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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:

- Fifth Circuit Rulings – In *Alliance for Fair Board Recruitment v. SEC*, a 9-8 majority of the Fifth Circuit sitting *en banc* ruled that the SEC exceeded its statutory authority and acted arbitrarily and capriciously in approving Nasdaq rules requiring Nasdaq-listed companies to disclose information about the diversity of their board members. In *U.S. v. Ashley*, the Fifth Circuit vacated a financial advisor's conviction on five of 17 counts after the government conceded there was insufficient evidence to convict him on those charges. The Court declined to apply the cumulative error doctrine with respect to the remaining counts despite concerns about trial errors.

- Federal District Court Rulings – Judge Mazzant issued a nationwide preliminary injunction enjoining enforcement of the Corporate Transparency Act (CTA) which requires companies registered under state law to report detailed personal information about their beneficial owners to the federal government (BOI Reports). The U.S. Supreme Court later stayed the injunction, but the government has stated it will review the benefits and burdens of the statute before attempting to enforce compliance. In the *Cassava Sciences* securities litigation, the magistrate judge recommended certification of a class of purchasers and rejected arguments that the plaintiff representatives were atypical of the class because they were day traders. The parties settled the long-running securities litigation against Apache Corp. relating to Alpine High, and the Court reduced the plaintiffs' requested attorney fees to 25% of the common settlement fund.

- State Court Rulings – Among other cases reported below, the First Court of Appeals reversed a bench trial ruling that a stockbroker who failed to disclose hundreds of thousands in customer account losses over a three-year period breached his fiduciary duties. The Court ruled there was no evidence that the failure to disclose caused the loss, that the customer would have terminated the broker's services if disclosure were made, or that the heavily margined account would have incurred fewer losses.

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CASE SUMMARIES

I. FEDERAL CASES

A. Fifth Circuit

1. *Alliance for Fair Board Recruitment v. SEC*, 125 F.4th 159 (Dec. 11, 2024)

The Fifth Circuit *en banc* reversed a panel opinion that had upheld the SEC's approval of three Nasdaq rules requiring Nasdaq-listed companies to disclose corporate-board diversity information.[1] The full court in a 9-8 vote held that the SEC acted arbitrarily and capriciously in approving the rules because corporate-board diversity information was not "related to" the purposes of the Exchange Act articulated by Congress. The Court also ruled that the SEC's approval violated the "major questions" doctrine by exceeding its statutory grant of power and encroaching on state power over corporations.[2]

Factual and Procedural Background

In 2020, in response to the social justice movement and calls by investors and investor groups for diversity in the board room, Nasdaq conducted an internal study of the current state of board diversity among Nasdaq-listed companies based on public disclosures. On February 26, 2021, Nasdaq filed three proposed amended rule changes to address corporate-board diversity:

- The Disclosure Rule required each Nasdaq-listed company to publicly disclose information on the voluntary, self-identified gender and racial characteristics and LGBTQ+ status of its board members. Nasdaq included definitions with the proposed rules for the terms Diverse, Female, Underrepresented Minority, and LGBTQ+.

- The Diversity Rule, with some limited exceptions for foreign issuers and boards with five or fewer directors, required any Nasdaq-listed company that did not identify at least two diverse board members (defined for domestic issuers as one female and one underrepresented minority or LGBTQ+ person) to explain why. Nasdaq was to confirm that an explanation was given but not review or comment on the substance of the explanation.

- The Recruiting Rule offered Nasdaq-listed companies who did not satisfy the Diversity Rule access to a board recruiting service to identify and evaluate diverse candidates.

After notice and comment, the SEC approved all three rules. While it did not find that Nasdaq was permitted to make rules designed to alter the composition of company boards, the SEC concluded that the Disclosure Rule and the Diversity Rule were related to the Exchange Act because information about the racial, gender, and sexual characteristics of directors was important to investors, citing comments from large institutional investors and managers such as BlackRock, Vanguard, State Street, CALPERS, and Goldman Sachs. The disclosure-based framework would make diversity information available on a consistent and comparable basis to eliminate some asymmetries in reported board-

[1] *See* FH 4Q23 Newsletter, at 2-6 (discussing *Alliance for Fair Board Recruitment v. SEC*, 85 F.4th 226 (5th Cir. 2023)).

