

**CASE LAW UPDATE:  
A SURVEY OF RECENT TEXAS  
PARTNERSHIP AND LLC CASES**

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2021 LLCs, LPs and PARTNERSHIPS

July 7, 8 & 9, 2021



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## Case Law Update: A Survey of Recent Texas Partnership and LLC Cases

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### I. Introduction

This paper summarizes recent Texas cases involving issues of partnership and limited liability company law. This paper only includes cases that have appeared since the paper for last year's program was prepared. Case law surveys that include cases from prior years are available on Professor Miller's profile page at the Baylor Law School web site.

### II. Recent Texas Cases Involving Partnerships

#### A. Creation/Existence of General Partnership

*J. Michael Ferguson, P.C. v. Ghrist Law Firm, PLLC*, No. 02-18-00332-CV, 2021 WL 2006321 (Tex. App.—Fort Worth May 20, 2021, no pet. h.) (mem. op.).

Because there was no objection to the instruction provided to the jury with respect to the formation of a joint venture, the court analyzed the sufficiency of the evidence to support the jury's finding of a joint venture based on the instruction rather than the statutory factors considered in determining whether a partnership or joint venture has been created. Because there was no evidence of an agreement to share losses, and the jury instruction stated that there must be an agreement to share losses, the evidence did not support the finding of a joint venture.

Among the issues addressed in this appeal of a dispute arising out of the relationship between a law firm (the "Ferguson Firm") and Ian Ghrist—a lawyer with whom the Ferguson Firm had an oral fee sharing agreement—was whether the oral fee sharing agreement amounted to a joint venture between the parties.

The court began its discussion of this issue by stating that "[t]he formation of a joint venture is governed by the same law as governs partnerships," citing Tex. Bus. Orgs. Code § 152.051(b) (providing "an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether ... the association is called a 'partnership,' 'joint venture,' or other name"). The court then listed the five factors considered in determining whether a partnership or joint venture exists as set forth in the Texas Business Organizations Code: (1) receipt or right to receive a share of profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing: (A) losses of the business; or (B) liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business. Tex. Bus. Orgs. Code § 152.052(a). The court noted that the statute does not require proof of all factors and that formation of a partnership is determined by the totality of the circumstances, citing *Ingram v. Deere*, 288 S.W.3d 886, 896 (Tex. 2009).

Based on the oral fee sharing agreement, Ghrist testified that he and the Ferguson Firm were engaged in a joint venture to represent clients and to split the attorney's fees 2/3 to the firm and 1/3 to himself, with each case being a separate joint venture. The Ferguson Firm argued that there could be no joint venture because there was no evidence that Ghrist had any right of control or that he agreed to share business losses. Ghrist responded, in reliance on *Ingram*, that he was not required to present evidence of those factors and that whether the parties entered a joint venture is determined by the totality of the circumstances. The court stated that Ghrist was "correct that, in the usual case, a party seeking to establish a joint venture need not prove every element listed in Section 152.052 or required by the common law. *See id.* But the sufficiency of the evidence is not measured by the usual case. Rather, it is measured by the particular charge given to the jury when there has been no objection to that charge."

The jury in this case was instructed: "A joint venture must be based on an agreement that has *all the following elements*: 1. A community of interest in the venture[,] 2. An agreement to share profits, 3. An express agreement to share losses, and 4. A ... mutual right of control or management of the venture." [Emphasis added by the court of appeals.] Because the record did not reflect any objection to this instruction, the instruction governed the court's review of the sufficiency of the evidence.

The court looked no further than the element of an agreement to share losses. The Ferguson Firm fronted the expenses for cases that were worked jointly with Ghrist, and those expenses were then reimbursed from the client's recovery. The firm took the risk that the expenses would not be recouped if there was no recovery. Ghrist had no liability to pay any expenses that were not reimbursed by the client. The court further explained that reimbursed case expenses were not losses, and deducting those expenses before splitting attorney's fees under the fee sharing agreement did not constitute a sharing of losses. The court stated that unreimbursed expenses that exceed collected fees, such as expenses fronted on cases that ultimately resulted in no recovery, were losses, but the evidence was undisputed that Ghrist did not agree to pay any portion of those unreimbursed expenses. Since Ghrist did not agree to share losses, the evidence as measured by the charge submitted to the jury was legally insufficient to support the finding that Ghrist entered into a joint venture with the Ferguson Firm.

*Hautanen v Picinic*, No. 02-20-00049-CV, 2021 WL 1229964 (Tex. App.—Fort Worth Apr. 1, 2021, no pet. h.) (mem. op.).

The court of appeals concluded that the plaintiff waived his argument that the trial court's finding that the parties created a joint venture required the trial court to impose loss sharing on the parties even though the trial court found that there was no express or implied agreement to share losses.

Osmo Hautanen, John Picinic, and James Mannering decided to renovate and sell a house in the Crestwood area of Fort Worth and split the profits, 50%, 25%, and 25%, respectively. Hautanen testified that he bore the financial risk, and Picinic testified that he had no obligation to cover any losses. Hautanen bought the house for \$390,000, and they hoped to renovate it and resell it for \$650,000. The project was fraught with problems, and the Hautanen ultimately spent \$142,000 for renovations and an additional \$10,000 for repairs. The house was on the market for more than a year and finally sold for \$480,000. Hautanen sued Picinic, Mannering, and two general contractors, but only Picinic remained as a defendant at the time of trial.

After a two-day bench trial, the court asked the parties each to submit a short letter brief addressing "whether or not a joint[-]venture agreement necessarily implies an obligation or agreement to share losses." Both parties responded that an agreement to share losses is one factor to consider when determining whether a joint venture has been formed but that it is not determinative. In its findings of fact and conclusions of law, the court concluded that the parties entered into a joint-venture agreement and that Picinic did not breach the agreement or any fiduciary duty owed to Hautanen or make any negligent misrepresentation. The court further concluded that Hautanen's losses, if any, were not the result of negligence or gross negligence by Picinic. The court made a fact finding that "[t]here was no agreement, expressed or implied, to share any losses arising from the [joint-venture agreement]."

Hautanen contended that the trial court erred as a matter of law by failing to assign a proportionate share of the joint venture's losses among the joint venturers. He characterized his complaint as seeking review of "the trial court's conclusion of law that an absence of an express or implied agreement to share losses means the parties do not share the losses of the joint venture," but the court of appeals said that the trial court did reach such a conclusion. According to the court of appeals, Hautanen's real contention was that the Texas statute provides for loss sharing as a default mechanism in the absence of an express or implied agreement on loss sharing and that the court thus should have rendered judgment allocating a portion of the joint venture's losses to Picinic.

Hautanen's loss-sharing theory of recovery was based on Chapter 152 of the Business Organizations Code, which provides that "an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name." Tex. Bus. Orgs. Code § 152.051(b). The court pointed out that, subject to certain exceptions not relevant here, "a partnership agreement governs the relations of the partners and between the partners and the partnership." *Id.* § 152.002(a). The statute governs those relationships "[t]o the extent that the partnership agreement does not otherwise provide." *Id.*

The parties did not contest the trial court's conclusion that Hautanen, Picinic, and Mannering formed a joint venture or its finding that there was no express or implied agreement to share losses, but Hautanen argued that the absence of such an agreement left a gap that is filled by Texas law, pointing specifically to Section 152.202, which provides:

- (b) Each partner is charged with an amount equal to:
  - (1) ...

- (2) the partner's share of the partnership's losses.
- (c) Each partner ... is chargeable with a share of the partnership's capital or operating losses in proportion to the partner's share of the profits.

*Id.* § 152.202(b), (c).

Hautanen argued that because the trial court found that the parties had not agreed to share any joint-venture losses, the court was required to conclude that each joint venturer was required to share losses in the same proportion as they would have shared in the profits. Thus, he sought remand for the trial court to determine the amount of losses suffered by the joint venture and to enter judgment against Picinic for his share of those losses.

Picinic responded that Hautanen waived this loss-sharing theory of recovery because he neither alleged it in his petition nor otherwise raised it in the trial court. The court pointed out that Hautanen repeatedly requested that the court award damages based on Picinic's alleged fault, but Hautanen did not correlate his requested recovery with any concept of proportionate loss sharing, instead identifying his damages as "the difference between the purchase price plus renovation and miscellaneous costs, and the final sales price of the subject property." Nevertheless, Hautanen argued on appeal that he preserved his loss-sharing theory of recovery because Picinic was put on notice of it through both Hautanen's petition and his proposed findings of fact and conclusions of law. He also argued that the theory was tried by consent and that the trial court acknowledged the theory by requesting briefing on the issue of sharing losses. The court of appeals addressed Hautanen's arguments and concluded that Hautanen never raised or brought to the court's attention the theory that Picinic should be ordered to pay a share of the joint venture's losses simply as a consequence of being a joint venturer.

*Adam v. Marcos*, 620 S.W.3d 488 (Tex. App.—Houston [14th Dist.] 2021, pet. filed).

The court of appeals held that the evidence supported the jury's finding that an attorney failed to comply with his fiduciary duty to his client and did not meet his burden to establish that his alleged partnership agreement with the client was fair and reasonable to the client and that the client was informed of all material facts relating to the agreement. Based on the jury's finding, the court of appeals held that the alleged partnership agreement was invalid and unenforceable and that the trial court thus correctly disregarded the jury's finding that the client breached the partnership agreement.

Souhail Adam owned and operated several small businesses in the Houston area, and Javier Marcos, who owned his own small law firm, was the primary attorney representing Adam and his businesses for several years. The men became friends and engaged in certain business transactions together, but they presented very divergent accounts at trial of their business relationship. Marcos asserted that he and Adam agreed to form a partnership on future joint ventures, sharing costs and profits equally. Marcos said that he was to be in charge of all legal matters, and Adam would run day-to-day operations. According to Marcos, they sealed the agreement with a "fist bump," but there was never any written agreement. Marcos claimed that Adams requested that Marcos be a "silent" partner whose name would not be included in the formation documents for any joint venture entity they created. Marcos alleged that the partnership formed or purchased as joint ventures several limited partnerships and corporations, and Marcos claimed a 50% interest in each of the businesses. Adam asserted that Marcos merely gave him funds to invest in Adam's businesses as Adam saw fit to make a return for Marcos on his investment. Adam denied that there was any agreement under which Marcos was to have an ownership interest in any of the businesses and pointed to evidence that none of the formation documents listed Marcos as a member, partner, or shareholder; Marcos failed to reveal his alleged ownership interest in several legal contexts; Adam signed loan guarantees for the entities, but Marcos did not; partnership K1 forms for the entities showing taxable income did not list Marcos as a party; and Marcos did not report any income for the entities or the alleged partnership on his tax returns, but Adam did. Adam said that he paid \$85,000 in cash over the years as earnings on Marcos's investment and returned all the initial funds that Marcos gave him.

Marcos asserted numerous causes of action against Adam, including breach of the partnership agreement and breach of fiduciary duty. The trial court entered a directed verdict on several claims, and the case went to the jury on Marcos's breach of partnership agreement claim as well as a claim for quantum meruit for legal services allegedly provided by Marcos. The jury was also asked whether Marcos had complied with his fiduciary duties to Adam, but this was apparently a defensive issue for Adam and not an affirmative claim for damages.

With respect to the partnership issues, the jury found that Marcos and Adam entered into a partnership with respect to two entities, that Adam failed to comply with the partnership agreement and that Marcos suffered damages in the amount of 50% of the value of the two entities, and that Marcos failed to comply with his fiduciary duties to Adam. After extensive post-trial briefing, the trial court determined that Marcos failed to establish that the alleged partnership agreement was fair and reasonable (as required for an attorney/fiduciary who has contracted with his client/beneficiary), and thus the trial court disregarded the jury's findings on breach of the partnership agreement. Marcos appealed.

The court of appeals noted that it was uncontested that the alleged partnership agreement was entered into while Marcos and Adam were in an attorney-client relationship, which is a fiduciary relationship as a matter of law. As such, attorneys must conduct their business with their clients with inveterate honesty and loyalty. Contracts between attorneys and their clients negotiated during the existence of the attorney-client relationship are closely scrutinized, and there is a presumption of unfairness or invalidity. Thus, the burden was on Marcos to prove the fairness and reasonableness of the alleged partnership agreement. Marcos had the burden to establish that Adams was fully informed of all material facts relating to the agreement, and additional factors in determining the fairness of the transaction included whether the consideration was adequate and whether Adam obtained independent advice.

The court characterized the jury question on whether Marcos complied with his fiduciary duty to Adam as a question that sought a finding on Marcos's burden to establish that the partnership agreement and resulting joint ventures were fair and reasonable to Adam and that Adam was informed of all material facts relating to the agreement. The court concluded that the evidence was sufficient to support the jury's finding that Marcos did not prove that he complied with his fiduciary duty, i.e., that the jury could have found that the agreement was unfair, inequitable, or that Marcos otherwise breached the duties listed in the jury question based on the following evidence: Marcos, Adam's attorney, allowed him to agree to a "fist bump" deal without any formal writing; Adam was the only person listed on the formation documents as an owner; both men supposedly contributed an equal amount of start-up funds, but only Adam personally guaranteed the \$1 million loan; the "silent partner" nature of Marcos's involvement led to possible violations of bank and tax laws; Adam was to be responsible for daily operations of the businesses while Marcos was to contribute legal services as needed. Furthermore, the court pointed to the absence of any evidence that Marcos fully informed Adam of the legal ramifications of such an agreement or encouraged Adam to consult independent counsel. The court of appeals agreed with the trial judge that Marcos displayed "a disgraceful lack of paying attention to [his] professional obligations." Based on the jury's finding that Marcos failed to fulfill his fiduciary duties to Adam with respect to the alleged partnership agreement, the court concluded that the presumption that the partnership agreement was invalid applied, and the trial court did not err in holding that the agreement was unenforceable.

The court of appeals also concluded that Adam could not be liable for breaching any fiduciary duty to Marcos since the only basis for a fiduciary duty owing by Adam to Marcos was the partnership agreement, and fiduciary relationships do not arise from unenforceable contracts.

*Anubis Pictures, LLC v. Selig*, No. 05-19-00817-CV, 2021 WL 805214 (Tex. App.—Dallas Mar. 3, 2021, no pet. h.) (mem. op.).

The plaintiff's claim that it presented evidence of factors indicating the creation of a partnership with the defendant under Section 152.052(a) of the Texas Business Organizations Code was precluded by a clause in the parties' nondisclosure agreement that the parties were not obligated to work together on any transaction unless both parties signed a formal, written agreement regarding the transaction.

Anubis Pictures, LLC and CMA Films, LLC (collectively "Anubis") sued Lauren Selig and Shake & Bake Productions (collectively "Selig"), asserting various claims arising out of a deal that did not materialize between the parties to finance a film based on a screenplay entitled "Downslope" by Stanley Kubrick. After the parties were introduced to one another, Anubis sent Selig a non-disclosure agreement in preparation to discuss a film opportunity. The NDA described Anubis as being "in the business of financing, developing, creating, distributing, and publishing visual content for television, film, video games, internet, on-line, mobile, and other forms of distribution" and described Selig "as a potential financial/creative partner." The NDA also included the following no obligation provision:

Neither party is bound to proceed with any transaction between the parties unless and until both parties sign a formal, written agreement setting forth the terms of such transaction. At any time



prior to the completion of such a formal, written agreement, either party may terminate the Discussions and refuse to enter into any subsequent transaction, for any reason or for no reason, without liability for such termination, even if the other performed work or incurred expenses related to a potential transaction in anticipation that the parties would enter into a formal, written agreement regarding such transaction.

After Selig decided not to participate in the first project discussed by the parties, a team from Anubis met with Selig to discuss several potential projects, including Downslope. Eventually Selig pursued the Downslope project without Anubis, and Anubis sued Selig and others asserting various claims, including breach of contract, quantum meruit, promissory estoppel, fraud and breach of fiduciary duty. The trial court granted Selig's motions for summary judgment on Anubis's claims, and Anubis appealed.

Anubis's claim against Selig for breach of fiduciary duty was based on an alleged partnership between Anubis and Selig. Anubis argued that it presented sufficient evidence to create a fact issue as to whether the parties created a partnership, relying on evidence of the factors indicating the creation of a partnership listed in Section 152.052(a) of the Texas Business Organizations Code. The court of appeals responded to this argument as follows:

These factors are irrelevant, however, where the parties have agreed that no binding or enforceable obligations will be created unless certain conditions are met. *See Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P.*, 593 S.W.3d 732, 741 (Tex. 2020). Such an agreement to not be bound absent the specified conditions is ordinarily conclusive on the issue of partnership formation. *Id.*

In this case, Selig and Anubis agreed they were not obligated to work together on any transaction unless both parties signed a formal, written transactional contract. It is undisputed that this did not occur. Although performance of a condition precedent to forming a partnership can be waived, in determining whether such waiver has occurred, we consider only evidence directly tied to the condition precedent, and not the factors relevant to partnership creation set out in section 152.052(a). *Id.* As discussed above, the evidence conclusively shows Selig did not waive her right to require a signed contract before being obligated to work with Anubis. Accordingly, Selig negated the creation of a partnership as a matter of law. *See id.* Anubis asserts no other basis upon which Selig would owe a fiduciary duty to Anubis. Accordingly, we conclude the trial court properly granted summary judgment in favor of Selig on this claim.

***In re Marriage of VanDusen and Kairis***, No. 10-18-00285-CV, 2020 WL 6302315 (Tex. App.—Waco Aug. 26, 2020, no pet.) (mem. op.).

The court of appeals reversed the trial court's findings that a business partnership had been created in 1995 and that real estate purchased was partnership property. The court remanded for a new trial on the issue of partnership formation and the division of any partnership property.

In 1995, Richard Kairis found a tract in Walker County that Susan VanDusen purchased near her mother. The property was purchased in VanDusen's individual name and she paid for it from her income. The property had a house on it that was in disrepair. Kairis moved in shortly after the purchase so that he could work on repairing the house and mowing the property. VanDusen continued working in Houston and would go to the property on the weekends.

In 1998, VanDusen purchased a second tract in her sole name which she sold to her mother for the same amount as the purchase price. The tract was adjacent to her mother's property. In 2002, VanDusen purchased another tract in the same area in her sole name with funds provided by VanDusen's mother. Kairis worked on the house on that property which was also in disrepair and began to work on that property as well. In 2002, Kairis also purchased some miniature pigs which were raised on the property purchased in 1995. Any profits from the sale of the pigs went into VanDusen's bank accounts and VanDusen either paid for the pigs' expenses or reimbursed Kairis for any expenses he paid. This business was never profitable and resulted in a loss which was taken fully by VanDusen as shown on her tax returns from 2003 to 2008, when they stopped selling the pigs. VanDusen's tax returns never indicated the existence of a partnership.

In 2004, Kairis assisted VanDusen's mother and sisters with selling property in another county. Kairis demanded to be paid for his assistance; thus, in 2005, he was paid either \$15,000 or \$30,000 (there was evidence as to both amounts) which VanDusen applied to the mortgage on the property purchased in 2002.

In 2006, VanDusen purchased another tract in her sole name. In 2007, VanDusen sold her residence in Houston and moved to the property purchased in 2002 while still commuting to her job in Houston. VanDusen used part of the proceeds from the sale of her residence to purchase additional property in her sole name in 2008. All of the real estate transactions were organized and executed by Kairis using a power of attorney for VanDusen.

Towards the end of 2008, the parties began raising cattle on the property, which continued until the time of their trial. While the parties were together, Kairis was responsible for procuring feed for the cattle. During this time, Kairis paid for expenses either with cash he kept (with VanDusen's agreement) from sales or with VanDusen's debit or credit cards. Alternatively, VanDusen would reimburse him by check that he could cash.

Kairis testified that the parties intended to purchase the tracts and to pursue the farming and ranching operations jointly and equally. Kairis alleged that VanDusen told him that the property was all "community property" and that "[t]his was the partnership that we formed up and this was the partnership we lived under." VanDusen testified that she did not ever intend for a business partnership to be formed and had paid for all of the real property herself other than the one-time contribution from Kairis on the property purchased in 2002, of which she disputed the amount and character.

VanDusen and Kairis were formally married on February 22, 2009, and continued everything in the same manner after their marriage until their separation. VanDusen filed for divorce in 2017 and Kairis filed a counterpetition in which he sought a finding that the parties had become informally married in 1984, or alternatively, that the parties had entered into a business partnership. VanDusen did not file a verified denial of the existence of a partnership as required by Rule 93(5) of the Rules of Civil Procedure.

At the beginning of the bench trial, the trial court made a finding that a business partnership existed due to VanDusen's failure to file a verified denial. Nevertheless, the court required the parties to present evidence to prove when the partnership was formed, the terms of the partnership, and the existence of any partnership property. The trial court ultimately entered a judgment that the parties were not informally married but had entered into a business partnership in 1995. The court also found that the real estate purchased between 1995 and 2008 was property of the partnership.

The court of appeals began by observing that it was not asked to determine if a business partnership ever existed between the parties due to VanDusen's failure to properly deny the existence of a partnership. Instead, it was called upon to determine whether or not the evidence supported the trial court's finding that a partnership was created in 1995. The court noted that "[A]n association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name." *Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P.*, 593 S.W.3d 732, 737 (Tex. 2020) (quoting Tex. Bus. Orgs. Code § 152.051(b)). It further explained that the Texas Business Organizations Code sets forth five factors that a court should review in determining whether a partnership exists: (1) receipt or right to receive a share of profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing: (A) losses of the business; or (B) liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business. Tex. Bus. Orgs. Code § 152.052(a). According to the court, whether a partnership exists must be determined by an examination of the totality of the circumstances. Evidence of none of the factors will preclude the recognition of a partnership, and even conclusive evidence of only one factor will also normally be insufficient to establish the existence of a partnership. Conclusive evidence of all five factors, however, establishes a partnership as a matter of law. For cases on the "continuum" between these two extremes, the court observed that whether an arrangement is considered a partnership will often present a question of fact.

After explaining the legal framework, the court of appeals concluded that there was legally insufficient evidence of a business partnership formed in 1995:

VanDusen argues that the evidence was insufficient for the trial court to have found that the partnership was established in 1995 because the elements required to form a partnership did not exist at that time. The evidence presented at trial relating to what occurred prior to 1995 was that VanDusen was assaulted outside of her residence and had her car stolen twice in the early

1990's which led to VanDusen and Kairis deciding to find land outside of Houston to get out of the city. In 1995, Kairis located and VanDusen purchased a tract in her name only that referred to her as a "sole" purchaser. VanDusen paid for everything relating to that property, including the purchase price and all taxes. Kairis testified that the intent was for VanDusen to "work hard" in Houston and for him to work on the property because it was overgrown with weeds and the house was in disrepair, including problems with the foundation. Kairis moved to that tract in 1995 or 1996 after making the house livable.

While Kairis testified that the parties' intent was for him to work on the property, there was no evidence presented that the parties were intending to use that property for the purpose of operating a business of any kind in 1995. There was no evidence presented regarding the right to receive a share of profits of a business, any intent to be partners in a business, any agreement regarding sharing losses or liability for claims owed to any third parties of any potential business, or an agreement to contribute property to a business. There was no evidence presented that a farming or ranching operation or any other business was even contemplated in 1995, and no reference to any operable business was made until the miniature pigs were purchased around 2002 and VanDusen began taking an individual loss from the pigs on her tax returns. We find that the evidence was legally insufficient for the trial court to have determined that a business partnership was formed in 1995. ... Neither party has requested this Court to determine whether, and if so, when the evidence established that the partnership was formed, so we will not do so.

The court then turned to the issue of partnership property and concluded that the evidence was legally insufficient for the trial court to have found that the real property purchased between 1995 and 2008 was partnership property, and the court remanded for a new trial on the issue of the formation of a partnership and related issues.

***Unitech Energy Tools Limited v. Nabors Drilling Technologies USA, Inc.***, Civ. A. No. H-18-0852, 2020 WL 4227467 (S.D. Tex. July 23, 2020).

The district court granted in part defendant Canrig's "Motion to Exclude Evidence or Testimony Contradicting Plaintiff's Corporate Representative Testimony" because Unitech's corporate representative did not testify that Unitech and Canrig were partners.

Nabors Drilling Technologies USA, Inc. did business as Canrig Drilling Technology, Ltd. Unitech filed a lawsuit against Canrig stemming from an alleged breach of contract. In response to Canrig's motion for summary judgment, Unitech alleged that Canrig and Unitech had agreed to a partnership where Unitech would supply and manufacture quills, spindles, and outer sleeves for Canrig's top drive business. Canrig objected to the allegation because Unitech's corporate representative, Dennis Joe, did not testify that there was a partnership. The court agreed with Canrig:

Joe testified that pursuant to the business relationship between the parties Canrig would buy quills, spindles, and sleeves from Unitech. Canrig argues that Joe did not testify that there was a partnership as stated in the first term enumerated in Unitech's Response to MSJ. A partnership is generally defined as "an association of two or more persons to carry on a business for profit as owners." *NMRO Holdings, LLC v. Williams*, No. 01-16-00816-CV, 2017 WL 4782793, at \*4 (Tex. App.—Houston [1st Dist.] Oct. 24, 2017, no pet.) (internal quotation marks omitted) (quoting Tex. Bus. Orgs. Code Ann. § 152.051(b)).

- (a) Factors indicating that persons have created a partnership include the persons':
- (1) receipt or right to receive a share of profits of the business;
  - (2) expression of an intent to be partners in the business;
  - (3) participation or right to participate in control of the business;
  - (4) agreement to share or sharing:
    - (A) losses of the business; or
    - (B) liability for claims by third parties against the business; and
  - (5) agreement to contribute or contributing money or property to the business.

Tex. Bus. Orgs. Code § 152.052(a). Joe did not testify that the parties were partners or to the existence of any of the partnership factors. Unitech is therefore precluded from introducing evidence that the parties entered into a partnership.

### **B. Partner’s Personal Liability for Obligations of Partnership**

*Enshikar v. Zaid*, No. 14-18-00933-CV, 2020 WL 6203348 (Tex. App.—Houston [1st Dist.] Oct. 22, 2020, no pet.) (mem. op.).

