicitations. Nor did the SEC explain how Bowen knew his name was omitted from offering materials, production from prior wells had declined, and sales commissions were not disclosed. It granted Bowen's motion to dismiss the §10(b) claims without prejudice and granted the SEC leave to file an amended complaint.

The Court then considered whether the SEC had stated a claim against Bowen under §17(a) and concluded it had because "obtaining money by means of an untrue statement" was broader than making a misstatement. Since Bowen was paid commissions and the defendants raised more than $2 million through the sale of unregistered securities, the SEC plausibly alleged conduct within the ambit of §17(a).

### 3. Derivative Actions

#### (a) *Sobel on Behalf of SolarWinds Corp. v. Thompson*, 2023 WL 4356066 (W.D. Tex. July 5, 2023) (Pitman, J.)

Judge Pitman granted a motion to dismiss this derivative action on grounds of *forum non conveniens* based on a provision in the company's certificate of incorporation making the Delaware Court of Chancery the exclusive forum for any derivative action or proceeding.[13] Many corporations have adopted similar provisions in their bylaws or certificates of incorporation, and Delaware recognizes the validity of these provisions.[14] The open issue posed by this case and similar cases is whether provisions making state courts the exclusive forum for derivative actions can deprive a federal court of jurisdiction over derivative claims under the federal Exchange Act. The Fifth Circuit has not ruled on the issue, and other circuit courts are split. *Compare Seafarers Pension Plan v. Broadway*, 23 F.4th 714 (7th Cir. 2022) (declining to apply exclusive forum provision to Exchange Act claims under §14(a)) *with Lee v. Fisher*, 70 F.4th 1129 (9th Cir. 2023) (applying exclusive forum selection provision and dismissing Exchange Act claims under §14(a) on *forum non conveniens* grounds).

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[12] *Id.* at *4 (citing *U.S. S.E.C. v. Benger*, 931 F.Supp.2d 908, 911 n.1, 912-13 (N.D. Ill. 2013) (citing cases on both sides of the split)).

[13] Delaware courts have upheld the validity of exclusive forum provisions. *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013). In 2015, the Delaware legislature codified this ruling. *See* 8 Del.C. §115 (a certificate of incorporation or bylaws "may require, consistent with the applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State.").

[14] The idea of adopting exclusive forum provisions probably originated in Delaware. *See In re Revlon, Inc. Shareholder Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010).

Factual and Procedural Background

SolarWinds Corporation provides software to monitor the health and performance of information-technology networks. In December 2020, SolarWinds disclosed that it was the subject of a cyberattack that allowed hackers to access sensitive information from SolarWinds clients from at least March through June. SolarWinds' stock price declined, and litigation ensued. Plaintiff David Sobel filed a derivative action against SolarWinds' directors and officers asserting violations of §10(b) and §14(a). SolarWinds' bylaws contained a provision making the Delaware Chancery Court the exclusive forum for derivative litigation.

Plaintiff sought the Company's consent to file his derivative action in Texas rather than in the Delaware Chancery Court. Company counsel responded by email as follows:

> Because the related securities action is currently pending in the W.D. Tex. before Judge Pitman, we believe it would be more efficient to litigate any related derivative action before Judge Pitman. Accordingly, if you file a derivative action in the W.D. Tex., SolarWinds does not intend to seek dismissal based on the provision in its bylaws …. But if related derivative cases are filed in other courts, including Delaware, SolarWinds reserves the right to take any action necessary to ensure that only one derivative action proceeds.
>
> For example, if a shareholder files a derivative action in Delaware Chancery Court and we are unable to convince that shareholder or the Delaware Chancery Court to dismiss or stay that action in favor of the derivative action in the W.D. Tex., SolarWinds reserves the right to seek a stay or dismissal of the W.D. Tex. derivative action in favor of the Delaware derivative action.
>
> This email should not be construed as a broad waiver by SolarWinds of its mandatory Delaware venue provisions, but rather is limited to the unique circumstances in this case.

*Id.* at *2.

Six months later, a separate group of SolarWinds shareholders filed a putative derivative action in Delaware Chancery Court based on the same cybersecurity attack. Defendants then moved to dismiss the Texas derivative action on *forum non conveniens* grounds. Before the motion was heard, the Delaware derivative action was dismissed.

Plaintiffs first argued the motion should be denied because the Company consented to litigate the derivative action in Texas and merely reserved the right to ensure that a single derivative action proceeds. Since the Delaware action was dismissed, it nullified the Company's reservation of rights. The Court disagreed, highlighting the plain language of the email response above, and noting that there was more than one derivative action pending when the motion to dismiss was filed.