[2] The nine judges in the majority were all appointed by Republican presidents (Reagan, Bush, and Trump). The eight dissenting judges were appointed by both Republican and Democratic presidents (Clinton, Bush, Obama, and Biden). Judge Ho, whose wife argued on behalf of Nasdaq, was recused.

diversity information. The SEC found the rules were designed (1) to promote just and equitable principles of trade; (2) remove impediments to and perfect the mechanism of a free and open market and a national market system; and (3) protect investors and the public interest.

The petitioners asked the Fifth Circuit to review the proposed rules, arguing they (1) violated the First and Fourteenth Amendments to the U.S. Constitution, and (2) violated the SEC's statutory obligations under the Exchange Act and the Administrative Procedure Act (APA). A three-judge panel of Judges Stewart, Dennis, and Higginson ruled that (1) Nasdaq was not a state actor; (2) the SEC did not exceed its statutory authority; and (3) the SEC did not act arbitrarily or capriciously in approving Nasdaq's rules.

En Banc Ruling

The *en banc* court did not address whether Nasdaq was a state actor or whether there was any merit to the constitutional arguments raised by petitioners. The majority opinion addressed only the SEC's statutory authority and whether it acted arbitrarily and capriciously in approving the rules. 125 F.4th at 169 n.2. The opinion includes a lengthy discussion of the history and purposes of the 1934 Exchange Act and the 1975 amendments to the Act, concluding that:

> Congress passed the original Exchange Act primarily to protect investors and the American economy from speculative, manipulative, and fraudulent practices. In 1975, it amended the Exchange Act to further those goals and, additionally, to remove barriers to development of a national market system. No doubt the Act has ancillary purposes – for example, protection of corporate suffrage. There may be other purposes buried in the Exchange Act's voluminous text, but our review of the Act's history makes clear that disclosure of any and all information about listed companies is not among them.

Id. at 174-75. The majority further stated that "before SEC approves an SRO rule, it must do more than posit that the rule furthers some 'core disclosure purpose' that is found nowhere in the Act. SEC may not approve even a disclosure rule unless it can establish the rule has some connection to an actual, enumerated purpose of the Act." *Id.* at 175. With that backdrop, the Court proceeded to reject the SEC's three arguments for why the rules were "related to" the purposes of the Exchange Act.

First, the SEC argued the rules were consistent with the "just and equitable" (J&E) provision that requires exchanges to promote ethical behavior. The Court defined "just" as what is morally right and "equitable" as what is fair. *Id.* at 176. It then concluded that the Disclosure Rule and Diversity Rule are "far removed from these ordinary applications of the concept of just and equitable principles of trade. . . . It is not unethical for a company to decline to disclose information about the racial, gender, and LGBTQ+ characteristics of its directors." *Id.* The fact that the SEC found the rules would satisfy some investors who demanded diversity information "is irrelevant for purposes of the J&E provision." *Id.*

Second, the SEC argued the rules removed impediments to a free and open market and the national market system. The Court explained that the purpose of this provision was to promote a free and open market for securities transactions. "Equipping investors to make investment and voting decisions might be a good idea, but it has nothing to do with the execution of securities transactions." *Id.* at 177.

Third, the SEC argued that the catch-all provision to protect investors and the public interest supported approval of the rules. The Court disagreed. Nasdaq told the SEC that there was a link between a diverse board and the quality of a company's financial reporting, internal controls, public disclosures, and management oversight. However, the SEC concluded the evidence was "mixed" and justified its finding that the rules were "related to" the purposes of the Exchange Act on the ground that some investors wanted board diversity information. *Id.* at 178-80. This was not enough according to the majority.

Finally, the majority noted that its interpretation of the Exchange Act was supported by the "major questions" doctrine which limits agency actions to those authorized by Congress. Given the economic and political significance of the Nasdaq board-diversity rules, the Court was skeptical that the vague purposes cited by the SEC were sufficient to justify approval. It further noted that the SEC appeared to exceed its authority because the regulation of domestic corporations is traditionally the domain of state law.

Dissenting Opinion

The dissent described the SEC's limited role in approving SRO rules and emphasized that the reviewing scheme created by Congress "doesn't permit the SEC to displace Nasdaq's private business judgment – informed by investor behavior – with agency policy priorities." *Id.* at 186. It criticized the majority for creating a mandatory rule requiring the SEC to "clip SRO authority" whenever an SRO does not show a sufficient connection to the specific ills identified by the majority. In particular, the dissent focused on Nasdaq's goal to eliminate information asymmetries in board diversity data since such statistics were not widely available. It also argued that disclosure of information about corporate board leadership – the very leaders entrusted with investors' money – was consistent with numerous Supreme Court cases describing full disclosure as the philosophy of the 1934 Act. *Id.* at 187.