“. . . Enshikar makes various arguments that Zaid and Jumaa are individually or vicariously liable for the 2015 judgment because at the time of Enshikar’s workplace accident Advance Tire was no longer an LLC but had transformed into a different entity, either a partnership run by Zaid and Jumaa or a sole proprietorship run by Jumaa. Each of Enshikar’s issues is premised on his contention that Advance Tire had ceased its existence as an LLC at the time of his injury and no longer shielded Zaid and Jumaa personally from liability. We begin with an analysis of Advance Tire’s status as an LLC at the time of Enshikar’s accident.

Under the Business Organizations Code, a filing entity such as an LLC does not cease existing until, after required windup of the entity is complete, the entity files a certificate of termination. Tex. Bus. Orgs. Code Ann. §§ 11.101, .102; *see id.* § 1.002(22) (LLC is filing entity). This requirement may not be waived. *See* Tex. Bus. Orgs. Code Ann. § 101.054(a)(6).

Enshikar does not contest that Advance Tire was formed as an LLC and does not challenge the trial court’s findings of fact that his accident occurred on January 23, 2012 and that Advance Tire filed a certificate of termination on March 23, 2012. Because the certificate of termination was filed two months after the accident, on the date of the accident Advance Tire existed as an LLC, not a partnership or sole proprietorship that might allow for personal liability of Zaid or Jumaa. *See* Tex. Bus. Orgs. Code Ann. § 11.102. . . .

Enshikar also raises various arguments positing that the LLC terminated before the filing of the certificate of termination due to violations of the company agreement and untimely winding up of the business. We conclude the cited non-waivable provisions from the Business Organizations Code dictating when an LLC terminates its existence controls over Enshikar’s theories as to why we should consider the entity to have terminated earlier. Enshikar also argues that Business Organizations Code section 11.051(3) compels a different result. *See* Tex. Bus. Orgs. Code Ann. § 11.051(3). This section, however, concerns when winding up of an entity is triggered, and does not dictate when the entity terminates its existence. *See id.*

Even if we were to agree with Enshikar, it is unclear how it would help him collect the judgment. In his negligence lawsuit, he sued Advance Tire and served its corporate representative. He did not bring suit against a partnership or sole proprietorship doing business as ‘Advance Tire and Wheels, LLC,’ nor did he sue Zaid or Jumaa individually or as a partner or sole proprietor. It is difficult to determine how Enshikar would collect the judgment from Zaid or Jumaa on the basis of individual or vicarious liability when neither they nor the entities they purportedly operated were sued in the negligence action.”

*David v. Howeth*, No. 02-20-00078-CV, 2020 WL 6165298 (Tex. App.—Fort Worth Oct. 22, 2020, pet. denied) (mem. op.) (“The 2019 suit alleges that Cantey Hanger operates as an LLP; thus, we set forth the law on an LLP’s liability: ‘If the law firm is practicing as a limited liability partnership[,] the partnership, but not an individual partner, is liable for the malpractice of another partner if the other partner is not under the supervision or direction of the first partner at the time of the errors, omissions, negligence, incompetence, or malfeasance occurred, unless the first partner was directly involved in the malpractice or had notice of it at the time it occurred.’ Roy W. McDonald & Elaine A. Grafton Carlson, *Texas Civil Practice* § 2:92 (2nd ed. 2019).”).

### **C. Authority and Power of Partner or Other Agent to Bind Partnership**

*Choksi v. Choksi*, No. 09-19-00183-CV, 2020 WL 6787410 (Tex. App.—Beaumont Nov. 19, 2020, pet. denied) (mem. op.) (“The record shows that prior to mediating the matter, the attorneys for the respective parties communicated about Asit’s authority to convey title to the various properties to the extent title was held by the family partnership. Asit participated in the mediation with two attorneys present on his behalf and executed the MSA [mediated settlement agreement] after extensive negotiations, without ever raising any issue about his lack of authority to execute the necessary documentation to transfer ownership of property held by the family

partnership. It was not until sometime after mediation and arbitration that Asit sought and obtained a temporary restraining order on behalf of Choksi, Ltd. in Harris County which prohibited Ulupi from ‘[p]urs[u]ing any motion to enforce the MSA to the extent it purports to require Choksi, Ltd. to convey property without compliance with the terms of the partnership agreement.’ However, neither the partnership agreement or its terms have been made a part of the record before us. Absent such evidence, Asit has failed to show that any provision of the MSA required a property transfer in violation of the partnership agreement or that the transfers outlined in the MSA were inconsistent with the partnership agreement. Asit cannot misrepresent his authority to transfer properties at a mediation, sign an MSA, move to arbitrate under the terms of the MSA, and then seek to have the MSA set aside based on his misrepresentation of authority by characterizing it as a ‘mistake.’ We overrule issue two.”).

*David v. Howeth*, No. 02-20-00078-CV, 2020 WL 6165298 (Tex. App.—Fort Worth Oct. 22, 2020, pet. denied) (mem. op.) (concluding that the word “counsel” in a release of an executor included both the individual lawyer signing the agreement and his firm, saying that it would be unreasonable to read the agreement as covering the individual lawyer representing the executor but not the lawyer’s firm because to do so would subject the firm to whatever vicarious liability it might have for the lawyer’s actions in the will contest and associated litigation, making the release meaningless, and stating in a related footnote: “The 2019 suit alleges that Cantey Hanger operates as an LLP; thus, we set forth the law on an LLP’s liability: ‘If the law firm is practicing as a limited liability partnership[,], the partnership, but not an individual partner, is liable for the malpractice of another partner if the other partner is not under the supervision or direction of the first partner at the time of the errors, omissions, negligence, incompetence, or malfeasance occurred, unless the first partner was directly involved in the malpractice or had notice of it at the time it occurred.’ Roy W. McDonald & Elaine A. Grafton Carlson, *Texas Civil Practice* § 2:92 (2nd ed. 2019).”).

#### **D. Fiduciary Duties of Partners and Affiliates**

*Cohen v. NewBiss Prop., L.P.*, No. 01-19-00397-CV, 2020 WL 6878414 (Tex. App.—Houston [1st Dist.] Nov. 24, 2020, no pet.) (mem. op.).

The court of appeals affirmed summary judgments granted in favor of NewBiss Property, LP and Sandcastle Homes, Inc. on Cohen’s claims for (1) aiding and abetting breach of fiduciary duty, (2) conspiring to breach fiduciary duty, (3) seeking rescission based on ultra vires acts, and (4) receiving property fraudulently transferred in violation of the Texas Uniform Fraudulent Transfer Act (TUFTA).

Jay Cohen was trustee of JHC Trusts I & II. He transferred several properties belonging to the trust into different partnerships. One instance involved “the West Newcastle property,” which Cohen transferred to Flat Stone II, Ltd., a limited partnership. In June 2006, Matthew Dilick, the controlling shareholder of Flat Stone II of Texas, Inc., Flat Stone II’s general partner, gave Regions Bank a first-lien deed of trust on the West Newcastle Property as collateral for a personal loan. Dilick defaulted and entered into a foreclosure-forbearance agreement with the bank in April 2009. Two weeks later, Dilick created a limited partnership called West Newcastle, Ltd. He then conveyed a tract from the West Newcastle property (“Tract I”) to this new limited partnership. Cohen sued, alleging Dilick fraudulently transferred the property and acted outside of his authority in all the transfers and subsequent transactions. Cohen filed notices of lis pendens on the various pieces of property involved in the suit.

One of the notices of lis pendens dealt specifically with the West Newcastle property and stated that the purpose of the underlying suit was to invalidate the transfer of property to West Newcastle Ltd. and to set aside and cancel any liens Flat Stone II granted, through Dilick, to Regions Bank. The trial court granted the defendants’ emergency motions to expunge the notices of lis pendens. Cohen sought mandamus relief in the court of appeals and obtained a stay of the trial court’s expungement order. While the matter was pending at the court of appeals, however, Dilick conveyed Tract I to Sandcastle for \$750,000.

The court of appeals conditionally granted mandamus relief to Cohen, holding that the trial court erred when it found that Cohen’s pleading did not articulate a real property claim on its face. Back at the trial court, Cohen added Sandcastle as a defendant and sought to set aside its recent purchase of Tract I. After another hearing on the applications to expunge the lis pendens notice, the trial court again ordered the lis pendens expunged, finding that Cohen “failed to establish by a preponderance of the evidence the probable validity of a real property claim.” Meanwhile, between the hearing and the trial court’s entering of the expungement order, Dilick transferred the remainder of the West Newcastle property (“Tract II”) back to Flat Stone II. Cohen filed another mandamus petition

and a motion to stay in the court of appeals, but the court denied his requests. Dilick subsequently sold Tract II to NewBiss for \$1.8 million. Cohen added NewBiss as a defendant to the lawsuit, seeking to set aside this latest purchase.

Sandcastle and NewBiss (the “purchasers”) claimed bona fide purchaser status, and each filed summary judgment motions. Both claimed that they lawfully relied on the trial court’s expungement order, which voided any notice derived from the lis pendens. The trial court granted both motions and rendered separate final judgments. Cohen appealed, and the court held that the purchasers were, in fact, bona fide purchasers because expunction of the lis pendens extinguished actual and constructive notice of the underlying claims. On petition for discretionary review, the Texas Supreme Court reversed the judgment of the court of appeals, holding that an expunged lis pendens did not “eradicate notice arising independently of the recorded instrument expunged.” Because of “an unresolved fact issue” regarding whether the purchasers “had actual, independent knowledge of the issues covered by the lis pendens notice,” the court remanded the case to the trial court “for further proceedings consistent” with its opinion.

On remand to the trial court, Cohen filed his Fourteenth Amended Petition, in which he asserted the following claims against the purchasers: (1) aiding and abetting Dilick in his breach of fiduciary duties, (2) conspiring with Dilick to breach his fiduciary duties, (3) seeking rescission of the sales based on the ultra vires actions of Dilick, and (4) receiving property fraudulently transferred by Dilick in violation of TUFTA. The trial court granted the purchasers’ no-evidence and traditional motions for summary judgment.

In this appeal, Cohen first contended that the trial court erred in granting summary judgment on his aiding and abetting claim against the purchasers. The court of appeals noted that “the Texas Supreme Court has not expressly decided whether Texas recognizes a cause of action for aiding and abetting,” but it assumed for purposes of the dispute that the action was recognized. According to the court, Cohen needed to show that “(1) Dilick committed a breach of fiduciary duty to Cohen, (2) the purchasers knew that Dilick’s conduct constituted a breach of his fiduciary duties, (3) the purchasers intended to assist Dilick in breaching his fiduciary duty, (4) the purchasers gave Dilick assistance or encouragement in his breach, and (5) the purchasers’ assistance or encouragement was a substantial factor in causing the tort.” The court ultimately accepted the purchasers’ argument that “[e]ven if Sandcastle and NewBiss knew about the allegations in the lawsuit, Cohen presented no evidence that Sandcastle and NewBiss knew that Dilick’s consummation of the sales in his capacity as President of the general partner of Flat Stone II could constitute a breach of fiduciary duty to Cohen.” Further, “Cohen presented no evidence that Sandcastle or NewBiss knew what Dilick’s intentions were with the sales proceeds.” In sum, the court agreed with the purchasers’ position that their purchases of the properties alone, even if done with knowledge of the pending lawsuit between Cohen and Dilick, were not evidence that they aided and abetted Dilick in any breach of fiduciary duty:

We believe that this case is more like [*KCM Financial, LLC v. Bradshaw*, 457 S.W.3d 70 (Tex. 2015)] than [*Graham Mortgage Corp. v. Hall*, 307 S.W.3d 472 (Tex. App.—Dallas 2010, no pet.)]. In *Graham*, the party held responsible for aiding and abetting, the mortgage broker, was extensively involved in the parties’ prior dealings, was aware of the terms and limitations of their previous agreements, and part of the funds that the defendant obtained by using the partnership property to improperly secure a loan went toward paying the mortgage broker on unrelated loans to the defendant. In contrast, the lessee in *Bradshaw* was unrelated to and uninvolved with either the non-participating royalty interest owner or the executive-right holder; he merely negotiated for and obtained a royalty lease on the property as a part of an arms-length transaction.

In this case, it is undisputed that the purchasers were not involved in anything Dilick and or his related companies may have done before the sales. Cohen’s only allegation is that the purchasers were aware of his dispute (and lawsuit) with Dilick before they purchased their properties. Cohen brought forth no evidence that either Sandcastle or NewBiss were aware of what Dilick intended to do with the proceeds from the sales.

While the purchasers’ knowledge of the underlying lawsuit between Cohen and Dilick might deprive them of a bona fide purchaser defense in a title dispute, such knowledge, without more, is no evidence that they intended to assist Dilick in committing a tort by diverting the proceeds from the sales for his personal use, assisted and encouraged Dilick in doing so, or that their actions were a substantial factor in Dilick’s breach of his fiduciary duty.

Because Cohen failed to come forth with evidence raising a genuine issue of material fact as to these three elements of his claim that the purchasers aided and abetted Dilick's breach of fiduciary duty, the trial court properly granted the purchasers' no-evidence summary judgment on this claim. Because Cohen failed to overcome his no-evidence burden on his aiding-and-abetting claim, we need not address the traditional motion to the extent it addresses the same claim.

The court then addressed Cohen's claim of a civil conspiracy to commit a breach of fiduciary duty. For such a claim, Cohen was required to show "(1) a combination between two or more persons; here, Dilick and/or his entities and Sandcastle and NewBiss, respectively; (2) the persons [sought] to accomplish an object or course of action; (3) the persons [reached] a meeting of the minds on the object or course of action; (4) one or more unlawful, overt acts [were] taken in pursuance of the object or course of action; and (5) damages occur[ed] as a proximate result." The court affirmed the grant of summary judgment against Cohen:

We agree with the purchasers' argument that knowledge of the lawsuit between Cohen and Dilick is no evidence that there was any "meeting of the mind[s]" between the purchasers and Dilick regarding Dilick's intention to breach his fiduciary duty to Cohen. As in [*Schlumberger Well Surveying Corp. v. Nortex Oil & Gas Corp.*, 435 S.W.2d 854 (1968)], while the purchasers may have been aware that someone else had committed or might commit a tort, there is no evidence that they participated in it. In *Schlumberger*, the alleged conspirator was a service company that worked on, and probably was aware of, the tortiously drilled wells, but its only involvement was to receive payment at its regular and customary rate for servicing the wells. Similarly, in this case, while the purchasers may have known about Dilick's breach of fiduciary duty to Cohen via the lawsuit, their only involvement was to pay fair market value for the properties.

In this case, the underlying tort of breach of fiduciary duty was that Dilick sold the properties to pay off his own personal loan. However, there is simply no evidence that the purchasers had any knowledge about what Dilick intended to do with the proceeds once he sold the properties. In a civil conspiracy case, "the parties must be aware of the harm or wrong at the inception of the combination or agreement," or there is no meeting of the minds. "One 'cannot agree, either expressly or tacitly, to the commission of a wrong which he knows not of.'" Absent evidence that the purchasers knew that Dilick intended to misappropriate the proceeds of the sale for his own personal use, they cannot have, as a matter of law, intended to facilitate that wrong.

Because Cohen failed to present evidence raising a genuine issue of material fact as to the "meeting-of-the-mind[s]" element of his conspiracy claim, the trial court properly granted the purchasers' no-evidence summary judgment on this claim. Because Cohen failed to overcome his no-evidence burden on his conspiracy claim, we need not address the traditional motion to the extent it addresses the same claim.

Cohen also argued that he was entitled to a constructive trust or to rescind the sales of the properties because of Dilick's ultra vires acts. The court disagreed, as it concluded that a cause of action for ultra vires conduct did not exist for partnerships:

Citing *Campbell v. Walker*, No. 14-96-01425-CV, 2000 WL 19143 (Tex. App.—Houston [14th Dist.] Jan. 13, 2000, no pet.) (mem. op., not designated for publication), Cohen argues that "[a]n ultra vires action is an act that is beyond the scope of the powers of the corporation as defined by its charter or the laws of the state of incorporation." Cohen further contends that Dilick acted ultra vires because "[t]he Limited Partnership Agreements do not permit the general partner to use Limited Partnership assets as collateral for an individual loan to be used for non-partnership business."

In their Motion for Traditional Summary Judgment, and again on appeal, the purchasers contend that the "ultra-vires doctrine is not applicable to limited partnerships under Texas law." We agree. The case relied upon by Cohen, *Campbell v. Walker*, specifically refers to "the powers of the corporation[.]" The Texas Business Organizations Code specifically provides a cause of

action for certain ultra vires acts by corporations. *See* TEX. BUS. ORGS. CODE § 20.002. No such cause of action exists for partnerships. *See* TEX. BUS. ORGS. CODE §§ 151.001-154.204.

Because the purchasers conclusively negated an element of Cohen’s ultra vires claim, i.e., an act beyond the scope of powers of a *corporation*, the trial court properly granted traditional summary judgment on this claim.

Finally, the court rejected Cohen’s claim under TUFTA. The court concluded that the purchasers negated an essential element of the claim—i.e., that Cohen was a “creditor” with a “claim”—and that summary judgment was therefore appropriate.

***Ron v. Ron***, No. 20-40248, 2020 WL 6494223 (5th Cir. Nov. 4, 2020) (“Fiduciary relationships can be formal or informal. ‘A formal fiduciary relationship arises as a matter of law in certain relationships, such as attorney-client, partnership, and trustee relationships.’”).

***Boucher v. Thacker***, 609 S.W.3d 206 (Tex. App.—Texarkana 2020, no pet.).

The court of appeals affirmed the trial court’s judgment that denied one partner’s (Boucher’s) claims for breach of contract, breach of fiduciary duty, and conversion against the other partner (Thacker) as they dissolved their business.

Boucher and Thacker were partners in Sinclair & Wright Architects. (The firm was actually a professional limited liability company, but the court and the parties applied partnership law to the dispute.) The partnership was not doing well, and the partners had begun to discuss dissolution. On February 16, 2015, Boucher provided to Thacker written notice of his intent to retire from the partnership as of February 20, 2015. In response to this notice, Thacker withdrew from the partnership on February 17, 2015.

Thacker sued Boucher for breach of the partnership agreement (the “Agreement”), breach of fiduciary duty in winding up the firm’s business, and several violations of partner obligations listed in Chapter 152 of the Texas Business Organizations Code. Among other claims, Thacker alleged that Boucher breached the Agreement by abandoning the firm at the time of dissolution and by failing to pay his share of the firm’s debts. Thacker alleged that Boucher’s actions resulted in payment of unnecessary interest on loans.

Boucher filed a counterclaim against Thacker for breach of the Agreement, breach of fiduciary duty, and conversion. Among other complaints, Boucher alleged that Thacker breached a noncompetition provision in the Agreement by continuing to operate the firm under a new business name and by failing to pay the value of Boucher’s ownership interest. Boucher claimed that he was owed \$306,728.33 for his retirement and attorney’s fees.

The trial court rendered judgment for Thacker. Among other determinations, the trial court concluded that (1) Boucher breached the Agreement in general, (2) Boucher breached the Agreement by not paying his part of the debts in violation of Section 152.202 of the Texas Business Organizations Code, (3) Boucher did not participate in winding down the business in violation of the Agreement and Section 152.205 of the Texas Business Organizations Code, (4) Boucher did not honor his fiduciary duty in winding down the firm, which violated Section 152.204 of the Texas Business Organizations Code, (5) there was no breach of fiduciary duty on Thacker’s part, (6) Boucher presented no credible evidence that Thacker owed \$306,728.00, (7) there was no evidence of conversion of assets by Thacker, (8) under Section 152.502 of the Texas Business Organizations Code, withdrawal of a partner occurs when an existing partner ceases to be a partner, (9) a partner may withdraw during winding down under Section 152.503 of the Texas Business Organizations Code, (10) the right to withdraw cannot be limited under Section 152.002 of the Texas Business Organizations Code, (11) after Thacker’s withdrawal on February 17, 2015, there was no partnership under Section 152.051 of the Texas Business Organizations Code, and (12) Thacker is entitled to the full amount of requested attorney’s fees.

Boucher argued that the evidence was factually insufficient to support the rejection of his claims against Thacker. The court of appeals disagreed:

Although Boucher timely filed a document requesting additional findings of fact and conclusions of law, Boucher did not specifically challenge any of the factual findings entered by the trial court. Rather, Boucher submitted forty additional findings of fact, several of which are slight variations of the trial court’s original findings. Moreover, “nothing in [Boucher’s] request



for additional findings alerted the trial court that it had omitted ... essential elements in its original findings.” “A request for additional findings must be specific; it cannot be buried among minute differentiations or numerous unnecessary requests.”

Additionally, on appeal, Boucher does not challenge specific findings of fact. Instead, he challenges the trial court’s general conclusions rejecting his claim that Thacker breached the Agreement, converted Firm assets for his own benefit, and erred in failing to award Boucher attorney fees for breach of contract.

We find that there was evidence supporting the trial court’s unchallenged factual findings that the Firm was dissolved before Boucher’s notice of retirement and that Thacker withdrew before the effective date of Boucher’s retirement. In turn, these factual findings supported the trial court’s conclusions that Thacker did not breach the Agreement or any fiduciary duty owed to Boucher, that Thacker did not convert assets from Boucher, and that Boucher was not entitled to retirement or the value of his interest in the Firm or attorney fees.

Because there was evidence supporting the trial court’s unchallenged findings, the court of appeals concluded that the trial court did not err in determining that Boucher was not entitled to retirement, the value of his interest in the firm, or attorney’s fees.

The court of appeals did, however, reverse the award of attorney’s fees to Thacker. Although Thacker prevailed on his breach of contract claim against Boucher, the trial court did not award any damages for breach of the Agreement. The court of appeals noted that “[t]o recover fees under section 38.001, a party must prevail on a cause of action for which attorney’s fees are recoverable, and ... recover damages,” and it observed that “[a] finding that a defendant breached a contract without recovery of damages generally precludes an award of attorney fees.” Because Thacker did not recover damages and no contractual provision provided for attorney’s fees to a prevailing party, the court of appeals concluded that Thacker was not entitled to an attorney’s fee award.

*Heatley v. Red Oak 86, L.P.*, \_\_ S.W.3d \_\_, 2020 WL 4745553 (Tex. App.—Dallas 2020, no pet.).

The court of appeals affirmed the trial court’s granting of equitable forfeiture as a remedy for breach of fiduciary duty.

Appellants Michael D. Heatley and Heatley Capital located an opportunity to invest in land in Royse City near I-30. Heatley Capital found the opportunity and performed its initial due diligence, and another of Heatley’s companies, HC Land Company, formed a partnership and presented the opportunity to investors. Royse City/I-30, LLP (“Royse City”) was formed as a single purpose entity to serve as a vehicle for the investment and was later converted into an LLC with the same general ownership and management structure.

Another of Heatley’s companies, HC Developers, was the managing member of Royse City. Class A members had an ownership interest commensurate with the investor’s initial capital contribution. Class B members were given a 30% interest in Royse City’s after-payout profits (i.e., profits remaining after all Class A investors recouped their capital contributions) and were not required to make capital contributions.

HC Developers had a 1% interest in Royse City’s after-payout profits. Heatley Capital would receive an organization fee from Royse City and an additional annual management fee. Heatley and Bryan Crow, a Heatley Capital employee, executed the Royse City formation agreement on behalf of HC Developers. Heatley and Crow also personally invested as Class A members. Charles Johnson acquired a 5% interest in Royse City as a Class A member, and Red Oak, a family partnership controlled by Jason Dodd, obtained a 3.5678% interest as a Class A member. HC Land Company was Royse City’s only Class B member.

Under the terms of the formation agreement, HC Developers, as managing member, was empowered to issue annual assessments to Class A investors to cover Royse City’s operating costs and debt servicing. Class A investors were required to pay those assessments within 30 days or they would be subject to having their ownership interests either diluted or forfeited.

Royse City purchased the land in November 2006 for nearly \$4.7 million (\$5.5 million after fees), approximately \$2.9 million of which was financed through a five-year loan. Johnson and Red Oak did not pay their 2008 and 2009 fees, citing concerns with the property and the bank loan. Heatley agreed that they did not have to pay the assessment until the issues were addressed. Johnson tried to get his concerns addressed throughout 2009, and he eventually decided that he wanted out of the investment.

During this time, Dodd also became concerned about the investment. Dodd spoke to Heatley only once or twice during 2009. During a conversation on December 1, 2009, Heatley discussed the fact that Dodd had not yet paid Red Oak's 2009 assessment, but assured him that Red Oak's interest would not be forfeited for failing to pay the assessment as long as Dodd "work[ed] on getting it in."

In early 2010, Crow, Dodd, and Johnson asked Heatley to set up a partnership meeting to discuss plans for Royse City, the details of the loan, and the partnership's accounting. After many delays, the meeting was eventually held at the end of April 2010. During this meeting, the bank loan, partnership accounting, and plans to market the property were discussed. Heatley also disclosed his involvement in ongoing litigation with Crow, which Crow had initiated in August 2008. Some Royse City members insisted that Johnson and Red Oak should have their interest forfeited for failure to pay the assessments. After the meeting, Johnson and Dodd were sent letters notifying them that if their shares of the 2008 and 2009 assessments were not received by May 12, 2010, their interest in Royse City would be forfeited and divided among the remaining partners. Johnson, who was out of the country, never received the letter. He only received an email from Heatley on May 11 informing him of the next day's deadline. Neither Johnson nor Dodd paid their assessments.

Crow obtained a temporary restraining order (TRO) prohibiting the Heatley-controlled entities from forfeiting any investors' interest. Crow and Heatley agreed to settle their claims before the TRO's expiration date, and the trial court signed the order dissolving the TRO on May 25. On May 26, Johnson and Red Oak sought their own TRO, asserting in their original petition: (1) breach of fiduciary duty based on alleged mismanagement, nondisclosure, and self-dealing; (2) minority-shareholder oppression based on the managing member's decision to forfeit rather than dilute their interests; and (3) breach of contract based on the managing member's purported failure to give Johnson and Red Oak valid notice of a required capital contribution before declaring their interests forfeited. Johnson and Red Oak also sought a declaratory judgment stating that the operating agreement's forfeiture provision was an unlawful penalty under Texas law. The trial court granted the TRO and later a temporary injunction. Heatley claimed that the injunction had no effect because Johnson's and Red Oak's membership interests were forfeited in the period between the dissolution of Crow's TRO and Johnson's and Red Oak's TRO.