Plaintiffs then argued that enforcement of the law would contravene federal policy underlying the Exchange Act and violate Delaware law. Since the Exchange Act gives federal courts exclusive

jurisdiction over suits filed under the Act, the §10(b) and §14(a) claims could not be filed in the Delaware Chancery Court, effectively precluding the plaintiff from asserting his claims in any forum. He further argued that this violated the Exchange Act's anti-waiver provision which voids "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title." *Id.* at *4-5 (citing 15 U.S.C. §78cc(a)).

The Court rejected these arguments. First, it noted that the U.S. Supreme Court had ruled that the anti-waiver provision in the Exchange Act did not prohibit enforcement of forum-selection provisions in international contracts or arbitration agreements. *Id.* at *5 (citing *Scherck v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) and *Shearson/Am. Exp. Inc. v. McMahon*, 482 U.S. 220, 224 (1987)). Second, it stated that the Fifth Circuit had considered and rejected the same arguments in *Haynsworth v. The Corp.*, 121 F.3d 956, 968-69 (5th Cir. 1997). The plaintiff in that action sued a foreign underwriting exchange and asserted federal securities violations. The defendants moved to dismiss on *forum non conveniens* grounds based on a forum-selection clause requiring suit to be brought in England. In responding to similar arguments made by plaintiffs in that case, the Fifth Circuit observed: "English law provides a variety of protections for fraud and misrepresentations in securities transactions," which were "adequate to protect [the investors'] interests and the policies behind the [securities] statutes at issue." *Haynsworth*, 121 F.3d at 969-70. The district court reasoned that, like England, Delaware law recognizes derivative state-law claims with available remedies that are commensurate to those available under Plaintiff's federal derivative claims. *Sobel*, 2023 WL 4356066, at *5. Moreover, the exclusive forum selection clauses did not prohibit the plaintiff from bringing direct claims under the Exchange Act, just derivative claims. *Id.*

The Plaintiff then argued that the district court should follow the Seventh Circuit decision in *Seafarers*. Acknowledging *Seafarers* lent support to Plaintiff's position, the Court declined to adopt it because of the Fifth Circuit opinion in *Haynsworth* and the fact that a majority of federal circuit courts have adopted the contrary view. *Id.* at *6 (citing decisions from the 2nd, 4th, 9th, 10th, and 11th circuits).

### (b) *In re Tesla, Inc., Stockholder Derivative Litigation*, 2023 WL 6060349 (W.D. Tex. Sept. 15, 2023) (Ezra, J.)

Judge Ezra adopted Magistrate Judge Howell's recommendation to dismiss this shareholder derivative action arising out of allegations that Tesla created a toxic workplace but granted plaintiffs leave to replead. Judge Ezra agreed that Plaintiffs had not met their burden of establishing that at least half of the Board faced a substantial likelihood of liability and had not adequately pled that a majority of the Board was interested or lacked independence. Based in part on the magistrate judge's failure to properly count the number of directors at the time the litigation was filed, Judge Ezra vacated the portion of the recommendation dismissing the claims with prejudice and instead gave Plaintiffs an opportunity to replead.

The complaint alleged that Tesla's officers and directors breached their fiduciary duties, unjustly enriched themselves, and made false and misleading proxy statements. The Company and the individual Defendants moved to dismiss Plaintiffs' complaint for failure to make a pre-litigation demand. Plaintiffs argued that demand would have been futile because (1) at least half the Board when litigation began faced a substantial likelihood of liability, and (2) a majority of the Board lacked independence from Elon Musk.

Because Tesla is a Delaware corporation, Delaware demand standards apply. Order at *2. Under Delaware law, demand is excused as futile if at least half of the Board members:

(i) received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;

(ii) face a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; or

(iii) lack independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

Order at *3 (citing *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1059 (Del. 2021)).

Substantial Likelihood of Liability

In recommending dismissal, Magistrate Judge Howell found that Plaintiffs failed to establish that a majority of the Board faced a substantial likelihood of liability. Because Plaintiffs did not specifically object to this finding, the Court reviewed it only to determine whether it was clearly erroneous or contrary to law. Order at *2, *4.