> Crucially, this case concerns a rule *proposed by Nasdaq*, a private company that, in a competitive market with other exchanges, contracts with other companies to facilitate the listing and trading of securities. Nasdaq updates its rules regularly, competing with other exchanges for listings. The Exchange Act requires that the SEC approve these exchange-proposed rules but encourages self-regulation by sharply limiting SEC review such that the SEC *must approve* rules if certain requirements are met. . . . The majority mis-equates the SEC's federal government disclosure-mandating authority with private sector SRO self-regulating authority.

Id. at 188.

Based on the limited review the SEC was authorized to conduct and the substantial evidence supporting the SEC's decision to approve the rules, the dissent would have ruled the SEC was not arbitrary and capricious and did not exceed its statutory authority.

2. *U.S. v. Ashley*, 123 F.4th 403 (5th Cir. 2024)

The Fifth Circuit vacated a financial advisor's conviction on five of 17 counts after the government conceded there was insufficient evidence to convict him on several wire fraud charges and two charges that resulted in life sentences. The Court declined to apply the cumulative error doctrine to the remaining courts despite concerns about trial errors because the defendant failed to

articulate how the errors resulted in a fundamentally unfair trial rather than "overreaching," which was an insufficient basis to challenge the whole trial's fairness. The case was remanded for resentencing.

Trial Court Conviction

Defendant Keith Todd Ashley was a financial advisor for Parkland Securities. He convinced four clients to invest in unit investment trusts that held securities without a guaranteed rate of return. When the clients deposited monies, Ashley used the funds to cover personal expenses, including casino expenses, personal business expenses, legal fees, mortgage expenses, and other bills. He occasionally made payments to the investors using funds transferred from one client to another, a characteristic trait of a Ponzi scheme. Notably, Ashley sold one client a $2 million life insurance policy then drugged, shot, and killed the client, staging the scene as a suicide. Ashley then obtained access to the client's phone from his widow and used an app on the phone to transfer $20,000 from the client's bank account to himself.

Ashley was charged and convicted on 17 federal counts, including mail and wire fraud, Hobbs Act robbery, and bank theft for operating a Ponzi scheme to steal funds from a client's bank account and benefit from the client's life insurance proceeds. The district court sentenced Ashley to 240 months' imprisonment to run consecutively for each of 15 counts of wire and mail fraud and imposed life sentences for the Hobbs Act robbery and bank theft counts. Ashley challenged the sufficiency of the evidence, claimed that his sentence was unreasonable, and sought a new trial under the cumulative error doctrine.

Appellate Ruling

On appeal, the government conceded there was insufficient evidence to convict on four counts of wire fraud based on client funds that were transferred first to Ashley's business account and then to his personal account. The district court concluded over Ashley's objection that the clients' money only became Ashley's when it was transferred to his personal account. The Fifth Circuit agreed that the money was available "for [Ashley's] use" when it was transferred to his business account so there was no basis for additional wire fraud charges when the money was transferred again to his personal account.

The Fifth Circuit also reversed several mail and wire fraud counts based on Ashley directing Midland National Insurance to change the beneficiary on the client's life insurance policy to a trust that Ashley controlled. The change in the trust beneficiary did not defraud Midland National. While the evidence supported the notion that Ashley intended to defraud the client's widow and son of the life insurance proceeds, the jury lacked sufficient evidence to conclude that Midland National was the victim.

The life sentences imposed under the Hobbs Act were also reversed because Ashley's alleged murder of his client, though a prerequisite to committing bank theft, did not occur directly "in committing" the theft. Likewise, his use of a firearm to murder his client was separate from the theft of $20,000 because he used the client's phone two days after the murder.

Finally, the Court rejected Ashley's argument that the cumulative error doctrine required a new trial on the remaining counts. While "the government's conduct in this case was unusual" and its "concession of numerous convictions on appeal certainly raises the prospect that serious error

existed," Ashley argued only that the government "overreached" which alone is insufficient to conclude such errors were fatal to the whole trial's fairness.