Royse City sold the property at a substantial profit, in large part because of Heatley's "strategic default" plan. Evidence showed that in 2009, Heatley and his entities engaged Danny Yoo, a banking consultant, to advise them on negotiating with banks holding notes on their properties. Yoo advised the "strategic default" to bring Wells Fargo to the negotiating table, which allowed a Yoo-controlled intermediary entity to acquire the Royse City note from the bank at a discount. This savings, along with the sale of the land at \$8 million, resulted in more than \$2.1 million in after-payout profits. Johnson and Red Oak, whose interests had been forfeited, neither recouped their investment nor shared in the profits.

Heatley recouped his initial \$80,000 investment and more than \$68,000 for an 85% profit. HC Land Company profited by more than \$326,000, and HC Developers profited by more than \$22,000. Heatley Capital, though neither a member nor the nominal manager of Royse City, received more than \$963,000 in various fees over the course of the investment.

Johnson and Dodd testified that they were never informed about the "strategic default" plan to repurchase the note at a discount, despite their specific inquiries in 2009 and at the April 2010 meeting. Heatley claimed he did not inform Johnson or Dodd of the plan because at the time it was not yet "fully formed," despite evidence presented to the contrary. Both Dodd and Johnson stated that if the plan had been shared with them, they would have most likely paid their assessments and participated in the plan.

The Heatley parties moved for partial summary judgment against claims asserted in Johnson's and Red Oak's second amended petition, which was granted by the trial court. Johnson and Red Oak had filed a third amended petition before the trial court's ruling, but the trial court based its ruling on the second amended petition. Heatley's later motion to strike the third amended petition was not ruled on, and although Heatley later noted that it was "not fully clear" which of Red Oak's claims were pending, both parties presented their evidence at trial as if all claims were pending.

At trial, the jury ultimately determined the following: (1) Heatley Capital owed a fiduciary duty to Johnson and Red Oak; (2) all three Heatley parties breached their fiduciary duties to Johnson and Red Oak in the management of Royse City; (3) neither Johnson nor Red Oak suffered monetary damages proximately caused by the Heatley parties' breaches of fiduciary duties; (4) none of the Heatley parties was unjustly enriched at the expense of Johnson; and (5) both Johnson and Red Oak failed to pay assessments properly made by Royse City's manager.

Neither side objected to the verdict and the trial court entered a take-nothing judgment. Johnson and Red Oak moved for judgment notwithstanding the verdict, requesting equitable relief. They asked for Heatley Capital to forfeit all fees received in connection with the Royse City land deal, and they asked for the court to hold Heatley, Heatley Capital, and HC Developers jointly and severally liable for the forfeiture. After hearing the motion, the trial court entered an amended judgment and awarded equitable forfeiture against the Heatley entities in the amount of Johnson's and Red Oak's contributions to Royse City, plus pre- and post-judgment interest and costs of court.

The Heatley parties appealed and contended that the trial court had abused its discretion by awarding equitable forfeiture, by holding Heatley and HC Developers jointly liable for forfeiting fees paid to Heatley Capital, and by awarding prejudgment interest to Johnson and Red Oak. The court of appeals reviewed the trial court's equitable forfeiture determination for abuse of discretion.

Under the factors listed in *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999), a trial court may order fee forfeiture as equitable relief when normal damage measures do not adequately address a breach of fiduciary duty. In ruling on a request for forfeiture the court must determine three elements:

[1] whether a "violation is clear and serious, [2] whether forfeiture of any fee should be required, and [3] if so, what amount." In making that determination, the court must consider non-exclusive factors: "[t]he gravity and timing of the breach of duty"; "the level of intent or fault"; "whether the principal received any benefit from the fiduciary despite the breach"; "the centrality of the breach to the scope of the fiduciary relationship"; "any threatened or actual harm to the principal"; "the adequacy of other remedies"; and "[a]bove all" whether "the remedy fit[s] the circumstances and work[s] to serve the ultimate goal of protecting relationships of trust... These "several factors embrace broad considerations which must be weighed together and not mechanically applied."

In examining the Heatley parties' first complaint that Red Oak and Johnson failed to request a jury question regarding the Heatley parties' level of intent when breaching their fiduciary duties, the court found that the Heatley parties did not adhere to Texas Rules of Civil Procedure 272, 274, and 278. The Heatley parties failed to properly object to the lack of such a question or submit the questions in "substantially correct wording" to the court, and in failing to do so, waived the error.

The Heatley parties next argued that the trial court abused its discretion in granting partial forfeiture because: (1) there was no evidence regarding the gravity or centrality of the breaches of duty; (2) there was no evidence that the Heatley parties acted intentionally, recklessly, or with gross negligence; (3) the Heatley parties received no benefit from breaching their fiduciary duties; and (4) the jury had found that the Heatley parties were not unjustly enriched and that their breaches of fiduciary duty caused no harm to appellees (i.e., Red Oak and Johnson). Addressing each of these arguments in turn, the court ultimately concluded that there was evidence submitted regarding the gravity of the breaches of duty, the evidence supported a finding that the breach was a knowing one, and that even in the absence of an additional benefit beyond the fees appellees paid or actual damages to the appellees, partial forfeiture can be an appropriate remedy. The appeals court found that the trial court's decision was not arbitrary or unreasonable and reflected careful attention to the *Burrow* factors. Therefore, the trial court did not abuse its discretion.

The Heatley parties next contended that the trial court abused its discretion by awarding forfeiture to Red Oak because the trial court initially granted summary judgment against Red Oak's claim that Heatley and his entities breached their fiduciary duties. However, as the Heatley parties acknowledged at the trial, it was "not fully clear" which of the claims in the third amended petition, if any, were resolved by the trial court's partial summary judgment. The court of appeals discussed the ability of a trial court to change or modify a partial summary judgment at any time before its plenary power expires, and while the trial court in this case may not have explicitly withdrawn the partial summary judgment, it was implicitly modified or withdrawn to the extent that it was inconsistent with the trial court's final findings of fact and conclusions of law. However, the court of appeals also acknowledged that when a trial court reverses course on issues decided as a matter of law prior to trial, it must allow the parties the opportunity to litigate the issues at trial. In this case, owing to the fact that the parties proceeded as if all claims were pending, the Heatley parties were given a full and fair opportunity to litigate Red Oak's claim for breach of fiduciary duty.

Next, the Heatley parties claimed that the trial court had abused its discretion by holding Heatley and HC Developers jointly liable for the forfeiture. The Supreme Court of Texas has held that a third party which knowingly

participates in the breach of duty of a fiduciary becomes a joint tortfeasor with the fiduciary and is liable as such. The evidence supported the trial court's finding that Heatley and HC Developers "committed the same breaches of duty in lockstep with" Heatley Capital, such that all three parties were "indistinguishable as actors."

The Heatley parties further contended that Johnson and Red Oak waived joint liability because they did not specifically cite "knowing participation" in their request for equitable forfeiture and because they failed to obtain a jury finding on the issue of knowing participation. Here the court of appeals held that Johnson and Red Oak were not required to use "magic words" to invoke the court's equitable power. Because the jury charge asked whether Heatley Capital had breached its fiduciary duty, as long as the evidence supported a finding of knowing participation (which the court found that it did), the judgment would not be subject to reversal based on the ground that Johnson and Red Oak failed to obtain such a jury finding.

Finally, the Heatley parties contended that the trial court erred by granting prejudgment interest, but they failed to preserve the issue by objecting to the prejudgment-interest award in the trial court.

The judgment of the trial court was affirmed.

*VTX Communications, LLC v. AT&T, Inc.*, Civ. A. No. 7:19-cv-00269, 2020 WL 4465968 (S.D. Tex. Aug. 4, 2020).

The court granted in part and denied in part defendants' motion to dismiss on breach of fiduciary duty and other claims. The court concluded that claims for breach of the duty of loyalty against the general partner and controllers of the general partner were successfully pled with respect to one of the three limited partnerships, but the other two limited partnerships had agreements that displaced fiduciary duties.

Certain limited partners of three limited partnerships that provided AT&T-branded wireless service in South Texas sued the partnerships' common general partner and affiliated entities. The general partner, New Cingular Wireless/AT&T Mobility, operated the three limited partnerships which had exclusive authority to provide cell service in the partnerships' respective service areas.

Plaintiffs alleged that defendants had been using the networks and wireless spectrums with disregard for the defendants' duties to the plaintiffs, specifically by defendants' operation of a Cricket Wireless network without proper compensation to the three limited partnerships, and thus to the detriment of the plaintiff limited partners. Plaintiffs brought causes of action for breach of fiduciary duty, breach of the partnership agreements, tortious interference, conversion/civil theft, aiding and abetting, and fraud.

After a lengthy analysis, the court held that Delaware law applied to all of plaintiffs' claims consistent with the choice-of-law provision in the three limited partnership agreements. The court then considered a number of arguments on defendants' motion to dismiss, including the following:

#### 1. Whether the Complaint Met FRCP 23.1's Requirements

Defendants asserted that plaintiffs had not met Rule 23.1's requirements for derivative claims. Rule 23.1 applies when one or more shareholders or members of a corporation or unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the owners who are similarly situated in enforcing the right of the corporation or association. Rule 23.1 requires that the complaint be "verified" and:

- (1) allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law;
- (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack; and
- (3) state with particularity:
  - (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and
  - (B) the reasons for not obtaining the action or not making the effort.

On this issue the court found that plaintiffs successfully cured any errors under Rule 23.1 in their last complaint, that defendants failed to show that plaintiffs could not fairly and adequately represent the shareholder

interests at issue, and that plaintiffs had sufficiently shown that pre-suit demand would be futile. The court denied defendants' motion to dismiss.

## 2. Whether AT&T Inc, AT&T Mobility, and the three Limited Partnerships Were Proper Defendants

Defendants argued that the plaintiffs' complaint lacked specific allegations as to each defendant and impermissibly grouped defendants together. Defendants sought to dismiss every defendant except the general partner New Cingular Wireless/AT&T Mobility. Plaintiffs argued that AT&T is a corporate amalgamation and that they had pled with the required specificity. FRCP 8 requires only that a claim for relief contain a short plain statement of the claim showing that the pleader is entitled to relief. Although the plaintiffs' complaint was unclear as to which defendants committed which alleged acts of misconduct, the plaintiffs did make allegations in the body of the complaint and asserted facts to illustrate the defendants' relationships and the alleged misconduct. The court found that although the plaintiffs' complaint was not a model of precision and clarity, the plaintiffs stated a claim for relief and gave sufficient notice of their claims. The motion to dismiss was denied.

## 3. Whether Plaintiffs' Tort Claims Were Foreclosed as Duplicative

Defendants argued that plaintiffs failed to allege any legal duty independent from defendants' contractual duties such that plaintiffs' tort claims should be dismissed. Defendants AT&T Mobility, Cricket Communications, Cricket Wireless, and AT&T Inc. were not parties to the limited partnership agreement, however, and defendants were unable to state why a tort claim would not apply to the defendants who were not bound by contractual duties. Defendants' motion to dismiss was denied, except as to the fiduciary duty claims (to be discussed below).

## 4. Breach of Contract Claim

Plaintiffs brought claims for breach of the partnership agreements. The partnership agreements required the general partner to act in the best interests of the partnerships and to provide the most profitable cell service. Defendants moved to dismiss on the grounds that plaintiffs could not state a breach of contract claim when their allegations were based on actions that the partnership agreement expressly permitted, which in this case included the general partner's authority to exercise whatever actions or forbearances it reasonably deemed to be necessary in furtherance of the purpose of the partnerships. According to the court, under Delaware precedent, when a partnership agreement empowers the general partner to exercise discretion in a reasonable manner, reasonableness is a question of fact which cannot be resolved on a motion for judgment on the pleadings. The court therefore found that the plaintiffs' allegations were sufficient to survive a motion to dismiss.

## 5. Breach of Fiduciary Duty Claim

Plaintiffs brought claims for breach of several fiduciary duties, which the court examined in three subsections: (i) claims against the general partner, New Cingular Wireless/AT&T Mobility; (ii) claims against the managers and controllers of the general partner; and (iii) claims for breach of the implied covenant of good faith and fair dealing.

### I. Breach of Fiduciary Duty Claim Against New Cingular Wireless/AT&T Mobility

Defendants moved to dismiss plaintiffs' claim for breach of fiduciary duty against the general partner because the partnership agreements at issue eliminated the traditional fiduciary duties and imposed contractual duties instead. The court noted, however, that any restrictions on fiduciary duties must be set forth clearly and unambiguously. After a review of the partnership agreements, the court found that none of the provisions explicitly modified fiduciary duties in precise terms. However, fiduciary standards may be displaced by sole discretion or good faith standards if the contract provides that all relevant judgments are displaced by the contractual standard. After further analysis, the court found that Section 7.5 of the partnership agreement, which addressed conflicting duties and transactions among affiliates, did displace fiduciary duties:

Section 7.5 states:

The General Partner and its Affiliates shall have the right to contract or otherwise deal with the Partnership for the sale or lease of real or personal property, the rendition of services and other purposes, and to receive payments and fees from the Partnership in connection therewith, provided that the terms and conditions of such transactions are comparable to, or not substantially less favorable than, similar arms'-length transactions between the General Partner or its Affiliate and unrelated third parties. The Partners recognize that the General Partner may have conflicting duties to its many Affiliates including without limitation in transactions between two of its Affiliates. In the absence of gross negligence or willful misconduct, the General Partner's resolution of such conflict of interest shall not constitute a breach of this Agreement or any other agreement contemplated herein. Nothing herein shall be construed to require the execution of written contracts in connection with management and operating services provided by the General Partner as contemplated in Sections 4.1 and 4.2. ...

The Court holds that section 7.5 does displace fiduciary duties. Section 7.5 specifically addresses "conflicting duties" and contains the "fair price" prong of the entire fairness standard, requiring transactions to be "comparable to, or not substantially less favorable than, similar arms'-length transactions." Section 7.5 then provides that, even though the parties are aware of conflicting interests in self-dealing transactions, they resolve that, "[i]n the absence of gross negligence or willful misconduct, the General Partner's resolution of such conflict of interest shall not constitute a breach." Therefore, "the Partnership Agreement, and not default rules of fiduciary duty, control." The "language cited ... does in fact reduce the general partner's duties from a fiduciary duty to merely a duty of good faith," that is, to not act with gross negligence or willful misconduct. This conclusion is consistent with the general partner's expectations under the agreements: even if a questioned transaction did not meet the "entire fairness standard," the transaction would be permissible under the partnership agreements so long as it was not accomplished by the general partner's gross negligence or willful misconduct and provided the transaction was consistent with all other applicable language, such as being not substantially less favorable than an arms'-length transaction. The provision is enforceable, because it limits the general partner's "fiduciary duties with regard to an interested transaction with the company to a duty to negotiate the transaction on arms' length terms, instead of imposing a duty to assure that the transaction would be entirely fair" to the limited partners.

Only two of the three limited partnership agreements included Section 7.5 or its like, so the court granted the motion to dismiss with respect to the plaintiffs' claims against the general partner only for those two limited partnerships.

ii. Breach of Fiduciary Duty Claim Against AT&T Mobility Corporation, Cricket Communications, Cricket Wireless, and AT&T Inc.

Defendants moved to dismiss plaintiffs' breach of fiduciary duty claims against defendants who were not the general partner or the three limited partnerships. Defendants argued that the plaintiffs' failed to plead vicarious liability, alter ego, or sufficient control to extend any fiduciary duty to the general partner's controllers and disputed the plaintiffs' claim that Section 1.4 of the partnership agreement (which stated that "[n]either the Partners nor any of their Affiliates shall take any action ... contrary to the best interest of the Partnership at any time") could create fiduciary duties for an entity that was not a party to the agreement. The court agreed with defendants regarding Section 1.4.

The court then examined in detail the Delaware precedent of *In re USACafes, L.P. Litigation*, 600 A.2d 43 (Del. Ch. 1991), which established that the individuals and entities controlling the general partner owe to the limited partners at a minimum the duty of loyalty. The rule in *USACafes* indicates that while mere ownership of the general partner does not in itself create a fiduciary relationship, those affiliates of a general partner who exercise control over the partnership's property may find themselves owing fiduciary duties to both the partnership and its limited partners. In order for the claim against the general partner's controllers to survive a motion to dismiss, the plaintiffs needed only to allege some control—which the plaintiffs did allege. However, the plaintiff's claims could not

extend beyond duty of loyalty claims. To the extent plaintiffs attempted to extend their claim to breach of the fiduciary duty of care, or breach of the duties of good faith, fair dealing, and candor, such an attempt was foreclosed by Delaware law. The court therefore dismissed plaintiff's claim for breach of the duty of care and the duties of good faith, fair dealing, and candor.

The court clarified that the *USACafes* rule did not apply where the limited partnership agreement entirely eliminated the general partner's common-law fiduciary duties to the limited partnership and its limited partners, as there is no fiduciary duty that may be extended to the general partner's controllers. Consistent with the court's previous ruling, the court dismissed the plaintiffs' claims arising out of the two limited partnerships whose partnership agreements did limit the fiduciary duties to contract terms, while the claim for breach of the duty of loyalty in connection with the third limited partnership remained.

### iii. Breach of the Implied Covenant of Good Faith and Fair Dealing Claim

Defendants moved to dismiss plaintiffs' claim for breach of the implied covenant of good faith and fair dealing, arguing that there was no contractual gap to be filled and that the partnership agreements expressly authorized the defendants' conduct. The court first noted that the covenant of good faith and fair dealing was an implied or quasi-contractual term which did not create any "free-floating" fiduciary duties. Therefore, it was improper for the plaintiffs to attempt to assert breach of the implied covenant as a component of the defendants' alleged breach of fiduciary duty.

Delaware law prohibits any partnership agreement from eliminating the implied contractual covenant of good faith and fair dealing or liability for breaching the implied covenant. However, the implied covenant of good faith and fair dealing is a limited and extraordinary legal remedy only applied to infer contractual terms to handle developments or contractual gaps that neither party anticipated. Examining the terms of the partnership agreement, the court found that no such gaps existed. Therefore, the court dismissed the plaintiff's claim for breach of the implied covenant.

### 6. Aiding and Abetting Breach of Fiduciary Duty Claim

Plaintiffs alleged that the AT&T and Cricket Defendants knowingly induced and participated in the breach of fiduciary duties to the partnerships and limited partners. Under Delaware law, a claim for aiding and abetting requires plaintiffs to show:

(1) the existence of a fiduciary relationship, (2) the fiduciary breached its duty, (3) a defendant, who is not a fiduciary, knowingly participated in a breach, and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and the non-fiduciary. These elements require "an underlying or predicate fiduciary breach" to be aided and abetted and ... knowing participation by a party that is not a fiduciary.

Because the court had already held that the general partner was in a direct fiduciary relationship with the partnerships and the limited partners, the court concluded that the general partner could not also be liable for aiding and abetting. The court extended that reasoning to the other defendants: "Under the *USACafes* rule, as explained above, Defendants AT&T Mobility Corporation; Cricket Communications, LLC; Cricket Wireless LLC; and AT&T Inc. are fiduciaries in a fiduciary relationship with the Plaintiffs and three limited partnerships, because these Defendants, at this stage, owe a fiduciary duty of loyalty .... A claim for aiding and abetting must be targeted at a nonfiduciary, but there is no nonfiduciary involved with the alleged breaches by Defendants ...." Accordingly, the court granted defendants' motion to dismiss with respect to Plaintiff's claim for aiding and abetting.

*Moheb v. Dizajiyani*, No. 14-18-00519-CV, 2020 WL 3240578 (Tex. App.—Houston [14th Dist.] June 16, 2020, no pet.) (mem. op.).

"The elements of a claim for breach of fiduciary duty are (1) a fiduciary relationship existed between the plaintiff and the defendant, (2) the defendant breached its fiduciary duty, and (3) the breach resulted in injury to the plaintiff or benefit to the defendant. Fiduciary duties arise as a matter of law in certain formal relationships,

including partnerships. Where a fiduciary relationship exists, the burden is upon the fiduciary to show he acted fairly and informed the beneficiary of all material facts relating to the challenged transaction. ...

It is undisputed that appellant and Dizajiyen entered into a partnership to form Lloyd Auto. The partners also agreed that they were to share profits and losses in equal shares. There is no written agreement and the partners otherwise dispute the partnership terms.

Dizajiyen testified that he and appellant agreed that Dizajiyen could take a salary of \$2,500 a month. Dizajiyen did not always take his payments each month due to cash flow issues. Dizajiyen also attested that he and appellant discussed Dizajiyen's withdrawal of capital from the partnership and that appellant was aware that he was doing so. Each withdrawal that Dizajiyen made was reflected on the partnership tax returns. Appellant and Dizajiyen shared an office space between 2008 and 2013. They sat in the same office daily and discussed all the business decisions that Dizajiyen was making.

There is some evidence to support the trial court's judgment of no liability on appellant's breach of contract and breach of fiduciary duty claims. From this evidence, the trial court could have concluded that appellant was fully informed of all material facts and decisions of the company, including that Dizajiyen would withdraw capital, and agreed to them. None of this testimony contradicts the tax returns or the testimony of appellant's expert witness. From this record, we cannot say that appellant demonstrated that there is no evidence to support the adverse findings on his breach of contract and breach of fiduciary duty claims.

Having also considered the entire record for evidence in favor of and contrary to the challenged findings, we conclude that the findings against appellant are not against the great weight and preponderance of the evidence. The evidence of the agreements between the partners consisted entirely of the conflicting testimony of appellant and Dizajiyen. Appellant testified that he did not know of or agree to the withdrawals. Dizajiyen testified that there were agreements and appellant was fully informed. We may not pass judgment upon the witnesses' credibility or substitute our judgment for that of the factfinder, even if the evidence would support a different result."

***Baldwin v. Mortgage Electronic Registration System, Inc.***, Civ. A. No. 4:19-CV-03921, 2020 WL 4227591 (S.D. Tex. June 8, 2020), report and recommendation adopted, 2020 WL 4227468 (S.D. Tex. July 23, 2020) ("Texas law views the fiduciary relationship 'as an extraordinary one [that] will not be lightly created.' There are two types of fiduciary relationships: (1) a 'formal' relationship in which a duty arises as a matter of law (such as attorney-client, principal-agent, trustee-beneficiary, or between partners in a partnership); and (2) an 'informal' relationship arising from a moral, social, domestic, or personal relationship called a 'confidential' relationship.").

***Brooks v. United Development Funding III, L.P.***, Civ. A. No. 4:20-cv-00150-O, 2020 WL 6132230 (N.D. Tex. Apr. 15, 2020).

"To bring a claim for breach of fiduciary duty, a plaintiff must allege '(1) that a fiduciary duty existed and (2) that the defendant breached that duty.' Plaintiffs allege that UDF III [a limited partnership] and UMTHLD [the general partner of UDF III] breached fiduciary duties to UDF III investors to 'deal honestly with unitholders in the sale of DRIP Units.' The UDF Entity Defendants move to dismiss these claims against UDF III and UMTHLD. The Court first turns to the breach of fiduciary duty claim against UDF III.

The UDF Entity Defendants argue that under Delaware law, 'UDF III (a limited partnership) is not a fiduciary to UDF III investors (limited partners).' Entity Defs.' Mem. 28, ECF No. 59 (citing *Klig v. Deloitte LLP*, 36 A.3d 785, 798 (Del. Ch. 2011) (holding that a 'partnership as an entity' does not owe fiduciary duties to limited partners) and *Emerald Partners v. Berlin*, No. 9700, 1995 WL 600881, at \*8 (Del. Ch. Sept. 22, 1995) (holding that a corporation 'owes no fiduciary duties to shareholders independently from its agents, and the corporation itself is not liable for a breach of fiduciary duties by its directors') (collecting cases), aff'd in part, rev'd in part on other grounds, 726 A.2d 1215 (Del. 1999)).

In response, Plaintiffs do not dispute that UDF III is organized under Delaware law and that, under Delaware law, a partnership does not owe fiduciary duties to partners. Plaintiffs contend, however, that UDF III owes fiduciary duties to its partners under Texas law. The Court has already concluded that under the 'internal affairs doctrine,' Delaware law governs Plaintiffs' claims that UDF III and UMTHLD breached a fiduciary duty owed to them. The Court, therefore, rejects Plaintiffs' arguments that are premised on Texas law.

The Court concludes that, under Delaware law, UDF III (a limited partnership) is not a fiduciary to UDF III investors (limited partners). Accordingly, the UDF Entity Defendants' motion to dismiss Plaintiffs' breach of fiduciary duty claim against UDF III is GRANTED. This claim will be dismissed with prejudice.



The UDF Entity Defendants also move to dismiss the breach of fiduciary duty claim against UMTHLD. They argue that Plaintiffs fail to allege any conduct by UMTHLD constituting a breach of fiduciary duty owed to them or the limited partners of UDF III. In support, they contend that the Amended Complaint does not plausibly allege any misrepresentations or omissions on the part of UMTHLD and, to the extent the claim is based upon alleged breaches of the Partnership Agreement by UMTHLD, the Partnership Agreement has not been breached because Plaintiffs do not allege that loans to any one borrower exceed the twenty percent loan concentration limit.

In response, although Plaintiffs contend that UMTHLD has a fiduciary duty to the limited partners, which is not disputed, their opposition brief contains no response to the moving parties' primary argument—namely, that Plaintiffs fail to allege any conduct by UMTHLD constituting a breach of fiduciary duty owed to them or the limited partners of UDF III, or any alleged misrepresentation or omission on the part of UMTHLD. As already explained, to bring a claim for breach of fiduciary duty, a plaintiff must establish '(1) that a fiduciary duty existed and (2) that the defendant breached that duty.' Because Plaintiffs' opposition brief does not address the second element required to allege a breach of fiduciary duty claim, notwithstanding that it is the basis of the UDF Entity Defendants' motion to dismiss Count VI, the UDF Entity Defendants' motion to dismiss Plaintiffs' breach of fiduciary duty claim against UMTHLD is GRANTED.

Given the Court's dismissal of Count VI alleging breach of fiduciary duty against UDF III and UMTHLD, the Court GRANTS the motions to dismiss Count VII, alleging aiding and abetting breaches of fiduciary duty, by UMTS, UMTH, UMTHGS, UMTHLD, the UDF Individual Defendants, and Whitley Penn. *See McGowan v. Ferro*, 859 A.2d 1012, 1041 (Del. Ch. 2004) (dismissing aiding and abetting claim where underlying fiduciary claim was deficient as a matter of law)."