Upon review, the Court found no error in Judge Howell's conclusion that Plaintiffs failed to establish that Tesla's Board faces a substantial likelihood of liability as to Plaintiffs' *Caremark* claim related to oversight of corporate activities. *Id.* at *4. Plaintiffs asserted a "prong two" claim under *Caremark*, arguing that Tesla's Board, despite regular reports about the toxic workplace culture, "utterly failed to take meaningful action to institute change, to hold management accountable, or to ensure proper oversight." The Court noted that Plaintiffs' pleadings regarding sufficient notice and failure to remediate are based almost entirely on information the Board received from Tesla's employee relations and legal departments through regular presentations. He agreed with Judge Howell that Plaintiffs' allegations did not support a pleading-stage inference that the Board acted in bad faith. *Id.* at *5. Delaware law protects directors who rely in good faith on information presented to the corporation by any of its officers or employees. *Id.* Further, the Court agreed with Defendants that Plaintiffs' conclusory characterization of the measures taken by the Board as "shallow" was not sufficient to satisfy the requirement that Plaintiffs must plead particularized facts showing the Board consciously disregarded its duty to address misconduct. *Id.*

The Court also found no error in Judge Howell's conclusion that Plaintiffs failed to adequately plead the existence of false or misleading statements in the Board's Proxy Statement for purposes of Plaintiffs' Section 14(a) claim. *Id.* at *4, *6. Plaintiffs alleged the 2021 Proxy omitted material information necessary to make certain statements not misleading by stating Tesla "has designed [its] workplace and policies to provide all employees with a respectful and safe working environment by not tolerating any discrimination, harassment, retaliation, or any other mistreatment at work, whether based on a legally protected status or otherwise." However, the Court pointed out that multiple courts have held that statements about a Board's goals are "inactionable puffery." *Id.* at *6. The Court also

noted that Plaintiffs did not provide authority supporting their position that disagreement with the Board's business judgment regarding management of employee relations adequately pleads false or misleading statements for a Section 14(a) claim. *Id.*

Interested or Lack of Independence

Judge Howell also found that Plaintiffs had not adequately pled that a majority of the Board was interested or lacked independence. *Id.* The Court conducted a de novo review of this finding, as Plaintiffs specifically objected that Judge Howell mistakenly assumed the company had twelve Board members at the time the complaint was filed. *Id.* at *2, *6. Plaintiffs argued that the relevant Board for purposes of assessing demand futility under Delaware law was only eight members because four of the members counted by Judge Howell left the Board before the lawsuit was filed. Plaintiffs contended that they adequately alleged demand futility as to four of the eight-member Board. *Id.* at *2. Because Tesla's Board has an even number of members, Plaintiffs were required to allege particularized facts showing interest or lack of independence for at least half of the Board. *Id.* at *6 (citing *Rales v. Blasband*, 634 A.2d 927, 930 (Del. 1993).

Defendants conceded that Judge Howell miscounted but argued it was harmless error because Plaintiffs failed to allege that Musk faced a substantial likelihood of liability. Thus, any claim that directors lacked independence from him were irrelevant. The Court agreed the complaint did not adequately allege that Musk faced a substantial likelihood of liability. *Id.* at *7. Plaintiffs claimed Musk did not set a good example and had knowledge of the investigation by California's Department of Fair Employment and Housing. This did not rise to the level of a "substantial" likelihood of liability. *Id.* However, the district court gave Plaintiffs the opportunity to amend their complaint and replead their claim. *Id.* at *7, *8.

### 4. Other Cases

#### (a) *Noble Capital Fund Mgmt., LLC v. US Capital Global Inv. Mgmt. LLC,* 2023 WL 5814390 (W.D. Tex. Sept. 7, 2023) (Pitman, J.)

Judge Pitman largely denied Defendants' motions for summary judgment in this breach of contract and breach of fiduciary duty dispute between the investment manager and the general manager of a real estate loan fund, as well as certain investors in the fund.

Plaintiff Noble Capital Fund Management, LLC ("Noble") and Defendant US Capital Global Investment Management LLC (US Capital) established an investment fund (Fund) to invest in real estate loans. Plaintiffs TXPLCFQ, LLC and TXPLCFNQ, LLC (the "Feeder Funds") are limited partners and investors in the Fund. The dispute relate to three agreements:

- The Management Advisory Services Agreement ("MASA"), pursuant to which Noble provides its investment expertise to US Capital in exchange for 70% of US Capital's carried interest in the investments. (governed by California law)
- The Limited Partnership Agreement for the Fund ("LPA"), which provides that US Capital as general partner has "sole and absolute discretion" to make decisions for the good of the partnership. (governed by Delaware law)

- The Placement Agent Agreement ("PAA") in which Noble engages US Capital to raise up to $250 million in investor funds. (governed by California law)

US Capital failed to raise any funds for the Fund, and Noble also accused US Capital of mismanaging the Fund. Noble asserted claims for fraud, breach of contract, breach of fiduciary duty, and conversion.