B. District Courts

1. *Texas Top Cop Shop, Inc. v. Garland*, 2024 WL 5049220 (E.D. Tex. Dec. 5, 2024)

In this lengthy opinion, Judge Amos Mazzant issued a nationwide preliminary injunction enjoining enforcement of the Corporate Transparency Act (CTA) which requires companies registered under state law to report detailed personal information about their beneficial owners to the federal government (BOI Reports). After the opinion was issued, the government appealed to the Fifth Circuit which initially stayed the injunction, then vacated the stay three days later. The Supreme Court then granted a stay of the injunction on January 23, 2025. Notwithstanding this decision, the Financial Crimes Enforcement Network (FinCEN) of the Department of the Treasury has indicated it will not attempt to enforce the law due to a nationwide ban issued in a separate case. In addition, new Treasury Secretary, Scott Bessent, has indicated Treasury will review the statute to ensure it combats illicit finance without imposing an undue burden on small businesses.

Background

The CTA was adopted as part of the National Defense Authorization Act (NDAA) for fiscal year 2021 in a portion of that legislation known as the Anti-Money Laundering Act of 2020 (AMLA). Among AMLA's provisions was the creation of a nonpublic database at FinCEN for beneficial ownership information. The stated purpose of the database was to facilitate important national security, intelligence, and law enforcement activities; counter the financing of terrorism; and satisfy customer due diligence requirements. *Id.* at *3 (citing § 6402 of the NDAA).

One individual and five entities challenged the statute, including Texas Top Cop Shop, Inc. (Top Cop), a licensed firearms dealer in Conroe, Texas, that sells equipment to first responders. Top Cop and other plaintiffs argued the CTA was unconstitutional because it (1) intrudes upon States' rights under the Ninth and Tenth amendments and exceeds Congress's powers; (2) compels speech and burdens Plaintiffs' right of association under the First Amendment; and (3) violates the Fourth Amendment by compelling disclosure of private information." *Id.* at *7. Whether the CTA is absolutely unconstitutional was "a question for another day," but the Court concluded that plaintiffs demonstrated irreparable harm and a substantial likelihood of success on the merits based on their Ninth and Tenth amendment challenges.

Substantial Threat of Irreparable Harm

Plaintiffs claimed that absent an injunction, they would be irreparably harmed by (1) spending the time and effort to make the required filings; and (2) revealing protected information on pain of criminal punishment. *Id.* at 11-12. The government disputed these claims, arguing that plaintiffs' declarations were conclusory and any time was *de minimis*. The Court ruled that plaintiffs need not plead a specific dollar amount it would cost for them to comply and cited FinCEN's own estimates that the total cost of filing BOI reports would be $22.7 billion in the first year and $5.6 billion in subsequent years. *Id.* at 12-13. The Court found the plaintiffs met their burden of showing irreparable harm and distinguished contrary cases cited by the government.

Substantial Likelihood of Success on the Merits

Plaintiffs challenged the constitutionality of the CTA (1) on its face for exceeding Congress's enumerated powers under the Ninth and Tenth Amendments, and (2) as applied with respect to the First and Fourth Amendments. The Court's opinion addressed only the facial challenge. The Court rejected the government's arguments that the CTA was authorized by the Commerce Clause and the Necessary and Proper Clause of the Constitution.

While the Commerce Clause allows Congress to impose relevant conditions and requirements on those who use channels of interstate commerce, the CTA regulates companies not their activities. Indeed, according to the Court, the CTA does not regulate any activity; rather, it creates an activity by requiring companies to file BOI Reports after they register with a state. While Congress may regulate intrastate activity that substantially affects interstate commerce and non-economic activity if it is economic in nature, *id.* at *24, the Court rejected the notion that the CTA met either of these requirements. "The fact that a company is a company does not knight Congress with some supreme power to regulate them in all aspects – especially through the CTA, which does not facially regulate commerce." *Id.* at *25.

The Necessary and Proper Clause gives Congress authority to enact provisions incidental to an enumerated power, but it must be coupled with an enumerated power. The Court rejected the government argument that it was necessary and proper to enact the CTA for the regulation of foreign affairs and as an adjunct to its taxing power. Plaintiffs argued the CTA was a purely domestic statute, affecting only domestic entities. The Court sided with the Plaintiffs, noting that the CTA itself regulated only entities that filed a document with a state or Indian tribe, and only regulated foreign entities that registered to do business in the United States by filing a document with a state or Indian tribe. It criticized the government for failing to provide any support for the proposition that Congress may legislate in areas traditionally controlled by the states simply because its findings make passing mention of an international impact. *Id.* at *31.