***Cohen v. Flat Stone Development Company, Inc.***, Civil Action No. 4:16-CV-00283, 2018 WL 11312998 (S.D. Tex. Oct. 5, 2018) (Although the court issued this opinion in 2018, it is included in this year's update because it did not appear in the Westlaw database until recently.).

The court concluded that limited partners stated a claim for breach of fiduciary duty and related claims against the general partner and its officer and various entities related to the officer and thus declined to dismiss those claims. Claims for defalcation and constructive fraud were dismissed as duplicative of the fiduciary duty claims, and a claim for misapplication of fiduciary property was dismissed because the court found no authority that it was recognized as a private cause of action.

This case arose out of loan and real-estate disputes between general and limited partners of three limited partnerships: Flat Stone, Ltd., Flat Stone II, Ltd., and Alabama & Dunlavy, Ltd. The parties asserted multiple claims and cross claims against one another. In this opinion, the court addressed a motion by the general partners of the limited partnerships, their officer Matthew Dilick, and various entities related to Dilick (the "Dilick parties") to dismiss claims asserted by Jay Cohen and his trusts (the "Cohen parties") against the Dilick parties.

The court first concluded that the Cohen parties alleged facts sufficient to state a claim for relief for breach of the duties of loyalty, care, and good faith and breach of fiduciary duties based on their allegations that the managing general partners and their officer Dilick breached duties owed to the limited partnerships by self-dealing, misusing funds, and mismanaging properties. In support of this conclusion the court stated:

As a general rule, "general partners owe fiduciary duties to the partnerships and the limited partners they serve." *In re Harwood*, 637 F.3d 615, 620 n.3 (5th Cir. 2011) (applying Texas law). If a party knowingly participates in the breach of a duty, he becomes a joint tortfeasor and is liable as such. *CBIF Ltd. P'ship v. TGI Friday's Inc.*, No. 05-15-00157-CV, 2017 WL 1455407, at \*16 (Tex. App.—Dallas Apr. 21, 2017, pet. denied). Additionally, an officer of a general partner who is entrusted with the management of the limited partnership and who exercises control over the limited partnership owes a duty to the partnership. *In re Harwood*, 637 F.3d at 622.

Because the court found that the Cohen parties' claims for defalcation (describing defalcation as "the failure to properly account for funds held in a fiduciary capacity") and constructive fraud (describing constructive fraud as "the breach of a legal or equitable duty that the law declares fraudulent because it violates a fiduciary relationship") were duplicative of their breach-of-fiduciary-duty claims, the court dismissed those claims. The court also dismissed a claim for misapplication of fiduciary property because the Cohen parties failed to cite, and the court failed to locate, any authority that the claim is recognized as a private cause of action under Texas law.

The court next concluded that the Cohen parties' allegations that the managing general partners and their officer Dilick had a duty to disclose information relating to certain loan and real estate transactions but failed to do so to the detriment of the limited partnerships alleged facts sufficient to state a claim for relief. In support of this conclusion, the court stated: "Failing to disclose information is fraudulent if a party has an affirmative duty to disclose, as in a confidential or fiduciary relationship. *Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 674–75 (Tex. 1998). Furthermore, statutory fraud in real estate involves the false representation of a material fact made to a party for the purpose of inducing that party to enter into a contract. Tex. Bus. & Com. Code Ann. § 27.01(a) (West Supp. 2018); *Tukua Investments, LLC v. Spenst*, 413 S.W.3d 786, 802 (Tex. App.—El Paso 2013, pet. denied)."

Because it was undisputed that the general partners and Dilick entered into valid limited partnership agreements, the court dismissed the Cohen parties' claims that were based on quasi contract/unjust enrichment and money had and received. The court cited case law for the proposition that "when a valid, express contract covers the subject matter of the parties' dispute, there can be no recovery under a quasi-contract theory."

The court concluded that the Cohen parties' allegations that the Dilick parties exercised dominion and control over certain proceeds from loans made to the limited partnerships and transferred those proceeds to the detriment of the limited partnerships alleged facts sufficient to state a claim for relief for conversion.

The court dismissed the Cohen parties' claims regarding certain ultra vires acts because the Cohen parties did not cite, and the court was unable to locate, any authority providing that ultra vires is a private cause of action under Texas law with regards to a limited partnership (as opposed to a corporation).

Finally, the court concluded that the Cohen parties had alleged facts sufficient to state a claim for relief based on the Texas Uniform Fraudulent Transfer Act, conspiracy/aiding and abetting Commission of a tort, and vicarious liability based on allegations that the Dilick parties were involved in self-dealing, misusing funds of the limited partnerships, and mismanaging properties of the limited partnerships.

#### **E. Partnership Property and Partnership Interest**

*In re Marriage of VanDusen and Kairis*, No. 10-18-00285-CV, 2020 WL 6302315 (Tex. App.—Waco Aug. 26, 2020, no pet.) (mem. op.).

The court of appeals reversed the trial court's findings that a business partnership had been created in 1995 and that real estate purchased was partnership property. The court remanded for a new trial on the issue of partnership formation and the division of any partnership property.

In 1995, Richard Kairis found a tract in Walker County that Susan VanDusen purchased near her mother. The property was purchased in VanDusen's individual name and she paid for it from her income. The property had a house on it that was in disrepair. Kairis moved in shortly after the purchase so that he could work on repairing the house and mowing the property. VanDusen continued working in Houston and would go to the property on the weekends.

In 1998, VanDusen purchased a second tract in her sole name which she sold to her mother for the same amount as the purchase price. The tract was adjacent to her mother's property. In 2002, VanDusen purchased another tract in the same area in her sole name with funds provided by VanDusen's mother. Kairis worked on the house on that property which was also in disrepair and began to work on that property as well. In 2002, Kairis also purchased some miniature pigs which were raised on the property purchased in 1995. Any profits from the sale of the pigs went into VanDusen's bank accounts and VanDusen either paid for the pigs' expenses or reimbursed Kairis for any expenses he paid. This business was never profitable and resulted in a loss which was taken fully by VanDusen as shown on her tax returns from 2003 to 2008, when they stopped selling the pigs. VanDusen's tax returns never indicated the existence of a partnership.

In 2004, Kairis assisted VanDusen's mother and sisters with selling property in another county. Kairis demanded to be paid for his assistance; thus, in 2005, he was paid either \$15,000 or \$30,000 (there was evidence as to both amounts) which VanDusen applied to the mortgage on the property purchased in 2002.

In 2006, VanDusen purchased another tract in her sole name. In 2007, VanDusen sold her residence in Houston and moved to the property purchased in 2002 while still commuting to her job in Houston. VanDusen used part of the proceeds from the sale of her residence to purchase additional property in her sole name in 2008. All of the real estate transactions were organized and executed by Kairis using a power of attorney for VanDusen.

Towards the end of 2008, the parties began raising cattle on the property, which continued until the time of their trial. While the parties were together, Kairis was responsible for procuring feed for the cattle. During this

time, Kairis paid for expenses either with cash he kept (with VanDusen's agreement) from sales or with VanDusen's debit or credit cards. Alternatively, VanDusen would reimburse him by check that he could cash.

Kairis testified that the parties intended to purchase the tracts and to pursue the farming and ranching operations jointly and equally. Kairis alleged that VanDusen told him that the property was all "community property" and that "[t]his was the partnership that we formed up and this was the partnership we lived under." VanDusen testified that she did not ever intend for a business partnership to be formed and had paid for all of the real property herself other than the one-time contribution from Kairis on the property purchased in 2002, of which she disputed the amount and character.

VanDusen and Kairis were formally married on February 22, 2009 and continued everything in the same manner after their marriage until their separation. VanDusen filed for divorce in 2017 and Kairis filed a counterpetition in which he sought a finding that the parties had become informally married in 1984, or alternatively, that the parties had entered into a business partnership. VanDusen did not file a verified denial of the existence of a partnership as required by Rule 93(5) of the Rules of Civil Procedure.

At the beginning of the bench trial, the trial court made a finding that a business partnership existed due to VanDusen's failure to file a verified denial. Nevertheless, the court required the parties to present evidence to prove when the partnership was formed, the terms of the partnership, and the existence of any partnership property. The trial court ultimately entered a judgment that the parties were not informally married but had entered into a business partnership in 1995. The court also found that the real estate purchased between 1995 and 2008 was property of the partnership.

The court of appeals began by observing that it was not asked to determine if a business partnership ever existed between the parties due to VanDusen's failure to properly deny the existence of a partnership. Instead, it was called upon to determine whether or not the evidence supported the trial court's finding that a partnership was created in 1995. The court noted that "[A]n association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name." Tex. Bus. Orgs. Code § 152.051(b)). It further explained that the Texas Business Organizations Code sets forth five factors that a court should review in determining whether a partnership exists. Tex. Bus. Orgs. Code § 152.052(a). Whether a partnership exists must be determined by an examination of the totality of the circumstances. After explaining the legal framework, the court of appeals concluded that there was legally insufficient evidence of a business partnership formed in 1995.

The court then turned to the issue of partnership property and concluded that the evidence was legally insufficient for the trial court to have found that the real property purchased between 1995 and 2008 was partnership property:

In her third and fourth issues, VanDusen complains that the evidence was legally and factually insufficient to support the trial court's finding that the real property purchased beginning in 1995 was property of the partnership pursuant to the Business Organizations Code. Section 152.102(c) of the Business Organizations Code, entitled "Classification as Partnership Property", states:

- (a) Property is partnership property if acquired in the name of:
  - (1) the partnership; or
  - (2) one or more partners, regardless of whether the name of the partnership is indicated, if the instrument transferring title to the property indicates:
    - (A) the person's capacity as a partner; or
    - (B) the existence of a partnership.
- (b) Property is presumed to be partnership property if acquired with partnership property, regardless of whether the property is acquired as provided by Subsection (a).
- (c) Property acquired in the name of one or more partners is presumed to be the partner's property, regardless of whether the property is used for partnership purposes, if the instrument transferring title to the property does not indicate the person's capacity as a partner or the existence of a partnership, and if the property is not acquired with partnership property.

(d) For purposes of this section, property is acquired in the name of the partnership by a transfer to:

- (1) the partnership in its name; or
- (2) one or more partners in the partners' capacity as partners in the partnership, if the name of the partnership is indicated in the instrument transferring title to the property.

TEX. BUS. ORGS. CODE § 152.102.

In its findings of fact, the trial court made a finding that at the time that each tract of real property was acquired, the parties intended for the real property purchased to be partnership property regardless of the source of the purchase money or in whose name the property was purchased. VanDusen complains that there was legally and factually insufficient evidence for the trial court to have made this finding.

It is undisputed that each of the tracts of real property were purchased by VanDusen individually, were titled in her name only with no reference to a partnership, and all initial payments for the property were paid by VanDusen. Kairis contends that because he presented some competing evidence that the property was partnership property, the presumption that the property was not partnership property was of no effect. VanDusen argues that the above facts conclusively establish that the property was not property of the partnership pursuant to Section 152.102 of the Business Organizations Code and that there is no presumption in the statute otherwise that applies in this circumstance. We disagree with VanDusen's assertion that no presumption applies. Section 152.102(c) uses the term "presumption" for property owned by a person that is not considered partnership property. To say that there is no presumption because she bought the property in her name and paid for it disregards what appears to be the clear intent of the statute. We find that there was a presumption that the property was not partnership property but was VanDusen's property. *See* TEX. BUS. ORGS. CODE § 152.102(c) ...

It was Kairis's burden to rebut this presumption and to prove that each of the tracts of real property were partnership property. At a minimum, the property acquired in 1995 was improperly characterized as partnership property because we have found that no partnership existed as of that time. Kairis argues that his testimony that he worked on the properties for years without compensation and that he would never have done so if he had thought that he did not own the property equally with VanDusen might be sufficient contradictory evidence to eliminate the presumption. However, there was no testimony as to the purpose for which any of the other tracts of real property were purchased at the time of their purchase, except one on which Kairis stated that VanDusen wanted to raise chickens and plant an orchard, although there was no evidence that this was for business or personal purposes or that either of these things ever took place. There was no testimony regarding a partnership business purpose for the properties by either Kairis or VanDusen given at the time of each purchase to support the trial court's finding of fact. Kairis had arranged for the purchases of each of the tracts and completed them using a power of attorney given to him by VanDusen yet he did not include a mention of a partnership on any of the deeds. All of the payments made on the property were made by VanDusen with the exception of the one-time payment in 2005 of either \$15,000 or \$30,000 from funds that were potentially attributable to Kairis that VanDusen applied to the tract of property purchased in 2002. There was no evidence that VanDusen intended for the real property to be partnership property when it was purchased. We do not find that the evidence was legally sufficient to support the trial court's findings that at the time of their purchase, the properties purchased between 2002 and 2008 were intended by both of the parties to be property of a partnership.

Thus, the court remanded for a new trial on the issue of the formation of a partnership and related issues.

## **F. Interpretation and Enforcement of Partnership Agreement**

### **1. Contractual Modification of Fiduciary Duties**

*VTX Communications, LLC v. AT&T, Inc.*, Civ. A. No. 7:19-cv-00269, 2020 WL 4465968 (S.D. Tex. Aug. 4, 2020).

The court granted in part and denied in part defendants' motion to dismiss on breach of fiduciary duty and other claims. The court concluded that claims for breach of the duty of loyalty against the general partner and controllers of the general partner were successfully pled with respect to one of the three limited partnerships, but the other two limited partnerships had agreements that displaced fiduciary duties.

Certain limited partners of three limited partnerships that provided AT&T-branded wireless service in South Texas sued the partnerships' common general partner and affiliated entities. The general partner, New Cingular Wireless/AT&T Mobility, operated the three limited partnerships which had exclusive authority to provide cell service in the partnerships' respective service areas.

Plaintiffs alleged that defendants had been using the networks and wireless spectrums with disregard for the defendants' duties to the plaintiffs, specifically by defendants' operation of a Cricket Wireless network without proper compensation to the three limited partnerships, and thus to the detriment of the plaintiff limited partners. Plaintiffs brought causes of action for breach of fiduciary duty, breach of the partnership agreements, tortious interference, conversion/civil theft, aiding and abetting, and fraud.

After a lengthy analysis, the court held that Delaware law applied to all of plaintiffs' claims consistent with the choice-of-law provision in the three limited partnership agreements. The court then considered defendants' motion to dismiss the breach of fiduciary duty claims against the general partner. Defendants argued that the partnership agreements at issue eliminated the traditional fiduciary duties and imposed contractual duties instead. The court noted, however, that any restrictions on fiduciary duties must be set forth clearly and unambiguously. After a review of the partnership agreements, the court found that none of the provisions explicitly modified fiduciary duties in precise terms. However, fiduciary standards may be displaced by sole discretion or good faith standards if the contract provides that all relevant judgments are displaced by the contractual standard. After further analysis, the court found that Section 7.5 of the partnership agreement, which addressed conflicting duties and transactions among affiliates, did displace fiduciary duties:

Section 7.5 states:

The General Partner and its Affiliates shall have the right to contract or otherwise deal with the Partnership for the sale or lease of real or personal property, the rendition of services and other purposes, and to receive payments and fees from the Partnership in connection therewith, provided that the terms and conditions of such transactions are comparable to, or not substantially less favorable than, similar arms'-length transactions between the General Partner or its Affiliate and unrelated third parties. The Partners recognize that the General Partner may have conflicting duties to its many Affiliates including without limitation in transactions between two of its Affiliates. In the absence of gross negligence or willful misconduct, the General Partner's resolution of such conflict of interest shall not constitute a breach of this Agreement or any other agreement contemplated herein. Nothing herein shall be construed to require the execution of written contracts in connection with management and operating services provided by the General Partner as contemplated in Sections 4.1 and 4.2. ...

The Court holds that section 7.5 does displace fiduciary duties. Section 7.5 specifically addresses "conflicting duties" and contains the "fair price" prong of the entire fairness standard, requiring transactions to be "comparable to, or not substantially less favorable than, similar arms'-length transactions." Section 7.5 then provides that, even though the parties are aware of conflicting interests in self-dealing transactions, they resolve that, "[i]n the absence of gross negligence or willful misconduct, the General Partner's resolution of such conflict of interest shall not constitute a breach." Therefore, "the Partnership Agreement, and not default rules of fiduciary duty, control." The "language cited...does in fact reduce the general partner's duties from a fiduciary duty to merely a duty of good faith," that is, to not act with gross negligence or willful misconduct. This

conclusion is consistent with the general partner's expectations under the agreements: even if a questioned transaction did not meet the "entire fairness standard," the transaction would be permissible under the partnership agreements so long as it was not accomplished by the general partner's gross negligence or willful misconduct and provided the transaction was consistent with all other applicable language, such as being not substantially less favorable than an arms'-length transaction. The provision is enforceable, because it limits the general partner's "fiduciary duties with regard to an interested transaction with the company to a duty to negotiate the transaction on arms' length terms, instead of imposing a duty to assure that the transaction would be entirely fair" to the limited partners.

Only two of the three limited partnership agreements included Section 7.5 or its like, so the court granted the motion to dismiss with respect to the plaintiffs' claims against the general partner only for those two limited partnerships.

## **2. Transfer of Partner's Interest, Admission of Partner**

*Cohen v. Flat Stone Development Company, Inc.*, Civil Action No. 4:16-CV-00283, 2018 WL 11312999 (S.D. Tex. Oct. 5, 2018) (Although the court issued this opinion in 2018, it is included in this year's update because it did not appear in the Westlaw database until recently.).

A limited partner transferred his interests in limited partnerships to trusts that did not become substituted limited partners, and the transferor limited partner thus remained a limited partner and had standing to assert derivative claims on behalf of the partnerships, but he did not meet the statutory pleading requirements to assert the claims. The assignee trusts did not have standing to assert derivative claims.

This case arose out of loan and real-estate disputes between general and limited partners of three limited partnerships: Flat Stone, Ltd. ("Flat Stone I"), Flat Stone II, Ltd. ("Flat Stone II"), and Alabama & Dunlavy, Ltd. ("A&D"). Flat Stone I was a Texas limited partnership formed by general partner Flat Stone Development Company, Inc. and limited partners Jay Cohen and Howard Hebert. Flat Stone II was a Texas limited partnership formed by general partner Flat Stone II of Texas, Inc. and limited partners Jay Cohen and Flat Stone II of Texas, Inc. A&D was a Texas limited partnership formed by general partner Commerce Equities II, LLC and limited partners JHC Trust II, Matthew Dilick, and Rocky Hollow Development Corporation. JHC Trust I and JHC Trust II were revocable trusts formed by Jay Cohen as grantor and Clifton Hebert as trustee. The trust agreements effectuated the transfer of Jay Cohen's limited partnership interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, and named Cohen as beneficiary of the trusts.

The limited partnership agreements of Flat Stone I, Flat Stone II, and A&D contained identical provisions regarding the transfer of limited partnership interests and the admission of assignees as limited partners. The agreement permitted a limited partner to transfer all or any of its interest in the limited partnership to "the trustee of a trust created for the benefit of [the] Limited Partner." After such a transfer, the "transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied." The agreements specified the requirements for "a transferee of an interest in the Partnership" to "be admitted to the Partnership as a substituted Limited Partner," including the execution of necessary documents, contribution of capital, and consent from all partners.

In this opinion, the court addressed the defendants' motion to dismiss claims brought by Cohen and his trusts for breach of duties owed to the limited partnerships. The court reviewed the requirements for bringing a derivative suit under Federal Rule 23.1 and the Texas Business Organizations Code. In addition to verifying the complaint, pleading that the plaintiff was a member of the corporation or association at the time of the transaction complained of, and explaining any effort by the plaintiff to urge the association to assert the claims as required by Rule 23.1, the court set forth the requirements at the time under Chapter 153 of the Texas Business Organizations Code. Under those provisions, a limited partner was permitted to bring a derivative action on behalf of the limited partnership if "(1) all general partners with authority to bring the action have refused to bring the action; or (2) an effort to cause those general partners to bring the action is not likely to succeed." Tex. Bus. Orgs. Code § 153.401. The plaintiff was required to be a limited partner when the action is brought and must have been a limited partner at the time of the transaction that was the subject of the action. Tex. Bus. Orgs. Code § 153.402. Additionally, the court cited case law in support of the proposition that the limited partner must maintain its status.

With regard to who was a limited partner and who was an assignee and the rights of such, the court relied on Chapter 153 of the Texas Business Organizations Code and the limited partnership agreements. An assignee of a partnership interest may become a limited partner to the extent that the partnership agreement provides. Tex. Bus. Orgs. Code § 153.253. Although Cohen transferred his interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, the limited partnership agreements governing both limited partnerships provided that Cohen retained his status as limited partner, stating that the “transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied.” The court located no evidence indicating that JHC Trust I or JHC Trust II as transferees met the requirements to become substituted limited partners, nor did the court locate any evidence indicating that JHC Trust II lost its status as limited partner of A&D. Therefore, only Cohen had standing as a limited partner to bring derivative claims on behalf of Flat Stone I and Flat Stone II, and only JHC Trust II had standing as a limited partner to bring derivative claims on behalf of A&D. The derivative claims asserted by the trusts as assignees were dismissed. Cohen and JHC Trust II had standing in their capacity as limited partners of the Flat Stone partnerships and A&D, respectively, to bring their derivative claims, but they failed to meet the verification requirement. Further, it was unclear whether they had satisfied an order requiring security (which had been entered under Tex. Bus. Orgs. Code § 153.404(a)). Thus, the court entered an order providing that these requirements must be met in order to avoid dismissal of their derivative claims.

### **3. Redemption/Buyout of Partner’s Interest**

*Green v. Tow (In re Garrison Municipal Partners, LP)*, Civil Action No. H-17-3567, Bankruptcy No. 14-32867, 2021 WL 1398971 (S.D. Tex. Mar. 17, 2021).

The court held that a claim by a withdrawn limited partner against the partnership for payment of the amount owed for the partner’s interest under the terms of the partnership agreement resembled a redemption and should not have been subordinated under Section 510(b) of the Bankruptcy Code.

Green was a limited partner in a limited partnership whose partnership agreement provided that a limited partner could voluntarily withdraw his interest at the end of each fiscal quarter. Green gave written notice of his intent to withdraw effective December 31, 2013. In May of 2014, the partnership filed for Chapter 7 bankruptcy. Green filed a claim for a general unsecured debt, and the bankruptcy court subordinated the claim under Section 510(b) of the Bankruptcy Code, which provides:

A claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security.

The position of the trustee and the bankruptcy court was that the claim was merely a breach of contract claim because the partnership violated the limited partnership agreement by not paying the withdrawal request on time, and the claim was not independent of the equity interest because it arose from the purchase of the security interest. Further, the trustee and the bankruptcy court took the position that the claim could not be a redemption because a redemption would require either that the debtor take action, such as issuing a promissory note, or that the provision be self-executing.

The district court held that Green’s claim most closely resembled a redemption claim, reasoning that once the deadline to pay Green had passed, what was originally an equity interest became a fixed debt. According to the court, the debt interest was sufficiently separate from the original limited partnership interest because Green no longer had the benefit of the equity interest in that he no longer had any right to the income, gains, and losses of the partnership. Green could only claim the fixed amount he should have been paid. The amount of his debt became fixed at the time of withdrawal and could no longer change in value like an equity interest would. The court found it irrelevant that a separate promissory note was not issued by the partnership. The withdrawal provision was self-executing, and the liability became fixed after the deadline to pay it passed. The partnership only had discretion as to how and by what means that liability could be paid. The court commented further that Green and the partnership “went through the trouble when creating the partnership agreement to design it as more than just a

simple cash loan—to the benefit of all parties. Allowing [the partnership] unilaterally to change the functioning of the agreement years later goes against common business sense.”

In sum, because Green’s claim had converted from an equity interest to a fixed debt interest, the bankruptcy court erred in subordinating the claim under 11 U.S.C. § 510(b).

*TSA-Texas Surgical Associates, L.L.P. v. Vargas*, No. 14-19-00135-CV, 2021 WL 729862 (Tex. App.—Houston [14th Dist.] Feb. 25, 2021, no pet. h.) (mem. op.).

The court of appeals held that a dispute among partners over the buyout of the interest of one of the partners in a medical partnership was purely a matter of private contract and did not involve the provision of medical services so as to involve a matter of public concern within the scope of the Texas Citizens Participation Act.

Dr. Vargas was a thoracic surgeon and partner in the cardiovascular surgery group TSA-Texas Surgical Associates, L.L.P. (“TSA”). Vargas suffered an injury that left him unable to continue practicing medicine so he notified TSA that he intended to retire. The other partners presented Vargas with an offer to buy out his partnership interest, but Vargas rejected the offer based on his assessment that the offer was for substantially less than the fair market value of his interest and was not calculated in accordance with the partnership agreement. Vargas alleged that the attorney for the other partners threatened to squeeze him out. He also alleged that a redemption agreement that was executed by one of the other partners “as a managing partner and ... allegedly as power of attorney for ... Vargas” was ineffective and contained false statements about Vargas’s retirement date and TSA’s actions after Vargas announced his intent to retire.

Vargas sued TSA and the other partners seeking damages and other relief based on breach of contract, breach of fiduciary duty, conversion, conspiracy, money had and received, reformation of the redemption agreement, and declaratory judgment. TSA and the other partners moved to dismiss the lawsuit under the Texas Citizens Participation Act (TCPA). The trial court denied the motion, and this interlocutory appeal followed.

The court of appeals explained that the TCPA was enacted “to encourage and safeguard the constitutional rights of persons to petition, speak freely, associate freely, and otherwise participate in government to the maximum extent permitted by law and, at the same time, protect the rights of a person to file meritorious lawsuits for demonstrable injury.” Tex. Civ. Prac. & Rem. Code § 27.002. It does so by authorizing a party to file a motion to dismiss a legal action that “is based on, relates to, or is in response to a party’s exercise of the right of free speech, right to petition, or right of association.” *Id.* § 27.003. If the movant satisfies its initial burden to establish by a preponderance of the evidence that the action is based on the movant’s right of free speech, right to petition, or right of association, then the burden shifts to the nonmovant to establish by clear and specific evidence a prima facie case for each essential element of the claim in question. If the nonmovant does so, then the burden shifts back to the movant to establish by a preponderance of the evidence each essential element of a valid defense. *Id.* § 27.005.