Fraud. As an initial matter, the Court ruled that the contractual choice of law provisions did not govern the fraud claims, which sounded in tort Applying the "substantial relationship" test used by Texas courts, the Court determined that Texas law governed the fraud claims.

US Capital asserted that merger clauses in the various contracts precluded reliance on the alleged misrepresentations. The Court largely disagreed. Under Texas law, merger clauses disclaiming external representations are not sufficient to disclaim reliance or fraud claims. "To negate a fraudulent inducement claim, 'a clause must expressly disclaim reliance on prior representations or expressly waive fraud claims.'" 2023 WL 5814390, at * 6 (quoting *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 334 (Tex. 2011). The Court compared two disclaimers previously reviewed by the Texas Supreme Court, one that was sufficient and another that was not:

- Sufficient to preclude a fraudulent inducement claim: "[Plaintiff] is not relying upon any representation made by on or behalf of [Defendant] that is not specified in the Agreement." *Int'l Bus. Machines Corp. v. Lufkin Indus., LLC*, 573 S.W.3d 224, 228 (Tex. 2019).

- Insufficient to preclude a fraudulent inducement claim: "Tenant acknowledges that [Landlord has not] made any representations or promises with respect to the Site, the Shopping Center or this lease except as expressly set forth herein." *Italian Cowboy*, 341 S.W.3d at 328.

Applying these standards, the Court found the disclaimers in the MASA and the PSA were not sufficient to waive reliance:

- "This Agreement constitutes the entire agreement between the parties with respect to the subject matter hereof, superseding all prior understandings and agreements whether written or oral." (MASA)

- "The Agreement represents our entire understanding relating to the Engagement and supersedes prior understandings whether written or oral." (PAA)

The Court found that the following language in the MASA and PAA was a closer call but was ultimately insufficient to disclaim reliance: "No promises or representations have been made to [Noble Capital] to induce [Noble Capital] to sign this Agreement." (MASA and PAA)

The Court found, however, that the LPA contained language sufficiently explicit to disclaim reliance: "No Limited Partner has executed and entered into this Agreement ... in reliance on any representation, arrangement, agreement or understanding, oral or written, that is not expressed in this Agreement." *Id.* at *7. Even though fraudulent inducement claims were precluded, the Court noted

that the Feeder Funds could still pursue claims for fraud arising from misrepresentations contained within the LPA, as well as misrepresentations made after the LPA was signed.

US Capital also argued that even if reliance were not disclaimed, Plaintiffs would be unable to show *justifiable* reliance. Under Texas law, "a party may justifiably rely on a false promise of future performance if it is (1) sufficiently certain and (2) made with no intent of performing at the time it was made." *Id.* at *8. The Court found that genuine issues of material fact precluded summary judgment on this issue.

Conversion. The Feeder Funds asserted a claim for conversion because US Capital refused to allow withdrawals from the Fund. US Capital asserted that the LPA gave it "sole and absolute discretion," to suspend withdrawal rights if withdrawal would be "seriously prejudicial to the Fund or the remaining Limited Partners." The Court found that fact questions remained as to whether US Capital genuinely believed such circumstances existed when it refused to allow withdrawals.

Breach of Fiduciary Duty. The Feeder Funds asserted breach of fiduciary claims against US Capital, but the LPA waived fiduciary duty claims to the fullest extent permitted by Delaware law:

> Any standard of care and duty imposed by this Agreement or under Delaware law or any applicable law shall be modified waived or limited, to the extent permitted by law, as required to permit the General Partner to act under this Agreement so long as such action is reasonably believed by the General Partner to be in, or not inconsistent with, the best interests of the Limited Partnership.

The Court found this language did not waive claims for breach, but rather converted the duty into a contractual fiduciary duty and that US Capital "still had a fiduciary duty to act in a way that it reasonably believed was in the best interests of the partnership." *Id.* at *11. Finding fact questions existed, the Court denied summary judgment.