Balance of the Equities

The Court quickly dispensed with this issue, ruling that an injunction would preserve the status quo and noting that "the Court cannot render a meaningful decision on the merits before the Plaintiffs suffer the very harm they seek to avoid." *Id.* at *34.

Scope of the Injunction

The Court determined that the injunction should apply nationwide because the CTA applies to approximately 32.6 million existing reporting companies. It also enjoined the government from enforcing the reporting rule. As noted above, the U.S. Supreme Court stayed the injunction, but the government has indicated it plans to review the matter before enforcing the reporting requirement.

2. *In re Cassava Sciences, Inc. Secs. Litig.*, 2024 WL 4824243 (W.D. Tex. Nov. 15, 2024)

Magistrate Judge Susan Hightower recommended certification of a class of those who purchased or acquired Cassava Sciences, Inc. common stock or sold put options on Cassava common stock during the period September 14, 2020 and October 12, 2023. The court rejected defendants'

arguments that the named plaintiffs' claims were not typical of the class members' claims simply because the named plaintiffs were day traders.

As previously reported,[3] Cassava is a small, Austin-based clinical-stage biopharmaceutical company that develops drugs to treat Alzheimer's disease. Its stock price began to rise in July 2017 when it announced FDA approval of its Investigational New Drug Application and as Cassava reported results from various trials. However, the stock price dropped precipitously in 2021 after a Citizen Petition was filed with the FDA that raised concerns about the quality and integrity of laboratory-based studies that appeared manipulated. The company then paid $40 million in civil penalties to settle charges filed by the SEC.

The Court reviewed each of the requirements for class certification under Rule 23(a), but the defendants only challenged typicality. Defendants argued that plaintiffs' claims were atypical of the class because plaintiffs were day traders who "did not purchase Cassava stocks or put options in reliance on Defendants' representations." *Id.* at *7. They claimed plaintiffs instead placed "reckless, short-term bets hoping to profit off Cassava's volatility. These high-risk trades – which frequently involved holding positions for less than a day – were disconnected from any representations by Defendants." *Id.* Defendants also claimed that plaintiffs' damages were atypical of the class because they stemmed in part from a broker's liquidation of one plaintiff's stock at an inopportune time, a risky options bet, purchases of stock after corrective disclosures were made, and individualized questions regarding their trading patterns and whether they have negative loss causation. *Id.*

The Magistrate Judge rejected the defendants' argument that day traders were atypical, noting that the district court had already ruled on this issue. It cited *Feder v. Elec. Data Sys. Corp.*, 429 F.3d 125, 137 (5th Cir. 2005) as rejecting the notion that post-corrective disclosure purchases of stock preclude typicality. And it cited *KB Partners I, L.P. v. Barbier*, 2013 WL 2443217, at *11 (W.D. Tex. June 4, 2013) as rejecting the argument that plaintiff's direct reliance on alleged misrepresentations made him atypical of a class that relied on the fraud-on-the-market theory. It found that plaintiffs' claims were typical because they arose from the same fraudulent scheme and were based on the same legal theories, and any factual differences did not defeat typicality. *Id.* (citing *Angell v. GEICO Advantage, Ins.*, 67 F.4th 727, 736 (5th Cir. 2023).

3. *In re Apache Corp. Secs. Litig.*, 2024 WL 4881432 (S.D. Tex. Nov. 25, 2024)

In the long-running securities litigation against Apache Corp. relating to Alpine High, the parties agreed to settle with a common fund of $65 million. Plaintiffs' counsel asked the Court to award one-third of that amount ($21.66 million) in attorney fees plus another $1.5 million in costs and expenses. Magistrate Judge Andrew Edison reviewed the request but reduced the attorney fee award to twenty-five percent of the common fund ($15.9 million).