Relying on the Texas Supreme Court’s recognition that the provision of medical services by a health care professional constitutes a matter of public concern, the appellants in this case argued that they met their initial burden to establish by a preponderance of the evidence that Vargas’s claims were based on, related to, or in response to the exercise of free speech because the claims purportedly involved communications regarding the provision of medical services. The court of appeals rejected this argument, stating that the matters in this case were not a matter of public concern but rather involved “a private contract dispute affecting only the fortunes of the partners.” According to the court, “The alleged representations were made to a limited business audience concerning a business dispute among the partners related to Vargas’s withdrawal from the partnership. Because the statements are not relevant to a wider audience of potential patients, the statements were not made ‘in connection with a matter of public concern.’”

The court next addressed whether the appellants met their initial burden to establish by a preponderance of the evidence that Vargas’s claims were based on, related to, or in response to the exercise of the right of association. The exercise of the right of association was defined in the version of the TCPA applicable to this case as “a communication between individuals who join together to collectively express, promote, pursue, or defend common interests.” The court had previously defined the word “common” in the TCPA to mean “of or relating to a community at large: public.” The court stated that the only communications at issue in Vargas’s claims were based on his allegations that the appellants (1) breached the partnership agreement and breached their fiduciary duties by making false statements and denying Vargas access to records, (2) wrongfully assumed and exercised control over Vargas’s partnership interest, (3) sought to deprive Vargas of his partnership interest, and (4) attempted to fraudulently induce Vargas to surrender his interest in the venture for less than its value. The court characterized



these communications as being related to disagreements about Vargas's withdrawal from the partnership and thus as relating to a private transaction between private parties rather than a matter of "common interest." Thus, the court concluded that the communications did not constitute an exercise of the right of association protected by the TCPA.

#### 4. Forum Selection

*Ryan v. Buckeye Partners, L.P.*, Civ. A. No. 4:19-CV-2645, 2020 WL 6140416 (S.D. Tex. July 17, 2020).

"Notably, through Amendment No. 5, a forum selection clause was added to the Partnership Agreement on December 13, 2017. Relevant to this dispute, the clause provides that each holder of limited partner units

irrevocably agrees that any claims, suits, actions or proceedings (A) arising out of or relating in any way to this Agreement (including any claims, suits or actions to interpret, apply or enforce the provisions of this Agreement or the duties, obligations or liabilities among Partners or of Partners to the Partnership, or the rights or powers of, or restrictions on, the Partners or the Partnership), (B) brought in a derivative manner on behalf of the Partnership, (C) asserting a claim of breach of a fiduciary or other duty owed by any director, officer, or other employee of the Partnership or the General Partner, or owed by the General Partner, to the Partnership or the Partners, (D) asserting a claim arising pursuant to any provision of the Delaware Act or (E) asserting a claim governed by the internal affairs doctrine shall be exclusively brought in the Court of Chancery of the State of Delaware (or, if such court does not have subject matter jurisdiction thereof, any other court located in the State of Delaware with subject matter jurisdiction), in each case regardless of whether such claims, suits, actions or proceedings sound in contract, tort, fraud or otherwise, are based on common law, statutory, equitable, legal or other grounds, or are derivative or direct claims.

Defendants argue that because Plaintiff's breach of the Partnership Agreement claim and breach of fiduciary claim against Defendants fall under subsections (A) and (C) of the forum selection clause, respectively, those claims must be brought in Delaware.

'[A] forum selection clause is prima facie valid and should be enforced unless the resisting party shows that enforcement would be unreasonable.' Here, Plaintiff does not contest enforceability of the forum selection clause on unreasonableness grounds. *Haynsworth [v. The Corp.]*, 121 F.3d 956, 963 (5th Cir. 1997)] (holding that unreasonableness could exist (1) if incorporation of clause was product of fraud, (2) party escaping enforcement would be deprived of its day in court, (3) chosen law would deprive resisting party of a remedy, or (4) enforcement of clause would contravene a strong public policy of forum state). Nor does Plaintiff argue that public interest considerations weigh in favor of denying transfer of this case to Delaware.

Instead, Plaintiff argues that the Court should deny the Motion to Transfer because Defendants have effectively rescinded the forum selection clause. In support, Plaintiff points to stipulations between Defendants and third parties and argues that those stipulations evince a choice and agreement by Defendants 'to have all the [m]erger-related claims heard here, in the Southern District of Texas, where Buckeye is headquartered.' However, as Plaintiff concedes, those stipulations concern other claimants represented by different counsel who also filed putative class action suits but did not assert claims implicating the forum selection clause in the Partnership Agreement. In short, nothing before the Court indicates that Defendants and Plaintiff effectively agreed to rescind the clause selecting Delaware as the forum state for any claims arising from the Partnership Agreement. Accordingly, because the forum selection clause controls, the Court grants the Motion.

For the foregoing reasons, the Motion to Transfer is GRANTED. Though the Court could sever Plaintiff's state law claims from his federal law claims, in the interest of judicial economy and efficiency, this action in its entirety is hereby TRANSFERRED to the United States District Court for the District of Delaware."

## 5. Arbitration

*Sanchez v. Doctor's Hospital at Renaissance, Ltd.*, No. 13-19-00365-CV, 2021 WL 266614 (Tex. App.—Corpus Christi-Edinburg Jan. 21, 2021, no pet. h.) (mem. op.).

The court held that the arbitration clause in a limited partnership agreement did not provide for expanded judicial review.

When the prevailing limited partnership sought confirmation of an arbitration award against a limited partner whose interest was repurchased by the partnership, the limited partner argued that the parties had agreed to expanded judicial review of the panel's award. The arbitration clause in the partnership agreement provided:

The arbitrator(s) shall apply the internal laws of the State of Texas (without regard to conflict of law rules) in determining the substance of the dispute, controversy or claim and shall decide the same in accordance with the applicable usages and terms of the trade.... The arbitrator(s)' award shall be in writing and shall set forth the findings and conclusions upon which the arbitrator(s) based the award.

This provision was in addition to a choice of law provision in the agreement and a provision requiring the panel to set forth its award in writing with findings and conclusions on which the award was based.

Under the Texas Arbitration Act, the parties must have a clear agreement if they want to change the default standard of restricted judicial review. The court concluded that the language in this case did not constitute a "clear agreement" to limit the arbitrators' authority and expand the scope of judicial review. Applying restricted review, the court decides only whether the panel decided matters not before them rather than whether it decided matters before them correctly. Applying this restricted standard, the court concluded that the panel did not exceed its authority in determining the claims and defenses set forth by the parties and in awarding attorney's fees.

### G. Ultra Vires

*Cohen v. NewBiss Prop., L.P.*, No. 01-19-00397-CV, 2020 WL 6878414 (Tex. App.—Houston [1st Dist.] Nov. 24, 2020, no pet. h.) (mem. op.).

The court of appeals affirmed a summary judgment that rejected an ultra vires claim in the limited partnership setting. The court concluded that an ultra vires action does not exist for partnerships:

Citing *Campbell v. Walker*, No. 14-96-01425-CV, 2000 WL 19143 (Tex. App.—Houston [14th Dist.] Jan. 13, 2000, no pet.) (mem. op., not designated for publication), Cohen argues that "[a]n ultra vires action is an act that is beyond the scope of the powers of the corporation as defined by its charter or the laws of the state of incorporation." Cohen further contends that Dilick acted ultra vires because "[t]he Limited Partnership Agreements do not permit the general partner to use Limited Partnership assets as collateral for an individual loan to be used for non-partnership business."

In their Motion for Traditional Summary Judgment, and again on appeal, the purchasers contend that the "ultra-vires doctrine is not applicable to limited partnerships under Texas law." We agree. The case relied upon by Cohen, *Campbell v. Walker*, specifically refers to "the powers of the corporation[.]" The Texas Business Organizations Code specifically provides a cause of action for certain ultra vires acts by corporations. *See* TEX. BUS. ORGS. CODE § 20.002. No such cause of action exists for partnerships. *See* TEX. BUS. ORGS. CODE §§ 151.001-154.204.

Because the purchasers conclusively negated an element of Cohen's ultra vires claim, i.e., an act beyond the scope of powers of a *corporation*, the trial court properly granted traditional summary judgment on this claim.

## H. Dissolution/Winding Up

*Boucher v. Thacker*, 609 S.W.3d 206 (Tex. App.—Texarkana 2020, no pet.).

The court of appeals affirmed the trial court’s judgment that denied one partner’s (Boucher’s) claims for breach of contract, breach of fiduciary duty, and conversion against the other partner (Thacker) as they dissolved their business.

Boucher and Thacker were partners in Sinclair & Wright Architects. (The firm was actually a professional limited liability company, but the court and the parties applied partnership law to the dispute.) The partnership was not doing well, and the partners had begun to discuss dissolution. On February 16, 2015, Boucher provided to Thacker written notice of his intent to retire from the partnership as of February 20, 2015. In response to this notice, Thacker withdrew from the partnership on February 17, 2015.

Thacker sued Boucher for breach of the partnership agreement (the “Agreement”), breach of fiduciary duty in winding up the firm’s business, and several violations of partner obligations listed in Chapter 152 of the Texas Business Organizations Code. Among other claims, Thacker alleged that Boucher breached the Agreement by abandoning the firm at the time of dissolution and by failing to pay his share of the firm’s debts. Thacker alleged that Boucher’s actions resulted in payment of unnecessary interest on loans.

Boucher filed a counterclaim against Thacker for breach of the Agreement, breach of fiduciary duty, and conversion. Among other complaints, Boucher alleged that Thacker breached a noncompetition provision in the Agreement by continuing to operate the firm under a new business name and by failing to pay the value of Boucher’s ownership interest. Boucher claimed that he was owed \$306,728.33 for his retirement and attorney’s fees.

The trial court rendered judgment for Thacker. Among other determinations, the trial court concluded that (1) Boucher breached the Agreement in general, (2) Boucher breached the Agreement by not paying his part of the debts in violation of Section 152.202 of the Texas Business Organizations Code, (3) Boucher did not participate in winding down the business in violation of the Agreement and Section 152.205 of the Texas Business Organizations Code, (4) Boucher did not honor his fiduciary duty in winding down the firm, which violated Section 152.204 of the Texas Business Organizations Code, (5) there was no breach of fiduciary duty on Thacker’s part, (6) Boucher presented no credible evidence that Thacker owed \$306,728.00, (7) there was no evidence of conversion of assets by Thacker, (8) under Section 152.502 of the Texas Business Organizations Code, withdrawal of a partner occurs when an existing partner ceases to be a partner, (9) a partner may withdraw during winding down under Section 152.503 of the Texas Business Organizations Code, (10) the right to withdraw cannot be limited under Section 152.002 of the Texas Business Organizations Code, (11) after Thacker’s withdrawal on February 17, 2015, there was no partnership under Section 152.051 of the Texas Business Organizations Code, and (12) Thacker is entitled to the full amount of requested attorney’s fees.

Boucher argued that the evidence was factually insufficient to support the rejection of his claims against Thacker. The court of appeals disagreed:

Although Boucher timely filed a document requesting additional findings of fact and conclusions of law, Boucher did not specifically challenge any of the factual findings entered by the trial court. Rather, Boucher submitted forty additional findings of fact, several of which are slight variations of the trial court’s original findings. Moreover, “nothing in [Boucher’s] request for additional findings alerted the trial court that it had omitted ... essential elements in its original findings.” “A request for additional findings must be specific; it cannot be buried among minute differentiations or numerous unnecessary requests.”

Additionally, on appeal, Boucher does not challenge specific findings of fact. Instead, he challenges the trial court’s general conclusions rejecting his claim that Thacker breached the Agreement, converted Firm assets for his own benefit, and erred in failing to award Boucher attorney fees for breach of contract.

We find that there was evidence supporting the trial court’s unchallenged factual findings that the Firm was dissolved before Boucher’s notice of retirement and that Thacker withdrew before the effective date of Boucher’s retirement. In turn, these factual findings supported the trial court’s conclusions that Thacker did not breach the Agreement or any fiduciary duty owed to

Boucher, that Thacker did not convert assets from Boucher, and that Boucher was not entitled to retirement or the value of his interest in the Firm or attorney fees.

Because there was evidence supporting the trial court's unchallenged findings, the court of appeals concluded that the trial court did not err in determining that Boucher was not entitled to retirement, the value of his interest in the firm, or attorney's fees.

The court of appeals did, however, reverse the award of attorney's fees to Thacker. Although Thacker prevailed on his breach of contract claim against Boucher, the trial court did not award any damages for breach of the Agreement. The court of appeals noted that "[t]o recover fees under section 38.001, a party must prevail on a cause of action for which attorney's fees are recoverable, and ... recover damages," and it observed that "[a] finding that a defendant breached a contract without recovery of damages generally precludes an award of attorney fees." Because Thacker did not recover damages and no contractual provision provided for attorney's fees to a prevailing party, the court of appeals concluded that Thacker was not entitled to an attorney's fee award.

### **I. Creditor's Remedies: Charging Order**

*In re M.W.M.*, No. 05-19-00757-CV, 2020 WL 6054337 (Tex. App.—Dallas Oct. 14, 2020, no pet.) (mem. op.).

The court of appeals affirmed the trial court's granting of a charging order on various grounds, including that it did not reach entities in which Father had no ownership interest and it did not result in a garnishment of Father's wages.

Following Father and Mother's 2010 divorce, Mother obtained two judgments against Father relating to his obligations under the divorce decree, but Father made no payment on those judgments. Upon Mother's application, the trial court signed an order that "charged" Father's interest in certain entities with Mother's judgments and ordered those entities not to pay Father any money or "expend any money for [his] personal benefit" until the judgments were paid.

The "Application for Charging Order" asserted that Father "ha[d] a position of authority in each of the following business organizations": Driskill Energy Partners, LP; Michael W. Mitchell Family LP; Mitchell Energy Partners, LLC; Mitchell Energy Advisors, LLC; and M2 Investment Properties, LLC (collectively, the Mitchell Entities). Father filed a response stating that he held an ownership interest in Michael W. Mitchell Family LP, but "does not have any interest in any of" the other four entities listed in the application (collectively, the four disputed entities). He contended that there is "no basis to impose a charging order" on any of the four disputed entities.

After a hearing, the trial court signed the complained-of order, which was titled "Charging Order" and described the Mitchell Entities as "business organizations owned, operated, or controlled by [Father]." The order provided that (1) "the interest of [Father] in any and all of the Mitchell Entities is hereby subjected to a charging order in favor of and for the benefit of [Mother]"; (2) "[a]ny money due or to become due to [Father] by reason of his interest in the partnership shall be paid directly to [Mother]"; and (3) "none of the Mitchell Entities shall (a) pay any money to [Father], (b) pay any personal living expenses of [Father], or (c) expend any money for [Father's] personal benefit, so long as any portion of this Court's [judgments] remains unpaid."

The four disputed entities filed a "Motion to Modify Charging Order," asserting that "[b]ecause the Business Organizations Code does not entitle a judgment creditor to a charging order over entities for which the judgment debtor merely works, whether in a position of authority or not, the Non-Owned Entities respectfully request that the Court modify the Charging Order so that it only affects Michael W. Mitchell Family, LP—the only entity in which [Father] holds a membership interest." The motion to modify cited Texas Business Organizations Code sections 101.112 (charging orders regarding limited liability companies) and 153.256 (charging orders regarding limited partnerships). In a declaration attached to the motion, Father stated that "[a]lthough I may hold manager or director positions in [the four disputed entities], I do not hold direct partnership, membership, or shareholder interests in any of those entities." After a hearing, the trial court denied the motion to modify.

On appeal, Father argued that the trial court "erred when it subjected [the four disputed entities] to a charging order." Father asserted (1) there is no evidence that Father holds an ownership interest in the four disputed entities; (2) the order "is void and must be vacated" because it "exceeded the court's statutory authority" under the Texas Business Organizations Code; and (3) the order "interferes with [Father's] interest in his current wages and, therefore, violates the Texas Constitution." The court of appeals rejected all of these challenges:

We begin with appellants' complaint regarding lack of evidence that Father holds an "ownership interest" in the four disputed entities. According to appellants, "[t]he threshold requirement for a charging order is that the debtor must have an ownership interest in the entity on which the charging order is imposed," and "[a]bsent such an ownership interest," it was "improper" for the trial court to "impose a charging order." But the complained-of order's qualifying language charges only "the interest of [Father] in any and all of the Mitchell Entities." Pursuant to the order's qualifying provision, if Father owns no interest in a particular entity, the trial court's order charges nothing as to that entity. Nothing in the charging statutes specifically prohibits such application. *See* TEX. BUS. ORGS. CODE §§ 101.112, 153.256. Because the order does not purport to charge an interest in entities in which Father has no ownership interest, we conclude the complained-of lack of evidence of ownership interest in the four disputed entities is immaterial.

In their second subpart, appellants contend the complained-of order "exceeded the court's statutory authority" and is "void" because "[a]lthough the Business Organizations Code gives judgment creditors a lien on any distributions made to a debtor on account of the debtor's ownership interest in an entity, the trial court's order in this case far oversteps that limitation." This voidness argument was not asserted in the trial court.

Even assuming without deciding this complaint can be raised on appeal, the business organizations code was not the trial court's sole means to enforce its judgments. Appellants state in their opening appellate brief that the trial court's order "not only places a lien on any distributions that [Father] would be entitled to receive (assuming that he had an ownership interest in the Non-Owned Entities)," but also "acts as an injunction" in that it "purports to preclude the entities from paying [Father]" as a non-owner. Injunctive relief is an available means to enforce a judgment. Though Mother's application did not use the word "injunction," her requested relief included enjoining payments to Father or payment of his living expenses by the Mitchell Entities, and the trial court granted that requested relief. To the extent appellants argue the trial court lacked "authority" to do so, we disagree.

We also reject appellants' contention in their third subpart that the trial court's order violates the Texas Constitution's garnishment provision. That provision states, "No current wages for personal service shall ever be subject to garnishment, except for the enforcement of court-ordered: (1) child support payments; or (2) spousal maintenance." TEX. CONST. art. 16, § 28. According to appellants, the "practical effect" of the complained-of order "is to preclude [Father] from receiving any compensation from any of the Non-Owned Entities, in any form whatsoever," and "[t]his implicates the exact concern the Texas Constitution addresses."

Appellants rely on *McLendon v. Mandel*, No. 05-96-00160-CV, 1996 WL 403974 (Tex. App.—Dallas July 9, 1996, no writ) (not designated for publication). In that case, several creditors of debtor Gordon B. McLendon, Jr. sought "an injunction against [debtor] from taking any further money or property" from three specified entities in which he held interests. The trial court signed an order enjoining the debtor "from receiving or taking any money or property" from those entities "by loans, bonuses, wages, distributions or in any other form or manner until further order of the Court."

The debtor appealed, asserting in part that "to the extent [the injunction] prevents him from receiving current wages," "that portion of the injunction constitutes an unconstitutional garnishment of his wages." This Court disagreed, stating "the injunction does not violate article XVI, section 28 of the Texas Constitution" because "[t]he injunction does not place McLendon's current wages in the hands of a third party or take them from a third party." [This Court then considered and agreed with Mr. McLendon's argument that the injunction constituted a "seizure" of his wages precluded under Texas Property Code section 42.001(b). To the extent appellants' reliance on *McLendon* is based on that portion of the ruling, they did not assert any property code violation in the trial court or in their opening appellate brief. They cite property code section 42.001(b) for the first time in their appellate reply brief and thus present no property code violation for our review.]

Here, as in *McLendon*, nothing in the trial court’s order places any wages of Father in “the hands of a third party” or “take[s] them from a third party.” Thus, we disagree with appellants’ position that the complained-of order violates the Texas Constitution’s garnishment provision and affirm the trial court’s order.

#### **J. Attorney’s Fees**

***Bierscheid v. JPMorgan Chase Bank***, 606 S.W.3d 493 (Tex. App.—Houston [1st Dist.] 2020, pet. filed).

“The Working Interest Owners argue that because the Japhets cannot recover damages on their claims for breach of the 1919 Assignment they cannot recover attorney’s fees. They further argue that the declaratory relief sought by the Japhets ‘merely duplicated issues already before the trial court’ and were ‘recast’ contract claims. They argue that the Japhets cannot use the Declaratory Judgments Act ‘merely as a vehicle to recover attorney’s fees.’ The Texas Supreme Court has held that ‘a party cannot use the [Declaratory Judgments] Act as a vehicle to obtain otherwise impermissible attorney’s fees.’ See *MBM Fin. Corp. v. Woodlands Operating Co., L.P.*, 292 S.W.3d 660, 669–70 (Tex. 2009) (holding, in case in which party did not recover damages on its breach of contract claim, and therefore could not recover attorney’s fees under Chapter 38, party could not use Chapter 37 and ‘a claim for declaratory relief [that] is merely tacked onto a standard suit based on a matured breach of contract’). We disagree with the Working Interest Owners that the Japhets merely ‘recast’ or ‘tacked on’ their requests for declaratory relief to their breach of contract action, such that the Japhets were using the Declaratory Judgments Act to recover attorney’s fees that they could not recover on their breach of contract claims.

First, as we have held above, the Japhets were entitled to, and did, recover money damages on their breach of contract claim. This is, therefore, not a situation in which the Japhets were not entitled to any award of attorney’s fees under Chapter 38 and therefore used the Declaratory Judgments Act as a method to recover attorney’s fees to which they were otherwise not entitled. The Japhets, as prevailing parties, are entitled to attorney’s fees under Chapter 38 for their breach of contract claim. Furthermore, while the Japhets sought declarations that they owned the Net Profits Interest and that the 1919 Assignment was binding on the Working Interest Owners, declarations relevant to their breach of contract claims, they also sought, and obtained, additional declarations ....

The Japhets’ declaratory relief claims were more than ‘recast’ contract claims, and we agree with the Japhets that they did not seek recovery of attorney’s fees under the Declaratory Judgments Act simply because they could not obtain attorney’s fees on any other basis. Because the Japhets obtained an award of damages and declaratory relief, they are entitled to attorney’s fees under both section 38.001 and 37.009, and the trial court did not err in awarding attorney’s fees to the Japhets. See TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (providing that plaintiff may recover reasonable attorney’s fees, in addition to amount of valid claim, if claim is for oral or written contract); *id.* § 37.009 (providing that, in proceeding under Declaratory Judgments Act, court may award reasonable and necessary attorney’s fees as are equitable and just).

[While section 38.001 has, as the Working Interest Owners contend, been interpreted to bar the recovery of attorney’s fees from limited liability companies and limited partnerships, section 37.009 of the Declaratory Judgments Act contains no such restriction. See *Choice! Power, L.P. v. Feeley*, 501 S.W.3d 199, 214 (Tex. App.—Houston [1st Dist.] 2016, no pet.) (holding that section 38.001 does not permit recovery of attorney’s fees from limited partnerships); *Alta Mesa Holdings, L.P. v. Ives*, 488 S.W.3d 438, 452–55 (Tex. App.—Houston [14th Dist.] 2016, pet. denied) (holding that section 38.001 does not permit recovery of attorney’s fees from limited liability company).]”

***MRI Pioneer and Colorado Inv. Fund, LP v. Pyatt***, No. 05-18-01399-CV, 2020 WL 4013147 (Tex. App.—Dallas July 16, 2020, pet. denied) (mem. op.).

“On the record before us, we conclude that MRI failed to demonstrate there is no evidence to support the trial court’s finding that it retained Pyatt’s security deposit in bad faith. We likewise conclude that MRI failed to demonstrate that its billed charges were reasonable. See TEX. PROP. CODE § 93.011(c) (requiring a landlord to prove ‘the retention of any portion of the security deposit was reasonable’)....

The trial court’s judgment awarded attorney’s fees ‘pursuant to either Chapter 38 of the Texas Civil Practice and Remedies Code or Section 93.011 of the Texas Property Code.’ MRI contends that the trial court could not award attorney’s fees under Chapter 38 of the civil practice and remedies code because MRI is not an individual or corporation and there was no evidence of a presentment. MRI argues that section 38.001 restricts recovery of

‘reasonable attorney’s fees from an individual or corporation’ and that ‘Appellant is a Texas limited partnership.’ See TEX. CIV. PRAC. & REM. CODE § 38.001. We agree .... Our conclusion does not affect our judgment, however, because, as discussed above, the evidence was legally and factually sufficient to support the trial court’s award under section 93.011 of the property code.”

*Accresa Health LLC v. Hint Health Inc.*, Civ. A. No. 4:18-cv-00536, 2020 WL 4644459 (E.D. Tex. Mar. 19, 2020), report and recommendation adopted, 2020 WL 2610908 (E.D. Tex. May 22, 2020) (“Under § 38.001 of the Texas Civil Practice and Remedies Code, ‘[a] person may recover reasonable attorney’s fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for: ... (8) an oral or written contract.’ TEX. CIV. PRAC. & REM. CODE § 38.001(8). Texas law authorizes a party to collect attorneys’ fees in some types of actions—but only from an individual or a corporation. ‘Under the plain language of section 38.001, a trial court cannot order limited liability partnerships, limited liability companies, or limited partnerships to pay attorney’s fees.’”).

### **K. Standing or Capacity to Sue**

*Picard v. Badgett*, N. 14-19-00006-CV, 2021 WL 786817 (Tex. App.—Houston [14th Dist.] Mar. 2, 2021, no pet. h.) (mem. op.).

In discussing an individual’s ability to sue on an asset purchase agreement under which one entity sold its assets to another entity and to which the individual was a party by virtue of her signature in her individual capacity, the court distinguished *Nauslar v. Coors Brewing Co.*, 170 S.W.3d 242, 249 (Tex. App.—Dallas 2005, no pet.) and further noted:

Moreover, the supreme court implicitly overruled *Nauslar* when it held that a limited partner in a partnership does indeed have constitutional standing to sue for an alleged loss in value of its interest in the partnership even if the limited partner does not have capacity to bring such a claim. *Pike v. Tex. EMC Mgmt., LLC*, 610 S.W.3d 763, 778 (Tex. 2020) (“[A] partner or other stakeholder in a business organization has constitutional standing to sue for an alleged loss in the value of its interest in the organization.”); see also *Lipshy v. Burk*, No. 05-19-00493-CV, 2020 WL 6696368, at \*2 (Tex. App.—Dallas Nov. 12, 2020, no pet. h.) (mem. op.).