Breach of Contract. The Court also found fact questions existed as to whether US Capital breached the PAA by failing to make "reasonable efforts" to identify investors for the Fund. The Court also found fact questions as to whether US Capital breached the LPA by refusing to fund loans. Even though the LPA gave US Capital "sole and absolute discretion" to determine whether to fund a particular loan, this "does not vest a party with total immunity under Delaware law, and they still must abide by their duty of loyalty to the limited partner and exercise good faith judgment." *Id.* at *12. Finally, Noble alleged that US Capital breached the MASA because its refusal to fund loans prevented Noble from earning any fees under the MASA. The Court found that "Even though the MASA did not obligate [US Capital] to authorize loans, it contained the implied covenant that [US Capital] would not, in bad faith, prevent Noble Capital from making investments and earning commissions on those investments." *Id.*

### (b) *Kinnie Ma Individual Retirement Account v. Ascendant Capital, LLC*, 2023 WL 5417142 (W.D. Tex. Aug. 21, 2023) (Hightower, M.J.)

Magistrate Judge Hightower stayed this putative class action arising out of an alleged Ponzi scheme, pending resolution of related criminal charges in New York against several of the same defendants. In balancing the relevant interests in a stay, the magistrate judge gave significant weight

to (1) the substantial overlap between the operative facts, witnesses, and evidence in the civil and criminal cases and (2) the likelihood that the individual defendants would be pressured into waiving their Fifth Amendment rights if the civil suit proceeded. *Id.* at *5. The magistrate judge also rejected Plaintiffs' argument that the earlier denial of a similar motion to stay was controlling.

Factual and Procedural Background

The civil complaint alleged Plaintiffs invested in individual funds managed by GPB Capital Holdings, LLC and were paid dividends from their own invested capital rather than from the funds' operating profits. It alleged undisclosed self-dealing and conflicts of interest among the parties, including that GPB Capital Holdings, Ascendant Capital, Ascendant Alternative Strategies, LLC, Axiom Capital Management, Inc., and principals David Gentile and Jeffry Schneider "commonly owned the entire revenue stream…" It asserted claims for violations of the Texas Securities Act and the Texas Uniform Fraudulent Transfer Act, fraud, breach of fiduciary duty, negligence, and civil conspiracy.

Several defendants in the Texas litigation, including GPB principals Gentile and Schneider, were indicted in the Eastern District of New York in 2021 arising out of the same alleged Ponzi scheme. Gentile and Schneider were charged with conspiracy to commit securities fraud, conspiracy to commit wire fraud, and securities fraud, and Gentile was charged with wire fraud. Both pleaded not guilty on all counts, and their criminal trial is scheduled for June 3, 2024.

Gentile, Schneider, and several other defendants in the class action (collectively, the "Indicted Defendants Group") moved to stay the civil proceedings until the criminal case was completed.[15] They argued that the significant overlap between the conduct alleged in the indictment and the class action would prevent Gentile and Schneider from protecting their Fifth Amendment rights and participating in the civil case. Plaintiffs opposed the stay based on the law of the case doctrine, waiver, and the balance of relevant interests. The district court referred the motion to stay to the magistrate judge.

Legal Standards and Analysis

There is no general rule against simultaneous parallel civil and criminal proceedings, and whether to grant a stay is within the trial court's discretion. Order at *3. Staying a civil proceeding "contemplates special circumstances and the need to avoid substantial and irreparable prejudice." *Id.* (citing *United States v. Little Al*, 712 F.2d 133, 136 (5th Cir. 1983) (quoting *SEC v. First Fin. Grp. of Tex., Inc.*, 659 F.2d 660, 668 (5th Cir. 1981)). The Court stated that the need to "preserve a defendant's Fifth Amendment right against self-incrimination and to resolve the conflict he would face between asserting this right and defending the civil action" are special circumstances. *Id.* (citing *Bean v. Alcorta*, 220 F. Supp. 3d 772, 775 (W.D. Tex. 2016)). Before weighing the relative interests in a stay, the Court addressed two preliminary arguments made by the Plaintiff.

First, Plaintiffs argued the law of the case barred consideration of the Indicted Defendants' motion to stay. The magistrate judge noted that when Judge Yeakel declined to stay the case in June 2022, before he retired, he explained that the parties could do many things without impacting Gentile

[15] The "Indicted Defendants Group" included Gentile, Schneider, Ascendant Capital, Ascendant Alternative Strategies, LLC, and DJ Partners LLC.

and Schneider's constitutional rights. He instructed the parties that issues related to constitutional rights should be handled "on a point-by-point basis." Following that ruling, the parties engaged in significant discovery, the case progressed to the class certification stage, and Gentile and Schneider's criminal case was set for trial. Based on the constitutional issues presented and the changed circumstances, the magistrate judge determined that the renewed motion to stay was not inconsistent with Judge Yeakel's denial of the original motion. *Id.* at *4.