The Court noted that the Fifth Circuit has endorsed two approaches to fee awards in common fund cases (1) the percentage method, in which the court awards fees as a reasonable percentage of the common fund; or (2) the lodestar method, in which the court computes fees by multiplying hours reasonably expended times a reasonable hourly rate and having discretion to apply an upward or

[3] *See* FH Newsletter 1Q23, at 15-17 (denying motion to lift PSLRA discovery stay); FH Newsletter 2Q23, at 10-13 (mostly denying motions to dismiss).

downward multiplier to the resulting amount. *Id.* at *3 (quoting *Union Asset Mgmt Holding A.G. v. Dell, Inc.*, 669 F.3d 632, 642-43 (5th Cir. 2012). However, in securities cases, there is "near-universal adoption of the percentage method" because the PSLRA specifically refers to fee awards that do not exceed "a reasonable percentage" of the amount paid to the class. *Id.* at *4 (citing 15 U.S.C. §u-4(a)(6)).

The Court then considered the benchmark percentage to use for the award and noted that the Fifth Circuit has never adopted a set percentage to award in common fund cases. *Id.* Within the Fifth Circuit, district courts have awarded percentage awards ranging from 18% to 36% in securities cases. *Id.* (listing cases). Empirical studies of fee awards in class action cases found that fees were approximately 27% of the gross recovery on average, but that the percentage declined as the size of class recoveries increased. *Id.* Ultimately, the Court selected a benchmark percentage of 25% and made no adjustment to that percentage after considering the *Johnson* factors. *Id.* at *5-*7.

4. *SEC v. Jaitley*, 2024 WL 5088389 (W.D. Tex. Dec. 12, 2024)

The SEC sued Leena Jaitley for running a stock options trading scheme that defrauded clients of more than $800,000. The Court adopted the magistrate judge's recommendation and found that Jaitley falsely represented to clients that she and her father (now deceased) had decades of financial services experience at Goldman Sachs; that they used proprietary trading techniques; that they employed numerous former Goldman Sachs traders; that they were located in the MetLife building in New York; and that they used "stops" to limit the risk of loss. None of these were true. Jaitley pleaded the Fifth Amendment during discovery, refused to provide information about her personal bank accounts, and offered no explanation why she would be entitled to approximately $672,833 in net profits from investors' money.

Based on the evidence presented by the SEC without objection by the defendant, the Court awarded (1) disgorgement of $672,833 in fraudulently obtained net profits with interest of $158,835; (2) a third-tier civil penalty equal to the gross pecuniary gain of $672,833; and (3) a permanent injunction against future violations of the Section 20(b) of the Securities Act, Section 21(d) of the Exchange Act, and Section 209(d) of the Advisers Act.

II. STATE CASES

A. Breach of Fiduciary Duty

1. *Shufood LLC v. Liu*, 2024 WL 4628402 (Tex. App.–Houston [1st Dist.] Oct. 31. 2024)

In this appeal from a bench trial, the Court of Appeals (1) reversed the trial court's judgment on plaintiff's breach of contract claim against three individuals and (2) affirmed the trial court's take-nothing judgment on all counterclaims. While the bulk of the opinion concerns breach of contract claims, we include it here because of its discussion of fraud and fiduciary duty claims.

Ron Liu and JingJing Liang met through a WeChat group interested in foods from the Chengdu region of China that is famous for native delicacies and spicy foods. They decided to open a restaurant that served Chengdu dishes and invited Lin Song and Jiemin Chen to invest in the business. The four individuals formed Shufood LLC and began working with a Chengdu restaurant chain called BangBang Chicken Legend. Liu and Liang also contributed their respective WeChat food

groups to the LLC for "advertising purposes." According to Liang, she and Chen were responsible for marketing while Song and Liu worked in the kitchen and were responsible for food preparation.

On March 20, 2019, Liu told Liang that she wanted to withdraw from the LLC because the business required too much time and she needed to care for her child at home. She asked for Shufood LLC to return her initial capital investment of $15,717.64, which she had borrowed. After some objections to returning the investment capital that had already been spent on the business, Shufood and Liu executed a Withdrawal Agreement on March 28, 2019. Chen signed the agreement on behalf of Shufood, but Chen, Liang, and Song did not sign it individually. The Withdrawal Agreement required Shufood to repay Liu's initial investment in three installments. In exchange, Liu promised to refrain from engaging in any conduct "harmful" to Shufood, including using food preparation techniques authorized by BangBang Chicken Legend and selling the same products. Less than a week later, Liu announced on her WeChat group that she was opening her own business one block from Shufood's restaurant and would be offering similar foods to those offered by Shufood.