*Cooke v. Karlseng*, 615 S.W.3d 911 (Tex. 2021) (per curiam).

The court declined to reconsider its recent opinion in *Pike v. Texas EMC Management, LLC*, 610 S.W.3d 763 (Tex. 2020) and reversed and remanded the court of appeals’ holding that the trial court lacked jurisdiction over claims of a limited partner for harm done to the partnership.

H. Jonathan Cooke formed real estate related partnerships with Robert Karlseng, Ashley Brigham Patten, and Jacques Yves LeBlanc. In 2006, Cooke sued Karlseng, Patten, and LeBlanc, along with new business entities they had formed without him (collectively, “the defendants”). He alleged that the individual defendants moved partnership assets to the new business entities without compensating him. Over the next several years, Cooke added new claims—including derivative claims on behalf of the partnerships—and added the partnerships as plaintiffs. Among the motions and responses filed by the defendants was a plea to the jurisdiction and motion for summary judgment. In their pleas to the jurisdiction, the defendants asserted that Cooke individually lacked standing to bring claims against the individual defendants because his claims belonged to the partnerships. The trial court denied the plea. The trial court granted the defendants’ motion for summary judgment as to certain defenses, but the trial court denied the defendants’ motion for summary judgment on their defense of limitations. The parties agreed to an interlocutory appeal.

On appeal, the defendants challenged the trial court’s denial of their plea to the jurisdiction and their motion for summary judgment based on limitations. The court of appeals agreed with the defendants that Cooke’s individual claims pleaded only an injury to the partnerships and thus did not belong to him individually. The court thus concluded that “Cooke lacked standing to assert his individual claims” and that the court was thus required to dismiss the claims.

The court of appeals also addressed the trial court’s denial of the defendants’ motion for summary judgment based on limitations. Based on its holding that Cooke lacked standing to assert his original individual claims and

that the trial court thus never obtained jurisdiction over them, the court of appeals held that the doctrine of relation back could not create jurisdiction where none existed. The court did not reach Cooke's issues regarding the trial court's summary judgment in favor of the defendants on their defenses of illegality and business judgment.

While Cooke's appeal to the Texas Supreme Court was pending, the supreme court decided *Pike v. Texas EMC Management, LLC*, 610 S.W.3d 763 (Tex. 2020). In this *per curiam* opinion, the supreme court reversed based on *Pike*, with the following explanation:

As relevant here, *Pike* addressed whether a partner lacked standing to sue for breach of a partnership agreement that harmed the value of his partnership interest on the ground that such a cause of action belongs to the partnership rather than individual partners. *Id.* at 773. We concluded that "the authority of a partner to recover for an alleged injury to the value of its interest in the partnership is not a matter of constitutional standing that implicates subject-matter jurisdiction." *Id.* at 775. We did recognize that statutory provisions define and limit a partner's ability to recover certain damages. *Id.* at 778. As we explained, however, those provisions "go to the merits of the claim; they do not strip a court of subject-matter jurisdiction to render a take-nothing judgment if the [partner] fails to meet the statutory requirements." *Id.*

Our analysis in *Pike* reveals that the court of appeals' contrary holding in this case is incorrect. As explained above, the court of appeals also relied on that holding to conclude that Cooke's derivative claims did not relate back to his original filing.

The defendants assert that *Pike* was wrongly decided, and we should reconsider it. We decline to do so. All the parties also ask us to address the issues the court of appeals did not reach. We believe that the court of appeals should have the opportunity to consider those issues first.

In sum, the court of appeals' holding regarding standing is in direct conflict with *Pike*, and that holding affected the court's consideration of the other issues it reached. Without hearing oral argument, *see* Tex. R. App. P. 59.1, we grant the petition for review. We reverse the judgment of the court of appeals and remand the case for the court of appeals to reconsider the limitations issue in light of *Pike* and to reach the remaining issues as necessary to dispose of this agreed interlocutory appeal. *See* Tex. R. App. P. 47.1.

***Fettner v. Daniel Jackson & Associates, P.C.***, No. 14-19-00497-CV, 2021 WL 126396 (Tex. App.—Houston [14th Dist.] Jan. 14, 2021, no pet. h.) (mem. op.).

A judgment entered against an individual doing business under an assumed name that was also the name of an alleged partnership was not a judgment against the partnership, and the partnership did not have standing to appeal the judgment.

Ana Maria Lara and Jose Sanchez jointly operated a used-car dealership known as "Cardenas Auto Sales." Lara maintained that she owned the dealership as a sole proprietorship, which she operated under the assumed name of "Cardenas Auto Sales," while Sanchez asserted that he and Lara were partners. To resolve this dispute, Sanchez sued Lara and included as a nominal defendant "Cardenas Auto Sales, a Texas General Partnership." Lara hired The Jackson Law Firm ("Jackson") to represent her and her purported business. Lara signed the representation agreement with Jackson solely in her individual capacity, consistent with her position that the business was a sole proprietorship. During the course of Sanchez's suit, the trial court appointed David Fettner as receiver for the dealership. Sanchez and Lara agreed to arbitration, and the arbitration panel determined that the dealership was a general partnership. Because the name "Cardenas Auto Sales" was previously claimed to be an assumed name referring to Lara only in her individual capacity, the court referred to the dealership business as "the Partnership" for the sake of clarity.

Lara failed to pay Jackson, and the firm sued her "individually and d/b/a Cardenas Auto Sales." Despite this language specifying that the "Cardenas Auto Sales" named in the petition refers only to an assumed name for Lara, Fettner filed an answer to the suit on behalf the Partnership. To eliminate any confusion, Jackson nonsuited any claims against the Partnership.

Jackson moved for summary judgment against Lara, and Fettner filed a petition in intervention seeking a declaration that the Partnership was not a party to Lara's legal-representation agreement with Jackson and was not liable on the contract. Pursuant to a Rule 11 agreement, Jackson again nonsuited any claims against the Partnership, and Fettner nonsuited his claims against the law firm.



After the trial court granted summary judgment against Lara “d/b/a Cardenas Auto Sales,” Fettner interjected himself into the lawsuit for a third time by filing motions in which he asked the trial court to modify, vacate, or void the judgment and require Lara and her counsel to show authority to represent the Partnership in the suit. The trial court denied the motions, and Fettner appealed.

The court of appeals stated that the threshold and dispositive issue was Fettner’s standing to appeal on behalf of the Partnership. The court stated that all of Fettner’s arguments rested on the same mistaken premise that any reference in the case to “Cardenas Auto Sales” necessarily referred to the partnership. The court explained that the judgment entered against “Ana Maria Lara, d/b/a Cardenas Auto Sales” did not equate to a judgment against “Ana Maria Lara *and* the Partnership.”

But, Fettner has failed to appreciate the significance of the expression, “d/b/a.” “D/b/a,” which means “doing business as,”[footnote omitted] indicates that the person or business whose name precedes the acronym uses an assumed name. “An ‘assumed name’ is a word or phrase by which a person may be made known to the public, and is not a legal entity.” *CA Partners v. Spears*, 274 S.W.3d 51, 69 n.11 (Tex. App.—Houston [14th Dist.] 2008, pet. denied). *See also Horie v. Law Offices of Art Dula*, 560 S.W.3d 425, 434 (Tex. App.—Houston [14th Dist.] 2018, no pet.) (“[T]he assumed name of a sole proprietorship is not a separate legal entity or even a different capacity of the individual sole proprietor.”). In effect, the expression “d/b/a” defines two or more names as synonyms, each of which refers to the same person or business.

Individuals and partnerships alike can sue and be sued in their assumed names. See TEX. R. CIV. P. 28. If Jackson had identified the sole defendant in this case only as “Cardenas Auto Sales,” then there might be some ambiguity about whether the firm had sued Lara or the Partnership, but there still would be only a single defendant. Here, however, Jackson identified the defendant as “Ana Maria Lara, individually and d/b/a Cardenas Auto Sales.” Thus, the firm asserted claims, and obtained a judgment, against Lara alone.

Fettner finds it significant that the arbitration panel found that the business known as “Cardenas Auto Sales” is a general partnership and not Lara’s sole proprietorship. That finding is immaterial to Fettner’s standing, because in rendering judgment against “Ana Maria Lara, d/b/a Cardenas Auto Sales,” the trial court effectively defined “Cardenas Auto Sales,” as used in the judgment at issue, to mean only the particular individual named Ana Maria Lara sued in this case and no one else. Because a partnership is an entity distinct from its partners,[footnote omitted] a judgment against Lara individually is not a judgment against the Partnership, regardless of whether the two in fact use the same name.

The court thus dismissed Fettner’s appeal for lack of standing.

***Lipshy v. Burk***, No. 05-19-00493-CV, 2020 WL 6696368 (Tex. App.—Dallas Nov. 12, 2020, no pet.) (mem. op.).

The trial court granted appellees Lawrence R. Burk, Credit Finance Corporation, and The Main Street Management Corporation’s (collectively the “General Partners”) plea to the jurisdiction concluding that appellants Barbara J. Lipshy, Debra Kaplan, and Ellen Lewis (collectively the “Limited Partners”) lacked standing to assert their breach of fiduciary duty and other claims against the General Partners. The court of appeals reversed and remanded on the grounds that the Limited Partners did have jurisdictional standing to assert a claim for the reduction in value of their respective partnership interests.

After the sale of partnership properties (two apartment complexes), the Limited Partners began to suspect misconduct by the General Partners in their management of the partnerships. Lipshy filed a lawsuit against the General Partners asserting claims for breach of fiduciary duty, common law fraud, declaratory and other relief with respect to the sale of the properties. Kaplan and Lewis intervened in Lipshy’s lawsuit and asserted similar claims against the General Partners.

In response to the lawsuit, the General Partners filed a plea to the jurisdiction and a motion to strike the first amended petition. They argued that the trial court did not have subject matter jurisdiction over the lawsuit because the Limited Partners’ claims actually belonged to the partnerships and therefore the Limited Partners lacked standing. The Limited Partners filed a response to the plea and filed their second amended petition, clarifying that

their claims were brought individually and derivatively on behalf of the partnerships. The General Partners then moved to strike the second amended petition. After hearings, the trial court struck the Limited Partners' pleadings, granted the General Partners' plea to the jurisdiction, and dismissed the Limited Partners' lawsuit.

On appeal, the Limited Partners argued that the trial court abused its discretion in granting the General Partners' plea to the jurisdiction. In light of the Texas Supreme Court's opinion in *Pike v. Texas EMC Management, LLC*, No. 17-0557, 2020 WL 3405812 (Tex. June 19, 2020), the court of appeals agreed with the Limited Partners' position:

In their plea and motion to strike, General Partners argued the trial court lacked subject matter jurisdiction over the suit because the Limited Partners lacked standing to pursue the claims they asserted. Specifically, General Partners contended the allegations set forth in Limited Partners' petition all involve alleged wrongs committed against and injuring the partnerships, rather than injuries suffered by the Limited Partners themselves. General Partners relied largely on a line of our cases beginning with *Nauslar v. Coors Brewing Company*, 170 S.W.3d 242 (Tex. App.—Dallas 2005, no pet.) which in turn cited *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990) for the proposition that “[a]n individual stakeholder in a legal entity does not have a right to recover personally for harm done to the legal entity.” In *Nauslar*, we, as have other Texas appellate courts, relied on *Wingate* to hold limited partners do not have an individual right to sue for the diminished value of their ownership interests in a partnership, and thus, lacked standing to pursue that claim. Accordingly, we affirmed the trial court's granting of the plea to the jurisdiction in *Nauslar* for lack of standing.

However, as General Partners candidly acknowledge on appeal, *Nauslar* and the other cases upon which they rely have been implicitly overruled by the Texas Supreme Court's recent opinion in *Pike* which held that a limited partner in a partnership does indeed have constitutional standing to sue for an alleged loss in value of its interest in the partnership even if the limited partner does not have capacity to bring such a claim.

In *Pike*, a limited partner recovered a \$7 million damage award for other partners' breach of the partnership agreement. Relying largely on *Wingate*, the *Pike* appellants challenged the limited partner's standing to recover the award, asserting the injury was suffered by the partnership, not the limited partner. The supreme court held the prohibition in *Wingate* does not implicate constitutional standing to sue for an alleged loss in value of a limited partner's interest in the partnership. In rejecting the standing argument, the supreme court reasoned “the question of whether a claim brought by a partner actually belongs to the partnership is ... a matter of capacity because it is a challenge to the partner's legal authority to bring suit.” The court indicated that question, in turn, should be decided on the merits and does not affect the trial court's subject matter jurisdiction to address the claim. ...

In the case before us, Limited Partners' first amended petition asserted claims individually for damages based on the reduction in value to their limited partnership interest. In other words, the legal injury giving Limited Partners standing is their diminution in value of equity interest. Because *Pike* makes clear Limited Partners do not lack constitutional standing to assert such claims, the trial court erred in granting General Partners' plea to the jurisdiction.

***RLB Contracting, Inc. v. Genesis Energy, L.P.***, Civ. A. No. H-18-3844, 2020 WL 5880918 (S.D. Tex. Oct. 2, 2020) (“RLB argues that the shareholder standing rule ... prevents Genesis Energy from raising a claim on behalf of its subsidiaries. The shareholder standing rule ‘is a longstanding equitable restriction that generally prohibits shareholders from initiating actions to enforce the rights of the corporation.’ ... The shareholder standing rule is ‘phrased in terms of corporations and shareholders, [but] it applies with equal force to limited partnerships’ and ‘limited liability companies’ like Genesis Energy and its subsidiaries.”).

***Benge v. Thomas***, No. 13-18-00619-CV, 2020 WL 5054800 (Tex. App.—Corpus Christi Aug. 27, 2020, no pet.) (mem. op.).

Based in part on standing problems, the court of appeals affirmed the trial court's summary judgment granted against the appellant on her breach of fiduciary duty and related claims.

In 2011, Anne Thomas, a wealthy rancher, established O&G, a general partnership with Harold Joe Adams and her daughter, Missi Thomas. On June 26, 2012, Anne created AFT Property, a Texas limited liability company, and she appointed herself, Adams, and Jack Andrew Carson, her lawyer, as managers. Anne was AFT Property's sole owner and member. Shortly thereafter, Anne created AFT Minerals, Ltd., a Texas limited partnership, with Anne being the sole limited partner and AFT Property being the sole general partner.

On July 23, 2012, Anne executed the 2012 Trust appointing herself and Missi as co-trustees. Anne then gave the 2012 Trust approximately \$3 million in AFT Minerals' limited-partnership interests. The trust, therefore, was a limited partner of AFT Minerals with a 66.389% interest along with Anne who owned the remaining percentage. Subsequently, Anne sold her percentage in AFT Minerals to O&G, making O&G and the 2012 Trust limited partners of AFT Minerals, while AFT Property remained the general partner.

Anne died on March 30, 2015. Upon her death, Anne designated Missi to serve as sole trustee and income beneficiary of the 2012 Trust and designated Debra Bengé and Dinah Voelkel, her only grandchildren and Missi's only children, as remainder beneficiaries of the 2012 Trust. Missi was also the sole independent executor of Anne's estate. At the time of this suit, Missi had become the sole manager of AFT Property.

On May 10, 2016, Bengé filed suit against Missi for removal of Missi as the executor of Anne's estate and for declaratory judgment and request for disclosure. Bengé later added claims against Adams, O&G, and Harold Joe Adams, Jr. LLC ("HJA"), and she asserted additional claims against Missi for breach of fiduciary duty in her various capacities.

Missi challenged Bengé's standing to raise many of her claims. Because Bengé was not a limited partner or general partner of AFT Minerals, Missi asserted that Bengé lacked standing to bring the claims on behalf of AFT Minerals. Missi further argued that Bengé lacked standing to bring a derivative claim on behalf of AFT Property because Bengé was "not a member of [AFT Property,] a limited liability company[, and she] cannot bring a derivative suit on behalf of the company." Similarly, Missi argued that Bengé lacked standing to sue on behalf of the 2012 Trust because she "is not a current income beneficiary of the 2012 Trust. Rather, when Missi (the sole income beneficiary) dies, any assets remaining in the 2012 Trust will pass to a trust for the benefit of [Bengé], and a trust for the benefit of Missi's other daughter, Dinah Voelkel." Missi further argued that Bengé lacked standing to file a derivative claim on behalf of the 2012 Trust because "even if [her] allegations are taken as true, there will still be sufficient assets to fund the 2012 Trust, and [her] derivative interest is in no way harmed." Adams, HJA, and O&G made similar arguments.

Bengé responded that she had standing "to sue [Missi] on behalf of the 2012 Trust because Missi, the trustee, 'cannot or will not enforce the cause of action' she has against third parties," and she had standing to sue parties on behalf of AFT Minerals and AFT Property because of her status as a beneficiary of the 2012 Trust. Finally, Bengé claimed that as a vested remainder beneficiary as opposed to a contingent remainder beneficiary, she had standing to sue Missi, Adams, HJA, and O&G on behalf of the 2012 Trust.

The trial court ultimately granted the pleas to the jurisdiction raised by Missi, Adams, HJA, and O&G and dismissed Bengé's derivative claims. The court also granted summary judgment to Missi on Bengé's breach of fiduciary duty claims against Missi as trustee of the 2012 trust.

The court of appeals affirmed the grant of summary judgment on Bengé's breach of fiduciary duty claims. The court observed that Bengé's claim that the 2012 Trust suffered damages was supported only by the testimony of an expert witness that was excluded by the trial court. As a result, Bengé provided no evidence supporting her claim for damages. The court also found standing problems with Bengé's claim:

In addition, the evidence that Bengé produced to support her claim that Missi breached her fiduciary duty to the 2012 Trust relates to transactions made by AFT Minerals' general partner, AFT Property. On appeal, Bengé claims that Missi breached her fiduciary duty in her capacity as trustee of the 2012 Trust because she should have prevented AFT Minerals from making advances to O&G and should have properly invested AFT Minerals' assets; however, as shown by the summary judgment evidence, AFT Property as general partner had the authority to make these decisions. The evidence establishes as a matter of law that the 2012 Trust as a limited partner had no decision-making rights regarding AFT Minerals' assets. Bengé's complaints all involve alleged damages to AFT Minerals and not to Bengé herself. Thus, AFT Minerals would have had to bring these claims and not Missi in her capacity as trustee or Bengé as a remainder beneficiary. *See Hall v. Douglas*, 380 S.W.3d 860, 873 (Tex. App.—Dallas 2012, no pet.) ("[C]laims for "a diminution

in value of partnership interests or a share of partnership income” may be asserted only by the partnership itself.”); *see also Adam v. Harris*, 564 S.W.2d 152, 156–57 (Tex. App.—Houston [14th Dist.] 1978, writ ref’d n.r.e.) (“A clear line exists between actions of a trustee and those of an officer of a corporation owned wholly or in part by the trust, even where the same person ‘wears both hats.’”). Therefore, we further conclude that the trial court properly determined that as a matter of law Missi owed no fiduciary duty to AFT Minerals in her capacity as trustee of the 2012 Trust. Accordingly, because Bengé failed to raise a question of fact on each element of her breach of fiduciary duty claim, the trial court properly granted Missi’s no evidence and traditional motion for summary judgment.

The court of appeals also affirmed the trial court’s summary judgment granted to Missi on Bengé’s claim that Missi had failed to maintain trust records. The court observed that Bengé did not complain about a lack of records of transactions involving the 2012 Trust, and she did not claim that Missi failed to maintain records of transactions in her capacity as trustee of the 2012 Trust. Instead, without supporting authority, Bengé complained that Missi’s duties of maintaining accounting records in her capacity as trustee encompassed a duty to also provide an accounting of AFT Minerals’ transactions and that Missi failed to maintain records of those transactions. According to the court, “Bengé [did] not adequately explain with citation to proper authority why Missi in her capacity as trustee of the 2012 Trust had a duty to maintain records of AFT Minerals’ transactions or how Missi failed to keep adequate records of the advances made by AFT Minerals to O&G.” In addition, the court of appeals made the following observations:

Moreover, as part of the agreements, as set up by Anne, AFT Property’s limited partners, including the 2012 Trust, were not guaranteed any distributions from AFT Minerals and owned no interest in AFT Minerals’ assets. Thus, to the extent that Bengé argues that Missi had a duty to maintain records of AFT Minerals’ transactions because AFT Minerals is a trust asset, we conclude that argument is without merit. Therefore, without more, we are unable to conclude that Missi had a duty in her capacity as trustee of the 2012 Trust to make an accounting of AFT Minerals’ transactions to Bengé and that Bengé in her capacity as a remainder beneficiary of the 2012 Trust can demand such an accounting of AFT Minerals’ transactions.

Furthermore, in her motion for traditional summary judgment, Missi argued that as a matter of law, Bengé has no standing to request an accounting of AFT Minerals’ finances. We agree. As a limited partner, the 2012 Trust would not have standing to sue “for injuries to the partnership that merely diminish the value of that partner’s interest.” Therefore, even assuming without deciding that AFT Minerals somehow suffered injuries as Bengé claims, AFT Property is the general partner of AFT Minerals, and under settled authority, it would have standing to bring suit. Bengé cites no authority, and we find none, supporting a conclusion that the 2012 Trust as a limited partner has standing to sue for an accounting of AFT Minerals or that Bengé as a remainder beneficiary of the 2012 Trust has standing to bring suit for an accounting of AFT Minerals’ transactions under these circumstances.

The court then concluded that Bengé did not have standing to bring a derivative claim on behalf of the 2012 Trust because she was a contingent remainder beneficiary and because “Bengé has not shown that Missi’s acts of not suing AFT Property, O&G, and AFT Minerals was a result of wrongful conduct.”

***Pike v. Texas EMC Management, LLC***, 610 S.W.3d 763 (Tex. 2020).

The Texas Supreme Court held that the rule prohibiting a limited partner from recovering individually for damage to the value of the partnership interest based on injury suffered by the partnership was not a matter of constitutional standing that affected a court’s subject-matter jurisdiction. Instead, the issue was a matter of capacity because it involved a challenge to the partner’s legal authority to bring the suit.

Texas EMC Products (the “Partnership”) was a limited partnership that manufactured and sold cement-based products. Texas EMC Management, LLC (“EMC Management”) was the general partner and owned a 1% interest in the Partnership; the members of EMC Management were Dan Walker, Atle Lygren, and Vladimir Ronin. EMC Cement BV was the Class A limited partner, owning 49.5% of the Partnership. Walker, Walker’s family

members, and Wilson owned the remaining 49.5% of the Partnership and were Class B limited partners. Clinton W. “Buddy” Pike, Sr. was hired as the general manager of EMC Management and the plant.

The Partnership took out a loan of over \$4 million. Because the Partnership did not have the ability to obtain its own financing, the note was guaranteed by Wilson, Walker and his wife, and Few Ready Mix (Walker’s company). The Partnership encountered business difficulties and it eventually defaulted on the bank loan. After Lygren threatened to sue the bank, Walker and Wilson—through Few Ready Mix—paid the bank the remaining balance of the loan. The next day, Few Ready Mix held a foreclosure sale of the Partnership’s property. VHSC Cement purchased the property at the foreclosure sale for \$3.1 million, and it purchased Few Ready Mix’s remaining interest in the bank loan shortly thereafter. VHSC had been formed less than a week before the foreclosure sale and was affiliated with John Preston and Alan Quasha—individuals affiliated with a company named C-Change who had earlier unsuccessfully negotiated with the Partnership regarding commercializing the Partnership’s technology in California. Prior to the foreclosure sale, Walker and Wilson had discussions about the Partnership’s business with Preston and Quasha that they did not disclose to Lygren or Ronin. The day of the foreclosure, VHSC also hired Pike to be its president and hired other employees of the Partnership.

The Partnership, EMC Management, and EMC Cement BV (collectively, the “EMC plaintiffs”) filed suit against Pike, Walker, Wilson, VHSC Cement, and Few Ready Mix, asserting several causes of action. The EMC plaintiffs’ claims against Walker and Wilson included breach of the partnership agreement and breach of fiduciary duty. The EMC plaintiffs asserted claims against all defendants for misappropriation of trade secrets and conspiracy. They also sought injunctive relief to prevent the defendants from disseminating or using the EMC plaintiffs’ proprietary and confidential information.

VHSC filed counterclaims against the Partnership and EMC Management for breach of contract and tortious interference with prospective business relationships. Walker and Wilson filed counterclaims against the Partnership for breach of the partnership agreement.

After trial, a jury found: (1) VHSC and Pike misappropriated EMC Cement BV’s trade secrets; (2) Walker and Wilson failed to comply with their fiduciary duties to EMC Cement BV; (3) Walker and Wilson failed to comply with the partnership agreement; (4) VHSC, Pike, and Few Ready Mix knowingly participated in that failure; (5) VHSC intentionally interfered with Pike’s management agreement; (6) Pike breached the management agreement; and (7) Walker, Wilson, Pike, VHSC, and Few Ready Mix were part of a conspiracy that damaged the Partnership and EMC Cement BV. The jury also found that the Partnership failed to comply with the partnership agreement as to Walker and Wilson.

The trial court rendered judgment on the jury’s verdict, awarding EMC Cement BV \$1.5 million for misappropriation of trade secrets and conspiracy and \$7 million from Walker and Wilson for breach of the partnership agreement. The court awarded the Partnership \$7 million for conspiracy and intentional interference with Pike’s management agreement and \$1 million from Pike for breach of the management agreement. The court also awarded attorneys’ fees to EMC Cement BV. The court denied the EMC plaintiffs’ request for injunctive relief. As for Walker and Wilson’s claims against the Partnership, the trial court awarded them each \$148,038, which it offset against the damages they owed to the Partnership.

Walker, Wilson, and Few Ready Mix appealed and challenged the damages awards, the validity of the claim for breach of the partnership agreement, and the joint-and-several liability theories. EMC Cement BV also appealed, contending that the trial court abused its discretion in refusing to grant its request for a permanent injunction.

The court of appeals affirmed in part and reversed in part. The court concluded that the trial court erred in denying EMC Cement BV’s request for a permanent injunction. The court also modified the trial court judgment to reflect that Pike was not liable for intentionally interfering with his own management agreement. The court otherwise affirmed the trial court’s judgment.

EMC Cement BV’s damages included an award of \$7 million for breach of the partnership agreement by Walker and Wilson (collectively, “Walker”). Walker challenged this award on several grounds, including that EMC Cement BV lacked “standing” as a limited partner to recover damages individually for an injury suffered by the Partnership.