Second, Plaintiffs argued that the Indicted Defendants Group waived their right to request a stay by supporting the scheduling order for the class action. The magistrate judge quickly dispensed with this argument, noting that Gentile had specifically reserved his objection to the case proceeding before the resolution of his criminal case. *Id.*

Finally, the Court addressed the balance of relevant interests in a stay using the following factors:

(1) the extent to which the issues in the criminal case overlap with the civil case;

(2) the status of the criminal case, including whether the defendants have been indicted;

(3) the private interests of the plaintiffs in proceeding expeditiously, weighed against the prejudice to plaintiffs caused by the delay;

(4) the private interest of and burden on the defendants;

(5) the interests of the courts; and

(6) the public interest.

*Id.* (citing *Bean*, 220 F. Supp. 3d at 775).

The magistrate judge acknowledged that the "most important factor at the threshold is the degree to which the civil issues overlap with the criminal issues," and that significant overlap makes self-incrimination more likely. *Id.* (citing *Bean*, 220 F. Supp. 3d at 775-776). To determine the extent of overlap, courts consider whether the civil and criminal cases arise from the "same set of operative facts" and involve the same witnesses and documentary evidence. *Id.* at *4. The Court noted that Gentile and Schneider were central figures in both cases, and both the indictment and the complaint accused them of defrauding investors in GPB Funds through material misrepresentations and omissions. *Id.* The Court concluded it was unlikely that Gentile and Schneider would be able to "effectively defend the civil suit without being pressured into waiving their Fifth Amendment rights." *Id.* (citing *Alcala v. Texas Webb Cnty.*, 625 F. Supp. 2d 391, 401 (S.D. Tex. 2009)). This factor weighed heavily in favor of a stay. *Id.* at *5.

The status of the criminal case also weighed heavily in favor of a stay because both Gentile and Schneider were indicted, and their criminal case was set for trial on June 3, 2024. The Court also noted that the criminal trial was subject to the Speedy Trial Act, making delay less likely.

The private interests of the plaintiffs weighed against a stay. Plaintiffs demonstrated more than a general interest in expeditious proceedings. Plaintiffs pointed out that many of the putative class

members were elderly retirees and argued they would be prejudiced as memories fade and gathering evidence becomes more difficult. Plaintiffs also argued they would be prejudiced due to insufficient funds to cover their losses because of other litigants pursuing the same pool of assets. While the Court acknowledged some mitigating factors might limit the prejudice to Plaintiffs, it found the third factor weighed against a stay.[16]

The private interests of the defendants weighed slightly in favor of a stay. The Indicted Defendants Group argued that issuing expert reports on class certification would require them to adopt positions related to the conduct alleged in the indictment. In response, Plaintiffs argued that Gentile and Schneider had not substantively participated in the action to date. However, the Court found this factor supported Gentile and Schneider's argument that they could not protect their Fifth Amendment rights while mounting a defense in the civil action. *Id.* at *7.

The Court characterized the interest of the Court as neutral, noting that the stay would not be indefinite and the criminal case could narrow the issues or promote settlement of the civil action. *Id.* at *8.

The public interest weighed in favor of a stay because denying a stay would risk endangering Fifth Amendment rights and granting a stay would not result in significant delay. *Id.*

After balancing all relevant factors, the Court found they favored staying the action. The Plaintiffs' legitimate interest in speedy resolution of this case was outweighed by Gentile and Schnieder's constitutional interests and the balance of the other factors. *Id.* Because Gentile and Schneider were the "central figures" in the criminal case, the Court found that a partial stay of this action allowing Plaintiffs to proceed against the corporate defendants would significantly hinder judicial efficiency. *Id.* The Court ordered a stay until Gentile and Schneider were sentenced or acquitted, or the charges against them were dismissed. *Id.* at *9.

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**Kenneth P. Held**

[16] The Court noted that some of the prejudice raised by Plaintiffs was mitigated by two factors. First, the SEC filed a civil action against GPB Capital Holdings and other defendants in the Eastern District of New York, and the district court in that case appointed a monitor over GPB Capital Holdings to protect investors. *SEC v. GPB Cap. Holdings, LLC*, No. 21-cv-00583-MKB-VMS (E.D.N.Y. Feb. 21, 2021). Second, similar lawsuits against GPB Capital Holdings and other defendants were filed in state and federal courts, but all cases except for the SEC action were stayed as to GPB Capital Holdings.

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