At trial, Chen claimed that he taught Liu to make Shufood's "spicy chicken paws" using BangBang Chicken Legend's techniques and that Lieu intended to offer this dish at her new restaurant. However, Liu was never questioned at trial about the recipes, preparation methods, and techniques she used to prepare the dishes at her new restaurant, and there was no evidence that she ever offered the "spicy chicken paws" dish.

When Shufood failed to make the initial payment under the Withdrawal Agreement to Liu, she sued Shufood, Liang, Chen, and Song. They then filed counterclaims against Liu for anticipatory breach, fraudulent inducement, fraud by non-disclosure, breach of fiduciary duty, and violation of the Texas Uniform Trade Secrets Act by taking confidential recipes and diverting customers from Shufood through her WeChat group.

Plaintiff's Breach of Contract Claim

Because Liang, Chen, and Song were not parties to the Withdrawal Agreement, the Court ruled there was no privity of contract between them and Liu. The plaintiff argued that they were individually bound because there was no operating agreement for the LLC, but the Court noted that Shufood was a separate entity by virtue of its LLC filing with the Secretary of State. The opinion did not overturn the judgment for breach of contract against Shufood LLC but reversed the judgment against the three individuals for lack of privity.

Defendants' Counterclaims

Defendants counterclaimed against Liu for anticipatory breach, fraudulent inducement, fraud by non-disclosure, breach of fiduciary duty, and violation of the Texas Uniform Trade Secrets Act.

The Court affirmed the trial court's ruling that there was insufficient evidence of a material breach by Liu. While there was testimony that Liu had opened a competing restaurant and may have used recipes and techniques she learned from Shufood, the evidence was speculative at best. The Withdrawal Agreement did not contain a non-compete provision, and there was no evidence presented that anyone had visited the restaurant or that it had been opened. The trial court was entitled to evaluate the credibility of the testimony.

As to the fraudulent inducement claim, there was no evidence that Liu made any misstatements about her reasons for withdrawing to spend more time with her child at home.

As to the breach of fiduciary duty claim, the defendants argued Liu breached her fiduciary duty to Shufood by (1) preparing to open a competing restaurant while she was a member of the LLC; (2) failing to disclose her plan to open a restaurant and convert Shufood's potential customers; and (3) misleading Shufood concerning her reasons for withdrawal. While the TEXAS BUSINESS ORGANIZATIONS Code presumes the existence of fiduciary duties owed by members and managers of an LLC, including the duty of loyalty, that duty is not breached by "merely planning to compete against its principal in the future." *Id.* at *15 (citing cases). A fiduciary may make plans to compete, but she may not appropriate the company's trade secrets, solicit customers while still working for his employer, solicit other employees, or carry away confidential information. *Id.* (citing *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503, 512 (Tex. App. – Houston [1st Dist.] 2003, no pet.)). Since there was insufficient evidence that Liu did any of these things while still employed by Shufood, the Court held there was insufficient evidence of a fiduciary breach. It also found the evidence of damages presented by defendants was not established with reasonable certainty. *Id.*

On the fraud by non-disclosure claim, the Court found no evidence that Liu's statements about leaving were false and defendants cited no case for the proposition that a fiduciary has a duty to disclose plans to compete with her fiduciary in the future.

As to the Texas Uniform Trade Secrets Act claim, the Court found there was insufficient evidence that Shufood took sufficient efforts to keep its secrets confidential. Liu was not required to sign a confidentiality agreement, and there was no evidence the "books" from BangBang Chicken Legend were marked confidential. Without evidence that Shufood took efforts to maintain the confidentiality of its information, the claim failed. In addition, Liu was not questioned at trial about the recipes, preparation methods, and techniques she used to prepare the food she advertised on the WeChat group. Since there was no evidence the trade secrets were actually used by Liu, the Court affirmed the trial court's dismissal of this claim.

2. *Slack v. Shreve*, 2024 WL 4644610 (Tex. App.–Tyler Oct. 31, 2024)

The Court of Appeals affirmed dismissal of plaintiff Marcia Slack's last remaining claim under Section 33(a)(2) of the Texas Securities Act. As previously reported,[4] Plaintiff Marcia Slack sued multiple defendants, including Robert Charles Shreve, Jr. and Joseph Shane Jackson, in connection with her investment in an oil and gas exploration company called SunRay Resources, LLC. According to Slack, she invested $250,000 in SunRay based on Shreve's statement that Jackson and certain other defendants were "trustworthy people." According to Slack, Shreve did not tell her that he would receive $107,500 of the money she invested or that her money would be used to buy a lease from a limited liability company owned by Shreve.