The Supreme Court began its analysis by considering whether Walker was challenging standing “in the true constitutional sense of that term, which if lacking would deprive the trial court of subject-matter jurisdiction,” or was instead challenging capacity, which involves when a plaintiff “is not entitled to recover in the capacity in which he sues.” Indeed, in the court of appeals, Walker asserted that EMC Cement BV lacked standing to bring its claim for breach of the partnership agreement because a cause of action alleging harm to the Partnership belongs to the

Partnership, not to its individual partners. The court of appeals concluded that this challenge implicated capacity, not standing, and it had been waived because Walker’s answer did not include a verified plea challenging EMC Cement BV’s authority to recover in its capacity as a limited partner. In the Supreme Court, Walker argued that the court of appeals erred in holding that a challenge to a partner’s ability to sue individually for injury to the partnership is an issue of capacity requiring special preservation, and he cited various cases referring to such a challenge as raising an issue of “standing.”

According to the Supreme Court, both capacity and standing are necessary to bring a lawsuit. “A plaintiff has standing when it is personally aggrieved, regardless of whether it is acting with legal authority; a party has capacity when it has the legal authority to act, regardless of whether it has a justiciable interest in the controversy.” A plaintiff lacks capacity when, as pertinent here, he “is not entitled to recover in the capacity in which he sues.” Tex. R. Civ. P. 93(2).

The court observed that concepts of standing and capacity have specialized application to business organizations and their stakeholders, requiring particular attention to the distinction between the two concepts. “Ordinarily,” for example, “the cause of action for injury to the property of a corporation, or the impairment or destruction of its business, is vested in the corporation.” *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990) (quoting *Massachusetts v. Davis*, 140 Tex. 398, 168 S.W.2d 216, 221 (1942)). “A corporate stockholder cannot recover damages personally for a wrong done solely to the corporation, even though he may be injured by that wrong” in the form of reduced stock value, because all stockholders will be made whole if the corporation obtains compensation. Rather, “to recover individually, a stockholder must prove a personal cause of action and personal injury.” The *Wingate* prohibition on recovering the lost value of an interest in an organization also applies to limited partners.

The Supreme Court noted that “[o]ur statutes—together with the organization’s governing agreement—now define more specifically which claims and remedies may be pursued by the organization and which by its stakeholders individually, and they also allow stakeholders to pursue the organization’s claims in a derivative capacity in certain circumstances. *E.g.*, TEX. BUS. ORGS. CODE §§ 152.002, 152.210–.211, 153.401–.413.” In addition, an organization may transfer its claim to a stakeholder, or vice versa.

Walker cited *Wingate* and its progeny to support his argument that EMC Cement BV lacked standing to recover the lost value of its interest in the Partnership. The court asked, however, whether “the *Wingate* prohibition—as now articulated in our statutes—[is] a matter of constitutional standing that affects a court’s subject-matter jurisdiction?” Because Texas’s test for constitutional standing paralleled the federal test for Article III standing, the court looked to federal standing jurisprudence for guidance in answering this question. It observed that federal courts, including the U.S. Supreme Court and the Fifth Circuit, had concluded that standing was not implicated. After discussing the case law, the court reached the same conclusion: “For these reasons, we hold that a partner or other stakeholder in a business organization has constitutional standing to sue for an alleged loss in the value of its interest in the organization. In so holding, we are mindful of the statutory provisions that define and limit a stakeholder’s ability to recover certain measures of damages, which protect the organization’s status as a separate and independent entity. Those provisions, however, go to the merits of the claim; they do not strip a court of subject-matter jurisdiction to render a take-nothing judgment if the stakeholder fails to meet the statutory requirements.”

Having concluded that Walker’s challenge to EMC Cement BV’s “standing” did not concern subject-matter jurisdiction, the court next considered whether Walker’s challenge raised an issue of capacity requiring special preservation. In the court of appeals’ view, Walker was challenging EMC Cement BV’s authority to recover its loss in its capacity as a limited partner, and the issue had been waived by failing to file a verified plea under Rule 93(2). The Supreme Court agreed with the court of appeals that, by challenging EMC Cement BV’s ability to recover the lost value of its interest in the Partnership, Walker was challenging EMC Cement BV’s capacity:

In *Pledger v. Schoellkopf*, we held that the question whether a claim brought by a shareholder actually belongs to the corporation is a matter of capacity. “When capacity is contested, Rule 93(2) requires that a verified plea be filed anytime the record does not affirmatively demonstrate the plaintiff’s ... right to bring suit ... in whatever capacity he is suing.” Because the defendants did not file a plea contending that the plaintiff’s claims were owned by the corporation, we concluded the plaintiff was entitled to recover on those claims and it was unnecessary to determine who owned them. Requiring a defendant to raise this “wrong plaintiff” problem by

verified plea allows the plaintiff an opportunity to correct the problem if possible, such as through assignment or joinder, and signals whether the parties need to develop and present evidence on the issue at trial. Absent such a plea, “[j]ust how [the plaintiff] acquired the cause of action is not before [the] Court.”

We hold that the question whether a claim brought by a partner actually belongs to the partnership is likewise a matter of capacity because it is a challenge to the partner’s legal authority to bring the suit. Chapters 152 and 153 of the Business Organizations Code include sections addressing a partner’s authority to sue.

Section 152.210 provides that one partner is liable to another (and to the partnership) for “a violation of a duty to the partnership or other partners under this chapter that causes harm to the partnership or the other partners.” Section 152.211 then delineates the authority of partners and partnerships to bring claims and seek various remedies. It provides that one partner “may maintain an action against ... another partner for legal or equitable relief” to enforce certain rights or otherwise protect its interests, and that the partnership “may maintain an action against a partner for a breach of the partnership agreement ... causing harm to the partnership.” *Id.* § 152.211(a)–(b). In addition, Chapter 153 expressly gives a limited partner authority to sue derivatively for injury to the limited partnership when certain requirements are met. *See id.* §§ 153.401–413.

Here, EMC Cement BV has not sued in a derivative capacity for injury to the Partnership. Instead, the parties dispute whether the damages EMC Cement BV recovered were personal or for harm to the Partnership, as well as whether sections 152.210 and 152.211 authorize EMC Cement BV to recover those damages. Because Walker’s answer did not include a verified plea challenging EMC Cement BV’s capacity to recover as required by Texas Rule of Civil Procedure 93(2), the court of appeals concluded he waived these challenges to EMC Cement BV’s damages.

In reaching this conclusion, the court of appeals did not consider our *In re Fisher* decision. There, one limited partner sued two others, who sought dismissal on the ground that the plaintiff’s claims against them actually belonged to the partnership. We explained that a partner “may bring claims for those injuries he suffered directly.” Because the plaintiff alleged that he suffered damages and nothing in his petition “affirmatively negate[d] his having been personally aggrieved,” we concluded the trial court did not clearly abuse its discretion in rejecting the defendants’ request for dismissal.

Although we agree with the court of appeals that challenges to capacity must be raised by a verified plea in the defendant’s answer, *see* TEX. R. CIV. P. 93(2), *Fisher* shows that issues regarding a partner’s authority to sue for damages to the partnership will not always be apparent from the face of the plaintiff’s petition. In this case, both the Texas EMC Products partnership and its limited partner EMC Cement BV sued other partners. EMC Cement BV did not plead that it was attempting to recover damages suffered by Texas EMC Products. Their petition referred to both Texas EMC Products and EMC Cement BV as “Plaintiffs,” and they alleged that “Plaintiffs have sustained damages as a direct and proximate result of Walker and Wilson’s breaches.”

Because EMC Cement BV alleged that it sustained damages as a result of Walker and Wilson’s breaches, Walker had no reason under *Fisher* to file a verified plea challenging EMC Cement BV’s capacity to recover for damages to Texas EMC Products. Walker’s complaint about what damages EMC Cement BV was attempting to recover did not arise until EMC Cement BV requested that the jury be instructed to base its damages for Walker and Wilson’s breach of the partnership agreement on the difference in the value of EMC Cement BV’s interest in the partnership before and after the breach. Walker objected to the instruction, asserting that the claim for damages belonged to the Partnership and there was no evidence of a separate loss to EMC Cement BV over and above any loss sustained by the Partnership. Because Walker timely raised this complaint in the trial court, we may consider it as part of his challenge to EMC Cement BV’s damages.

The Supreme Court went on to conclude that it did not need to decide whether EMC Cement BV lacked capacity to recover because there was insufficient evidentiary support for EMC Cement BV’s damages even if it had capacity. The court observed that the damage awards (other than for misappropriation of trade secrets) were

all based on the loss in value of the Partnership or the loss in value of EMC Cement BV's interest in the Partnership. "Value" was defined in the jury charge as "'Market Value,' the amount that would be paid in cash by a willing buyer who desires to buy, but is not required to buy, to a willing seller who desires to sell, but is under no necessity of selling." Consistent with the jury's findings, the trial court's judgment awarded the Partnership \$7 million for lost value caused by tortious interference with Pike's management agreement and \$1 million for lost value caused by breach of that management agreement. The judgment also awarded EMC Cement BV \$7 million for lost value of its interest caused by breach of the partnership agreement. After discussing the evidence of damages presented at trial, the Supreme Court concluded that it was insufficient:

We hold that none of the EMC plaintiffs' evidence was legally sufficient to support the damages awarded. Generally, when we sustain a no-evidence issue after a trial on the merits, we render judgment on that issue. When there is evidence to support some amount of damages, but not all, rendition is not appropriate. But here, there was no evidence of any damages because the testimony of Lygren and [financial consultant Paula] Miller was conclusory, and [Harry] Swanstrom's testimony of purchase price was no evidence of market value. [Swanstrom's engineering firm designed and built the Partnership's plant.] Because there is no evidence of damages, we reverse the portions of the judgment awarding damages and render a take-nothing judgment.

The court also concluded that EMC Cement BV should not recover in damages for misappropriation of trade secrets, that the trial court did not abuse its discretion in denying EMC Cement BV a permanent injunction, and that the award of attorney's fees to EMC Cement BV needed to be reversed ("[b]ecause we have held that the evidence of actual damages is insufficient, we must also reverse the award of attorneys' fees").

Justice Bland dissented in part from the court's ruling:

To grant limited partners standing to sue individually for claims against other partners or a third party for an injury to the partnership causes instability in business organizations and costly litigation for claims that should be dismissed immediately, absent compliance with the Legislature's derivative standing rules.

Because EMC Cement claimed an injury based on lost value of the partnership, we should dismiss its claim for lack of standing. As a limited partner, it lacked standing to recover the partnership's lost profits. Because standing implicates subject-matter jurisdiction, the court of appeals erred in concluding that the defendant partners waived a challenge to this direct recovery. This Court compounds that error by disregarding a partnership's status as an independent entity in concluding that derivative standing requirements may be waived—and a partnership's recovery taken—in a limited partner's enforceable judgment, in contravention of the limited partnership's governing documents.

We instead should hold that EMC Cement, as a limited partner, has no legal standing to sue for an injury to ... the partnership, and dismiss EMC Cement's recovery on that claim for lack of jurisdiction. Because we do not, I respectfully dissent to all but Part IV of the Court's opinion and judgment.

***Stacy v. JPMorgan Chase Bank, N.A.***, No. 3:19-cv-446-M-BN, 2020 WL 3979728 (N.D. Tex. June 19, 2020) ("Ecarlink, L.P. is a Texas limited partnership, which makes it a separate legal entity from its partners. TEX. BUS. ORGS. CODE § 154.001(a)-(c). As a result, Stacy cannot recover damages sustained by Ecarlink, L.P. Nor can Stacy 'rest his claim to relief on the legal rights or interests of third parties.' A partner to a limited partnership cannot complain of an injury incurred by, or wrong done to, the limited partnership.").

***Association Ins. Co. v. Clarendon Nat'l Ins. Co.***, Case No. 1:19-CV-1248-LY, 2020 WL 3403073 (W.D. Tex. June 18, 2020), report and recommendation adopted, 2020 WL 6059859 (W.D. Tex. July 8, 2020).

The court concluded that a corporation and a partnership were not covered under insurance policies that named an individual as the insured and excluded multi-owner business organizations. A motion to dismiss on duty to defend and duty to indemnify claims was granted in favor of the insurer.



Plaintiff Association Insurance Company (“Association”) sought reimbursement for defense and indemnity fees and costs that it paid on behalf of Joseph Fowler Homes, Ltd. (“Partnership”) and J.E. Fowler, Inc. (“Corporation”)—defendants in an underlying lawsuit. Association alleged that Clarendon National Insurance Company (“Clarendon”) had a duty to defend and indemnify Partnership and Corporation under the terms of Clarendon’s insurance policies. Clarendon argued that Association’s claim should be dismissed for failure to state a claim pursuant to Rule 12(b)(6) because it did not issue any policy covering the Partnership or the Corporation.

The named insureds under Clarendon’s policies were “Joseph Fowler Homes” and “Joseph Fowler d/b/a Joseph Fowler Homes.” The policies stated that “[i]f you are designated in the Declarations as: An individual, you and your spouse are insureds, but only with respect to the conduct of a business of which you are the sole owner. No person or organization is an Insured with respect to the conduct of any current or past partnership, joint venture or limited liability company that is not shown as a Named Insured in the Declarations.”

Clarendon argued that because the named defendants in the underlying lawsuit were a partnership and a corporation—not an individual—its policy language established that it had no duty to defend or indemnify. The court agreed:

As stated above, to determine whether a party has a duty to defend, the Court may consider only the complaint and the insurance policy documents. If an insurance contract uses unambiguous language, a court should construe the contract as a matter of law and enforce it as written. The Policies clearly state that they cover individuals only. The Underlying Lawsuit named as a defendant not an individual, but a partnership and a corporation. Because the Policies expressly state that coverage would not extend to the conduct of any partnerships, joint ventures, or LLCs, Clarendon had no duty to defend the Partnership and the Corporation in the Underlying Lawsuit. Accordingly, Defendant’s Motion to Dismiss should be granted as to Plaintiff’s duty to defend claim. ...

Here, the Underlying Lawsuit ended via a settlement agreement. The settlement agreement makes no reference to Joseph Fowler individually or Joseph Fowler d/b/a Joseph Fowler Homes—only the Partnership (Joseph Fowler Homes, Ltd.), the Corporation (J.E. Fowler, Inc.), and unrelated entities. Clarendon insured Joseph Fowler Homes, an entity listed as an individual, and Joseph Fowler d/b/a Joseph Fowler Homes, an individual, “with respect to the conduct of a business of which [the named insured] [was] the sole owner.” The Policies expressly state that coverage did not extend to the acts of partnerships, LLCs, or other entities related to the covered individual.

The Court finds that Clarendon had no duty to indemnify in the Underlying Lawsuit because Clarendon’s insured was not liable for any damages. Accordingly, Defendant’s Motion to Dismiss for failure to state a duty to indemnify claim should be granted.

***Cohen v. Flat Stone Development Company, Inc.***, Civil Action No. 4:16-CV-00283, 2018 WL 11312999 (S.D. Tex. Oct. 5, 2018) (Although the court issued this opinion in 2018, it is included in this year’s update because it did not appear in the Westlaw database until recently.).

A limited partner transferred his interests in limited partnerships to trusts that did not become substituted limited partners, and the transferor limited partner thus remained a limited partner and had standing to assert derivative claims on behalf of the partnerships, but he did not meet the statutory pleading requirements to assert the claims. The assignee trusts did not have standing to assert derivative claims.

Flat Stone I was a Texas limited partnership formed by general partner Flat Stone Development Company, Inc. and limited partners Jay Cohen and Howard Hebert. Flat Stone II was a Texas limited partnership formed by general partner Flat Stone II of Texas, Inc. and limited partners Jay Cohen and Flat Stone II of Texas, Inc. A&D was a Texas limited partnership formed by general partner Commerce Equities II, LLC and limited partners JHC Trust II, Matthew Dilick, and Rocky Hollow Development Corporation. JHC Trust I and JHC Trust II were revocable trusts formed by Jay Cohen as grantor and Clifton Hebert as trustee. The trust agreements effectuated the transfer of Jay Cohen’s limited partnership interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, and named Cohen as beneficiary of the trusts.

The limited partnership agreements of Flat Stone I, Flat Stone II, and A&D contained identical provisions regarding the transfer of limited partnership interests and the admission of assignees as limited partners. The

agreement permitted a limited partner to transfer all or any of its interest in the limited partnership to “the trustee of a trust created for the benefit of [the] Limited Partner.” After such a transfer, the “transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied.” The agreements specified the requirements for “a transferee of an interest in the Partnership” to “be admitted to the Partnership as a substituted Limited Partner,” including the execution of necessary documents, contribution of capital, and consent from all partners.

In this opinion, the court addressed the defendants’ motion to dismiss claims brought by Cohen and his trusts for breach of duties owed to the limited partnerships. The court reviewed the requirements for bringing a derivative suit under Federal Rule 23.1 and the Texas Business Organizations Code. In addition to verifying the complaint, pleading that the plaintiff was a member of the corporation or association at the time of the transaction complained of, and explaining any effort by the plaintiff to urge the association to assert the claims as required by Rule 23.1, the court set forth the requirements at the time under Chapter 153 of the Texas Business Organizations Code. Under those provisions, a limited partner was permitted to bring a derivative action on behalf of the limited partnership if “(1) all general partners with authority to bring the action have refused to bring the action; or (2) an effort to cause those general partners to bring the action is not likely to succeed.” Tex. Bus. Orgs. Code Ann. § 153.401. The plaintiff was required to be a limited partner when the action is brought and must have been a limited partner at the time of the transaction that was the subject of the action. Tex. Bus. Orgs. Code Ann. § 153.402. Additionally, the court cited case law in support of the proposition that the limited partner must maintain its status.

With regard to who was a limited partner and who was an assignee and the rights of such, the court relied on Chapter 153 of the Texas Business Organizations Code and the limited partnership agreements. An assignee of a partnership interest may become a limited partner to the extent that the partnership agreement provides. Tex. Bus. Orgs. Code Ann. § 153.253. Although Cohen transferred his interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, the limited partnership agreements governing both limited partnerships provided that Cohen retained his status as limited partner, stating that the “transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied.” The court located no evidence indicating that JHC Trust I or JHC Trust II as transferees met the requirements to become substituted limited partners, nor did the court locate any evidence indicating that JHC Trust II lost its status as limited partner of A&D. Therefore, only Cohen had standing as a limited partner to bring derivative claims on behalf of Flat Stone I and Flat Stone II, and only JHC Trust II had standing as a limited partner to bring derivative claims on behalf of A&D. The derivative claims asserted by the trusts as assignees were dismissed. Cohen and JHC Trust II had standing in their capacity as limited partners of the Flat Stone partnerships and A&D, respectively, to bring their derivative claims, but they failed to meet the verification requirement. Further, it was unclear whether they had satisfied an order requiring security (which had been entered under Tex. Bus. Orgs. Code § 153.404(a)). Thus, the court entered an order providing that these requirements must be met in order to avoid dismissal of their derivative claims.

## **L. Direct and Derivative Claims**

***Cooke v. Karlseng***, 615 S.W.3d 911 (Tex. 2021) (per curiam).

The court declined to reconsider its recent opinion in *Pike v. Texas EMC Management, LLC*, 610 S.W.3d 763 (Tex. 2020) and reversed and remanded the court of appeals’ holding that the trial court lacked jurisdiction over claims of a limited partner for harm done to the partnership.

H. Jonathan Cooke formed real estate related partnerships with Robert Karlseng, Ashley Brigham Patten, and Jacques Yves LeBlanc. In 2006, Cooke sued Karlseng, Patten, and LeBlanc, along with new business entities they had formed without him (collectively, “the defendants”). He alleged that the individual defendants moved partnership assets to the new business entities without compensating him. Over the next several years, Cooke added new claims—including derivative claims on behalf of the partnerships—and added the partnerships as plaintiffs. Among the motions and responses filed by the defendants was a plea to the jurisdiction and motion for summary judgment. In their pleas to the jurisdiction, the defendants asserted that Cooke individually lacked standing to bring claims against the individual defendants because his claims belonged to the partnerships. The trial court denied the plea. The trial court granted the defendants’ motion for summary judgment as to certain defenses, but the trial court

denied the defendants' motion for summary judgment on their defense of limitations. The parties agreed to an interlocutory appeal.

On appeal, the defendants challenged the trial court's denial of their plea to the jurisdiction and their motion for summary judgment based on limitations. The court of appeals agreed with the defendants that Cooke's individual claims pleaded only an injury to the partnerships and thus did not belong to him individually. The court thus concluded that "Cooke lacked standing to assert his individual claims" and that the court was thus required to dismiss the claims.

The court of appeals also addressed the trial court's denial of the defendants' motion for summary judgment based on limitations. Based on its holding that Cooke lacked standing to assert his original individual claims and that the trial court thus never obtained jurisdiction over them, the court of appeals held that the doctrine of relation back could not create jurisdiction where none existed. The court did not reach Cooke's issues regarding the trial court's summary judgment in favor of the defendants on their defenses of illegality and business judgment.

While Cooke's appeal to the Texas Supreme Court was pending, the supreme court decided *Pike v. Texas EMC Management, LLC*, 610 S.W.3d 763 (Tex. 2020). In this *per curiam* opinion, the supreme court reversed based on *Pike*, with the following explanation:

As relevant here, *Pike* addressed whether a partner lacked standing to sue for breach of a partnership agreement that harmed the value of his partnership interest on the ground that such a cause of action belongs to the partnership rather than individual partners. *Id.* at 773. We concluded that "the authority of a partner to recover for an alleged injury to the value of its interest in the partnership is not a matter of constitutional standing that implicates subject-matter jurisdiction." *Id.* at 775. We did recognize that statutory provisions define and limit a partner's ability to recover certain damages. *Id.* at 778. As we explained, however, those provisions "go to the merits of the claim; they do not strip a court of subject-matter jurisdiction to render a take-nothing judgment if the [partner] fails to meet the statutory requirements." *Id.*

Our analysis in *Pike* reveals that the court of appeals' contrary holding in this case is incorrect. As explained above, the court of appeals also relied on that holding to conclude that Cooke's derivative claims did not relate back to his original filing.

The defendants assert that *Pike* was wrongly decided, and we should reconsider it. We decline to do so. All the parties also ask us to address the issues the court of appeals did not reach. We believe that the court of appeals should have the opportunity to consider those issues first.

In sum, the court of appeals' holding regarding standing is in direct conflict with *Pike*, and that holding affected the court's consideration of the other issues it reached. Without hearing oral argument, *see* Tex. R. App. P. 59.1, we grant the petition for review. We reverse the judgment of the court of appeals and remand the case for the court of appeals to reconsider the limitations issue in light of *Pike* and to reach the remaining issues as necessary to dispose of this agreed interlocutory appeal. *See* Tex. R. App. P. 47.1.

***Lipshy v. Burk***, No. 05-19-00493-CV, 2020 WL 6696368 (Tex. App.—Dallas Nov. 12, 2020, no pet.) (mem. op.).

The trial court granted appellees Lawrence R. Burk, Credit Finance Corporation, and The Main Street Management Corporation's (collectively the "General Partners") plea to the jurisdiction concluding that appellants Barbara J. Lipshy, Debra Kaplan, and Ellen Lewis (collectively the "Limited Partners") lacked standing to assert their breach of fiduciary duty and other claims against the General Partners. The court of appeals reversed and remanded on the grounds that the Limited Partners did have jurisdictional standing to assert a claim for the reduction in value of their respective partnership interests.

After the sale of partnership properties (two apartment complexes), the Limited Partners began to suspect misconduct by the General Partners in their management of the partnerships. Lipshy filed a lawsuit against the General Partners asserting claims for breach of fiduciary duty, common law fraud, declaratory and other relief with respect to the sale of the properties. Kaplan and Lewis intervened in Lipshy's lawsuit and asserted similar claims against the General Partners.

In response to the lawsuit, the General Partners filed a plea to the jurisdiction and a motion to strike the first amended petition. They argued that the trial court did not have subject matter jurisdiction over the lawsuit because

the Limited Partners' claims actually belonged to the partnerships and therefore the Limited Partners lacked standing. The Limited Partners filed a response to the plea and filed their second amended petition, clarifying that their claims were brought individually and derivatively on behalf of the partnerships. The General Partners then moved to strike the second amended petition. After hearings, the trial court struck the Limited Partners' pleadings, granted the General Partners' plea to the jurisdiction, and dismissed the Limited Partners' lawsuit.

On appeal, the Limited Partners argued that the trial court abused its discretion in granting the General Partners' plea to the jurisdiction. In light of the Texas Supreme Court's opinion in *Pike v. Texas EMC Management, LLC*, No. 17-0557, 2020 WL 3405812 (Tex. June 19, 2020), the court of appeals agreed with the Limited Partners' position:

In their plea and motion to strike, General Partners argued the trial court lacked subject matter jurisdiction over the suit because the Limited Partners lacked standing to pursue the claims they asserted. Specifically, General Partners contended the allegations set forth in Limited Partners' petition all involve alleged wrongs committed against and injuring the partnerships, rather than injuries suffered by the Limited Partners themselves. General Partners relied largely on a line of our cases beginning with *Nauslar v. Coors Brewing Company*, 170 S.W.3d 242 (Tex. App.—Dallas 2005, no pet.) which in turn cited *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990) for the proposition that “[a]n individual stakeholder in a legal entity does not have a right to recover personally for harm done to the legal entity.” In *Nauslar*, we, as have other Texas appellate courts, relied on *Wingate* to hold limited partners do not have an individual right to sue for the diminished value of their ownership interests in a partnership, and thus, lacked standing to pursue that claim. Accordingly, we affirmed the trial court's granting of the plea to the jurisdiction in *Nauslar* for lack of standing.

However, as General Partners candidly acknowledged on appeal, *Nauslar* and the other cases upon which they rely have been implicitly overruled by the Texas Supreme Court's recent opinion in *Pike* which held that a limited partner in a partnership does indeed have constitutional standing to sue for an alleged loss in value of its interest in the partnership even if the limited partner does not have capacity to bring such a claim.