In her initial appeal, the Court affirmed the dismissal of Slack's claims for fraud, conversion, negligence, and theft liability but remanded her claim for alleged misrepresentations under the TSA because the trial court applied a 3-year instead of a 5-year limitations period. On remand, Shreve filed both traditional and no-evidence summary judgment motions. He submitted an affidavit stating that

[4] See FH Newsletter 1Q23, at 28-29.

he did not offer or sell Slack anything, much less a security, and he pointed to a deemed admission by Slack that affirmed Shreve never sold her a security.

Shreve argued that the summary judgment evidence raised a genuine issue of material fact because:

> (1) Shreve was the sole member at Gryphon Global Investments, LLC (GGI), to which SunRay Resources sent $107,500 following Slack's $250,000 investment; (2) Shreve was a member of Oklahoma Shelf Exploration and Development Company (OSED) in 2014, along with Jackson, Carlson, Blair, and Woods, and failed to disclose to Slack that OSED was involved in a lawsuit during 2015; (3) Shreve was the Chief Financial Officer of SunRay Resources and did its taxes for a period of years; (4) Shreve had a prior, business relationship with and previously agreed to sell to Jackson, Carlson, Blair, and Woods the "Hanks Oil Lease" and let them take over all of his shares in SunRay Operating; and (5) Shreve provided Jackson and Slack with "primo" seats to a Texas Rangers baseball game to "entice her investment."

Id. at *6. After reviewing this "evidence," the Court ruled that it did not raise a genuine issue of material fact. "None of the evidence in the summary-judgment record indicates that Shreve sold or offered to sell a security to Slack or was in privity to such a transaction." *Id.* The Court rejected all of Slack's objections to Shreve's summary judgment evidence and other arguments.

3. *Badgett v. G'Sell*, 2024 WL 4885845 (Tex. App. - Houston [1st Dist.] Nov. 26, 2024)

On appeal from a bench trial, the Court of Appeals ruled there was insufficient evidence to support a judgment for breach of fiduciary duty against a stockbroker who failed to disclose hundreds of thousands in customer account losses over a three-year period. The appeals court found there was insufficient evidence of proximate cause.

The customer sued the broker for fraud, negligence, and violations of the Texas Securities Code, but the sole claim pursued at trial was for breach of fiduciary duty arising from the stockbroker's failure to disclose substantial losses in the account. Based on this limited claim, the Court ruled there was no evidence that the failure to disclose caused the loss, that the customer would have terminated the broker's services if disclosure were made, or that the heavily margined account would have incurred fewer losses.

Monte Land G'Sell employed Jack Thomas Badgett and his son to manage her retirement account. When the brokerage firm where the son worked ceased offering services in 2012, she paid Badgett approximately $15,000 to continue managing the account even though he did not work for a registered representative and did not have an active securities license. Over the next three years, the account lost $347,298, but Badgett did not disclose this fact to G'Sell until late 2016. At trial, Badgett admitted that he had done a "lousy job" of managing the account and did not disclose the substantial losses but claimed most were due to G'Sell's failure to meet margin calls after borrowing $165,000 to buy a house. The trial court awarded damages of $197,037 to G'Sell based on the $307,037 net loss in the account less $111,000 G'Sell recovered in arbitration against the brokerage firm and Badgett's son.

Badgett appealed the award arguing that the evidence submitted at trial was insufficient to support the award. The appellate court agreed, noting that a claim for breach of fiduciary duty requires a claimant to prove that the breach of fiduciary duty proximately caused the plaintiff's damages. The breach must be a substantial factor in bringing about the injuries. If the defendant's negligence merely furnished a condition that made the injuries possible, there is no cause in fact.

The Court of Appeals reviewed the evidence and concluded that there was insufficient evidence that nondisclosure was the proximate cause of the plaintiff's losses. The brokerage account lost money due to several factors, including G'Sell's withdrawal of cash, sales of stock made to satisfy margin calls, and Badgett's poor stock choices. Since G'Sell did not pursue any negligence-based claims against Badgett and failed to present evidence that the non-disclosure of losses in the account caused any of her damages, the judgment was reversed.

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