In *Pike*, a limited partner recovered a \$7 million damage award for other partners' breach of the partnership agreement. Relying largely on *Wingate*, the *Pike* appellants challenged the limited partner's standing to recover the award, asserting the injury was suffered by the partnership, not the limited partner. The supreme court held the prohibition in *Wingate* does not implicate constitutional standing to sue for an alleged loss in value of a limited partner's interest in the partnership. In rejecting the standing argument, the supreme court reasoned “the question of whether a claim brought by a partner actually belongs to the partnership is ... a matter of capacity because it is a challenge to the partner's legal authority to bring suit.” The court indicated that question, in turn, should be decided on the merits and does not affect the trial court's subject matter jurisdiction to address the claim. ...

In the case before us, Limited Partners' first amended petition asserted claims individually for damages based on the reduction in value to their limited partnership interest. In other words, the legal injury giving Limited Partners standing is their diminution in value of equity interest. Because *Pike* makes clear Limited Partners do not lack constitutional standing to assert such claims, the trial court erred in granting General Partners' plea to the jurisdiction.

*VTX Communications, LLC v. AT&T, Inc.*, Civ. A. No. 7:19-cv-00269, 2020 WL 4465968 (S.D. Tex. Aug. 4, 2020).

The court granted in part and denied in part defendants' motion to dismiss on breach of fiduciary duty and other causes of action. The court concluded that the derivative claims met the requirements of FRCP 23.1.

Certain limited partners of three limited partnerships that provided AT&T-branded wireless service in South Texas sued the partnerships' common general partner and affiliated entities. The general partner, New Cingular Wireless/AT&T Mobility, operated the three limited partnerships which had exclusive authority to provide cell service in the partnerships' respective service areas.

Plaintiffs alleged that defendants had been using the networks and wireless spectrums with disregard for the defendants' duties to the plaintiffs, specifically by defendants' operation of a Cricket Wireless network without proper compensation to the three limited partnerships, and thus to the detriment of the plaintiff limited partners. Plaintiffs brought causes of action for breach of fiduciary duty, breach of the partnership agreements, tortious interference, conversion/civil theft, aiding and abetting, and fraud.

After a lengthy analysis, the court held that Delaware law applied to all of plaintiffs' claims consistent with the choice-of-law provision in the three limited partnership agreements. The court then considered defendants' assertion that plaintiffs had not met Rule 23.1's requirements for derivative claims. Rule 23.1 applies when one or more shareholders or members of a corporation or unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the owners who are similarly situated in enforcing the right of the corporation or association. Rule 23.1 requires that the complaint be "verified" and:

- (1) allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law;
- (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack; and
- (3) state with particularity:
  - (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and
  - (B) the reasons for not obtaining the action or not making the effort.

The court found that plaintiffs successfully cured any errors under Rule 23.1 in their last complaint, that defendants failed to show that plaintiffs could not fairly and adequately represent the shareholder interests at issue, and that plaintiffs had sufficiently shown that pre-suit demand would be futile. The court denied defendants' motion to dismiss.

***Pike v. Texas EMC Management, LLC***, 610 S.W.3d 763 (Tex. 2020).

The Texas Supreme Court held that the rule prohibiting a limited partner from recovering individually for damage to the value of the partnership interest based on injury suffered by the partnership was not a matter of constitutional standing that affected a court's subject-matter jurisdiction. Instead, the issue was a matter of capacity because it involved a challenge to the partner's legal authority to bring the suit.

Texas EMC Products (the "Partnership") was a limited partnership that manufactured and sold cement-based products. Texas EMC Management, LLC ("EMC Management") was the general partner and owned a 1% interest in the Partnership; the members of EMC Management were Dan Walker, Atle Lygren, and Vladimir Ronin. EMC Cement BV was the Class A limited partner, owning 49.5% of the Partnership. Walker, Walker's family members, and Wilson owned the remaining 49.5% of the Partnership and were Class B limited partners. Clinton W. "Buddy" Pike, Sr. was hired as the general manager of EMC Management and the plant.

The Partnership took out a loan of over \$4 million. Because the Partnership did not have the ability to obtain its own financing, the note was guaranteed by Wilson, Walker and his wife, and Few Ready Mix (Walker's company). The Partnership encountered business difficulties and it eventually defaulted on the bank loan. After Lygren threatened to sue the bank, Walker and Wilson—through Few Ready Mix—paid the bank the remaining balance of the loan. The next day, Few Ready Mix held a foreclosure sale of the Partnership's property. VHSC Cement purchased the property at the foreclosure sale for \$3.1 million, and it purchased Few Ready Mix's remaining interest in the bank loan shortly thereafter. VHSC had been formed less than a week before the foreclosure sale and was affiliated with John Preston and Alan Quasha—individuals affiliated with a company named C-Change who had earlier unsuccessfully negotiated with the Partnership regarding commercializing the Partnership's technology in California. Prior to the foreclosure sale, Walker and Wilson had discussions about the Partnership's business with Preston and Quasha that they did not disclose to Lygren or Ronin. The day of the foreclosure, VHSC also hired Pike to be its president and hired other employees of the Partnership.

The Partnership, EMC Management, and EMC Cement BV (collectively, the "EMC plaintiffs") filed suit against Pike, Walker, Wilson, VHSC Cement, and Few Ready Mix, asserting several causes of action. The EMC

plaintiffs' claims against Walker and Wilson included breach of the partnership agreement and breach of fiduciary duty. The EMC plaintiffs asserted claims against all defendants for misappropriation of trade secrets and conspiracy. They also sought injunctive relief to prevent the defendants from disseminating or using the EMC plaintiffs' proprietary and confidential information.

VHSC filed counterclaims against the Partnership and EMC Management for breach of contract and tortious interference with prospective business relationships. Walker and Wilson filed counterclaims against the Partnership for breach of the partnership agreement.

After trial, a jury found: (1) VHSC and Pike misappropriated EMC Cement BV's trade secrets; (2) Walker and Wilson failed to comply with their fiduciary duties to EMC Cement BV; (3) Walker and Wilson failed to comply with the partnership agreement; (4) VHSC, Pike, and Few Ready Mix knowingly participated in that failure; (5) VHSC intentionally interfered with Pike's management agreement; (6) Pike breached the management agreement; and (7) Walker, Wilson, Pike, VHSC, and Few Ready Mix were part of a conspiracy that damaged the Partnership and EMC Cement BV. The jury also found that the Partnership failed to comply with the partnership agreement as to Walker and Wilson.

The trial court rendered judgment on the jury's verdict, awarding EMC Cement BV \$1.5 million for misappropriation of trade secrets and conspiracy and \$7 million from Walker and Wilson for breach of the partnership agreement. The court awarded the Partnership \$7 million for conspiracy and intentional interference with Pike's management agreement and \$1 million from Pike for breach of the management agreement. The court also awarded attorneys' fees to EMC Cement BV. The court denied the EMC plaintiffs' request for injunctive relief. As for Walker and Wilson's claims against the Partnership, the trial court awarded them each \$148,038, which it offset against the damages they owed to the Partnership.

Walker, Wilson, and Few Ready Mix appealed and challenged the damages awards, the validity of the claim for breach of the partnership agreement, and the joint-and-several liability theories. EMC Cement BV also appealed, contending that the trial court abused its discretion in refusing to grant its request for a permanent injunction.

The court of appeals affirmed in part and reversed in part. The court concluded that the trial court erred in denying EMC Cement BV's request for a permanent injunction. The court also modified the trial court judgment to reflect that Pike was not liable for intentionally interfering with his own management agreement. The court otherwise affirmed the trial court's judgment.

EMC Cement BV's damages included an award of \$7 million for breach of the partnership agreement by Walker and Wilson (collectively, "Walker"). Walker challenged this award on several grounds, including that EMC Cement BV lacked "standing" as a limited partner to recover damages individually for an injury suffered by the Partnership.

The Supreme Court began its analysis by considering whether Walker was challenging standing "in the true constitutional sense of that term, which if lacking would deprive the trial court of subject-matter jurisdiction," or was instead challenging capacity, which involves when a plaintiff "is not entitled to recover in the capacity in which he sues." Indeed, in the court of appeals, Walker asserted that EMC Cement BV lacked standing to bring its claim for breach of the partnership agreement because a cause of action alleging harm to the Partnership belongs to the Partnership, not to its individual partners. The court of appeals concluded that this challenge implicated capacity, not standing, and it had been waived because Walker's answer did not include a verified plea challenging EMC Cement BV's authority to recover in its capacity as a limited partner. In the Supreme Court, Walker argued that the court of appeals erred in holding that a challenge to a partner's ability to sue individually for injury to the partnership is an issue of capacity requiring special preservation, and he cited various cases referring to such a challenge as raising an issue of "standing."

According to the Supreme Court, both capacity and standing are necessary to bring a lawsuit. "A plaintiff has standing when it is personally aggrieved, regardless of whether it is acting with legal authority; a party has capacity when it has the legal authority to act, regardless of whether it has a justiciable interest in the controversy." A plaintiff lacks capacity when, as pertinent here, he "is not entitled to recover in the capacity in which he sues." Tex. R. Civ. P. 93(2).

The court observed that concepts of standing and capacity have specialized application to business organizations and their stakeholders, requiring particular attention to the distinction between the two concepts. "Ordinarily," for example, "the cause of action for injury to the property of a corporation, or the impairment or destruction of its business, is vested in the corporation." *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990) (quoting *Massachusetts v. Davis*, 140 Tex. 398, 168 S.W.2d 216, 221 (1942)). "A corporate stockholder cannot

recover damages personally for a wrong done solely to the corporation, even though he may be injured by that wrong” in the form of reduced stock value, because all stockholders will be made whole if the corporation obtains compensation. Rather, “to recover individually, a stockholder must prove a personal cause of action and personal injury.” The *Wingate* prohibition on recovering the lost value of an interest in an organization also applies to limited partners.

The Supreme Court noted that “[o]ur statutes—together with the organization’s governing agreement—now define more specifically which claims and remedies may be pursued by the organization and which by its stakeholders individually, and they also allow stakeholders to pursue the organization’s claims in a derivative capacity in certain circumstances. *E.g.*, TEX. BUS. ORGS. CODE §§ 152.002, 152.210–.211, 153.401–.413.” In addition, an organization may transfer its claim to a stakeholder, or vice versa.

Walker cited *Wingate* and its progeny to support his argument that EMC Cement BV lacked standing to recover the lost value of its interest in the Partnership. The court asked, however, whether “the *Wingate* prohibition—as now articulated in our statutes—[is] a matter of constitutional standing that affects a court’s subject-matter jurisdiction?” Because Texas’s test for constitutional standing paralleled the federal test for Article III standing, the court looked to federal standing jurisprudence for guidance in answering this question. It observed that federal courts, including the U.S. Supreme Court and the Fifth Circuit, had concluded that standing was not implicated. After discussing the case law, the court reached the same conclusion: “For these reasons, we hold that a partner or other stakeholder in a business organization has constitutional standing to sue for an alleged loss in the value of its interest in the organization. In so holding, we are mindful of the statutory provisions that define and limit a stakeholder’s ability to recover certain measures of damages, which protect the organization’s status as a separate and independent entity. Those provisions, however, go to the merits of the claim; they do not strip a court of subject-matter jurisdiction to render a take-nothing judgment if the stakeholder fails to meet the statutory requirements.”

Having concluded that Walker’s challenge to EMC Cement BV’s “standing” did not concern subject-matter jurisdiction, the court next considered whether Walker’s challenge raised an issue of capacity requiring special preservation. In the court of appeals’ view, Walker was challenging EMC Cement BV’s authority to recover its loss in its capacity as a limited partner, and the issue had been waived by failing to file a verified plea under Rule 93(2). The Supreme Court agreed with the court of appeals that, by challenging EMC Cement BV’s ability to recover the lost value of its interest in the Partnership, Walker was challenging EMC Cement BV’s capacity:

In *Pledger v. Schoellkopf*, we held that the question whether a claim brought by a shareholder actually belongs to the corporation is a matter of capacity. “When capacity is contested, Rule 93(2) requires that a verified plea be filed anytime the record does not affirmatively demonstrate the plaintiff’s ... right to bring suit ... in whatever capacity he is suing.” Because the defendants did not file a plea contending that the plaintiff’s claims were owned by the corporation, we concluded the plaintiff was entitled to recover on those claims and it was unnecessary to determine who owned them. Requiring a defendant to raise this “wrong plaintiff” problem by verified plea allows the plaintiff an opportunity to correct the problem if possible, such as through assignment or joinder, and signals whether the parties need to develop and present evidence on the issue at trial. Absent such a plea, “[j]ust how [the plaintiff] acquired the cause of action is not before [the] Court.”

We hold that the question whether a claim brought by a partner actually belongs to the partnership is likewise a matter of capacity because it is a challenge to the partner’s legal authority to bring the suit. Chapters 152 and 153 of the Business Organizations Code include sections addressing a partner’s authority to sue.

Section 152.210 provides that one partner is liable to another (and to the partnership) for “a violation of a duty to the partnership or other partners under this chapter that causes harm to the partnership or the other partners.” Section 152.211 then delineates the authority of partners and partnerships to bring claims and seek various remedies. It provides that one partner “may maintain an action against ... another partner for legal or equitable relief” to enforce certain rights or otherwise protect its interests, and that the partnership “may maintain an action against a partner for a breach of the partnership agreement ... causing harm to the partnership.” *Id.* § 152.211(a)–(b).

In addition, Chapter 153 expressly gives a limited partner authority to sue derivatively for injury to the limited partnership when certain requirements are met. *See id.* §§ 153.401–413.

Here, EMC Cement BV has not sued in a derivative capacity for injury to the Partnership. Instead, the parties dispute whether the damages EMC Cement BV recovered were personal or for harm to the Partnership, as well as whether sections 152.210 and 152.211 authorize EMC Cement BV to recover those damages. Because Walker’s answer did not include a verified plea challenging EMC Cement BV’s capacity to recover as required by Texas Rule of Civil Procedure 93(2), the court of appeals concluded he waived these challenges to EMC Cement BV’s damages.

In reaching this conclusion, the court of appeals did not consider our *In re Fisher* decision. There, one limited partner sued two others, who sought dismissal on the ground that the plaintiff’s claims against them actually belonged to the partnership. We explained that a partner “may bring claims for those injuries he suffered directly.” Because the plaintiff alleged that he suffered damages and nothing in his petition “affirmatively negate[d] his having been personally aggrieved,” we concluded the trial court did not clearly abuse its discretion in rejecting the defendants’ request for dismissal.

Although we agree with the court of appeals that challenges to capacity must be raised by a verified plea in the defendant’s answer, *see* TEX. R. CIV. P. 93(2), *Fisher* shows that issues regarding a partner’s authority to sue for damages to the partnership will not always be apparent from the face of the plaintiff’s petition. In this case, both the Texas EMC Products partnership and its limited partner EMC Cement BV sued other partners. EMC Cement BV did not plead that it was attempting to recover damages suffered by Texas EMC Products. Their petition referred to both Texas EMC Products and EMC Cement BV as “Plaintiffs,” and they alleged that “Plaintiffs have sustained damages as a direct and proximate result of Walker and Wilson’s breaches.”

Because EMC Cement BV alleged that it sustained damages as a result of Walker and Wilson’s breaches, Walker had no reason under *Fisher* to file a verified plea challenging EMC Cement BV’s capacity to recover for damages to Texas EMC Products. Walker’s complaint about what damages EMC Cement BV was attempting to recover did not arise until EMC Cement BV requested that the jury be instructed to base its damages for Walker and Wilson’s breach of the partnership agreement on the difference in the value of EMC Cement BV’s interest in the partnership before and after the breach. Walker objected to the instruction, asserting that the claim for damages belonged to the Partnership and there was no evidence of a separate loss to EMC Cement BV over and above any loss sustained by the Partnership. Because Walker timely raised this complaint in the trial court, we may consider it as part of his challenge to EMC Cement BV’s damages.

The Supreme Court went on to conclude that it did not need to decide whether EMC Cement BV lacked capacity to recover because there was insufficient evidentiary support for EMC Cement BV’s damages even if it had capacity. The court observed that the damage awards (other than for misappropriation of trade secrets) were all based on the loss in value of the Partnership or the loss in value of EMC Cement BV’s interest in the Partnership. “Value” was defined in the jury charge as “‘Market Value,’ the amount that would be paid in cash by a willing buyer who desires to buy, but is not required to buy, to a willing seller who desires to sell, but is under no necessity of selling.” Consistent with the jury’s findings, the trial court’s judgment awarded the Partnership \$7 million for lost value caused by tortious interference with Pike’s management agreement and \$1 million for lost value caused by breach of that management agreement. The judgment also awarded EMC Cement BV \$7 million for lost value of its interest caused by breach of the partnership agreement. After discussing the evidence of damages presented at trial, the Supreme Court concluded that it was insufficient:

We hold that none of the EMC plaintiffs’ evidence was legally sufficient to support the damages awarded. Generally, when we sustain a no-evidence issue after a trial on the merits, we render judgment on that issue. When there is evidence to support some amount of damages, but not all, rendition is not appropriate. But here, there was no evidence of any damages because the testimony of Lygren and [financial consultant Paula] Miller was conclusory, and [Harry] Swanstrom’s testimony of purchase price was no evidence of market value. [Swanstrom’s



engineering firm designed and built the Partnership’s plant.] Because there is no evidence of damages, we reverse the portions of the judgment awarding damages and render a take-nothing judgment.

The court also concluded that EMC Cement BV should not recover in damages for misappropriation of trade secrets, that the trial court did not abuse its discretion in denying EMC Cement BV a permanent injunction, and that the award of attorney’s fees to EMC Cement BV needed to be reversed (“[b]ecause we have held that the evidence of actual damages is insufficient, we must also reverse the award of attorneys’ fees”).

Justice Bland dissented in part from the court’s ruling:

To grant limited partners standing to sue individually for claims against other partners or a third party for an injury to the partnership causes instability in business organizations and costly litigation for claims that should be dismissed immediately, absent compliance with the Legislature’s derivative standing rules.

Because EMC Cement claimed an injury based on lost value of the partnership, we should dismiss its claim for lack of standing. As a limited partner, it lacked standing to recover the partnership’s lost profits. Because standing implicates subject-matter jurisdiction, the court of appeals erred in concluding that the defendant partners waived a challenge to this direct recovery. This Court compounds that error by disregarding a partnership’s status as an independent entity in concluding that derivative standing requirements may be waived—and a partnership’s recovery taken—in a limited partner’s enforceable judgment, in contravention of the limited partnership’s governing documents.

We instead should hold that EMC Cement, as a limited partner, has no legal standing to sue for an injury to ... the partnership, and dismiss EMC Cement’s recovery on that claim for lack of jurisdiction. Because we do not, I respectfully dissent to all but Part IV of the Court’s opinion and judgment.

***Cohen v. Flat Stone Development Company, Inc.***, Civil Action No. 4:16-CV-00283, 2018 WL 11312999 (S.D. Tex. Oct. 5, 2018) (Although the court issued this opinion in 2018, it is included in this year’s update because it did not appear in the Westlaw database until recently.).

A limited partner transferred his interests in limited partnerships to trusts that did not become substituted limited partners, and the transferor limited partner thus remained a limited partner and had standing to assert derivative claims on behalf of the partnerships, but he did not meet the statutory pleading requirements to assert the claims. The assignee trusts did not have standing to assert derivative claims.

Flat Stone I was a Texas limited partnership formed by general partner Flat Stone Development Company, Inc. and limited partners Jay Cohen and Howard Hebert. Flat Stone II was a Texas limited partnership formed by general partner Flat Stone II of Texas, Inc. and limited partners Jay Cohen and Flat Stone II of Texas, Inc. A&D was a Texas limited partnership formed by general partner Commerce Equities II, LLC and limited partners JHC Trust II, Matthew Dilick, and Rocky Hollow Development Corporation. JHC Trust I and JHC Trust II were revocable trusts formed by Jay Cohen as grantor and Clifton Hebert as trustee. The trust agreements effectuated the transfer of Jay Cohen’s limited partnership interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, and named Cohen as beneficiary of the trusts.

The limited partnership agreements of Flat Stone I, Flat Stone II, and A&D contained identical provisions regarding the transfer of limited partnership interests and the admission of assignees as limited partners. The agreement permitted a limited partner to transfer all or any of its interest in the limited partnership to “the trustee of a trust created for the benefit of [the] Limited Partner.” After such a transfer, the “transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied.” The agreements specified the requirements for “a transferee of an interest in the Partnership” to “be admitted to the Partnership as a substituted Limited Partner,” including the execution of necessary documents, contribution of capital, and consent from all partners.

In this opinion, the court addressed the defendants’ motion to dismiss claims brought by Cohen and his trusts for breach of duties owed to the limited partnerships. The court reviewed the requirements for bringing a

derivative suit under Federal Rule 23.1 and the Texas Business Organizations Code. In addition to verifying the complaint, pleading that the plaintiff was a member of the corporation or association at the time of the transaction complained of, and explaining any effort by the plaintiff to urge the association to assert the claims as required by Rule 23.1, the court set forth the requirements at the time under Chapter 153 of the Texas Business Organizations Code. Under those provisions, a limited partner was permitted to bring a derivative action on behalf of the limited partnership if “(1) all general partners with authority to bring the action have refused to bring the action; or (2) an effort to cause those general partners to bring the action is not likely to succeed.” Tex. Bus. Orgs. Code Ann. § 153.401. The plaintiff was required to be a limited partner when the action is brought and must have been a limited partner at the time of the transaction that was the subject of the action. Tex. Bus. Orgs. Code Ann. § 153.402. Additionally, the court cited case law in support of the proposition that the limited partner must maintain its status.

With regard to who was a limited partner and who was an assignee and the rights of such, the court relied on Chapter 153 of the Texas Business Organizations Code and the limited partnership agreements. An assignee of a partnership interest may become a limited partner to the extent that the partnership agreement provides. Tex. Bus. Orgs. Code Ann. § 153.253. Although Cohen transferred his interests in Flat Stone I and Flat Stone II to JHC Trust I and JHC Trust II, respectively, the limited partnership agreements governing both limited partnerships provided that Cohen retained his status as limited partner, stating that the “transferring Limited Partner shall continue to exercise all rights and be liable for all duties imposed by [the] Agreement.... Assignee shall not automatically become a substituted Limited Partner unless the conditions of Section 8.1 are satisfied.” The court located no evidence indicating that JHC Trust I or JHC Trust II as transferees met the requirements to become substituted limited partners, nor did the court locate any evidence indicating that JHC Trust II lost its status as limited partner of A&D. Therefore, only Cohen had standing as a limited partner to bring derivative claims on behalf of Flat Stone I and Flat Stone II, and only JHC Trust II had standing as a limited partner to bring derivative claims on behalf of A&D. The derivative claims asserted by the trusts as assignees were dismissed. Cohen and JHC Trust II had standing in their capacity as limited partners of the Flat Stone partnerships and A&D, respectively, to bring their derivative claims, but they failed to meet the verification requirement. Further, it was unclear whether they had satisfied an order requiring security (which had been entered under Tex. Bus. Orgs. Code § 153.404(a)). Thus, the court entered an order providing that these requirements must be met in order to avoid dismissal of their derivative claims.

*See also RLB Contracting, Inc. v. Genesis Energy, L.P.*, Civ. A. No. H-18-3844, 2020 WL 5880918 (S.D. Tex. Oct. 2, 2020); *Benge v. Thomas*, No. 13-18-00619-CV, 2020 WL 5054800 (Tex. App.—Corpus Christi Aug. 27, 2020, no pet.) (mem. op.) summarized above under “Standing or Capacity to Sue.”

## **M. Divorce of Partner**

*In re Marriage of VanDusen and Kairis*, No. 10-18-00285-CV, 2020 WL 6302315 (Tex. App.—Waco Aug. 26, 2020, no pet.) (mem. op.).

The court of appeals reversed the trial court’s findings that a business partnership had been created in 1995 and that real estate purchased was partnership property. The court remanded for a new trial on the issue of partnership formation and the division of any partnership property.

In 1995, Richard Kairis found a tract in Walker County that Susan VanDusen purchased near her mother. The property was purchased in VanDusen’s individual name and she paid for it from her income. The property had a house on it that was in disrepair. Kairis moved in shortly after the purchase so that he could work on repairing the house and mowing the property. VanDusen continued working in Houston and would go to the property on the weekends.

In 1998, VanDusen purchased a second tract in her sole name which she sold to her mother for the same amount as the purchase price. The tract was adjacent to her mother’s property. In 2002, VanDusen purchased another tract in the same area in her sole name with funds provided by VanDusen’s mother. Kairis worked on the house on that property which was also in disrepair and began to work on that property as well. In 2002, Kairis also purchased some miniature pigs which were raised on the property purchased in 1995. Any profits from the sale of the pigs went into VanDusen’s bank accounts and VanDusen either paid for the pigs’ expenses or reimbursed Kairis for any expenses he paid. This business was never profitable and resulted in a loss which was taken fully by

VanDusen as shown on her tax returns from 2003 to 2008, when they stopped selling the pigs. VanDusen's tax returns never indicated the existence of a partnership.

In 2004, Kairis assisted VanDusen's mother and sisters with selling property in another county. Kairis demanded to be paid for his assistance; thus, in 2005, he was paid either \$15,000 or \$30,000 (there was evidence as to both amounts) which VanDusen applied to the mortgage on the property purchased in 2002.

In 2006, VanDusen purchased another tract in her sole name. In 2007, VanDusen sold her residence in Houston and moved to the property purchased in 2002 while still commuting to her job in Houston. VanDusen used part of the proceeds from the sale of her residence to purchase additional property in her sole name in 2008. All of the real estate transactions were organized and executed by Kairis using a power of attorney for VanDusen.

Towards the end of 2008, the parties began raising cattle on the property, which continued until the time of their trial. While the parties were together, Kairis was responsible for procuring feed for the cattle. During this time, Kairis paid for expenses either with cash he kept (with VanDusen's agreement) from sales or with VanDusen's debit or credit cards. Alternatively, VanDusen would reimburse him by check which he could cash.

Kairis testified that the parties intended to purchase the tracts and to pursue the farming and ranching operations jointly and equally. Kairis alleged that VanDusen told him that the property was all "community property" and that "[t]his was the partnership that we formed up and this was the partnership we lived under." VanDusen testified that she did not ever intend for a business partnership to be formed and had paid for all of the real property herself other than the one-time contribution from Kairis on the property purchased in 2002, of which she disputed the amount and character.

VanDusen and Kairis were formally married on February 22, 2009 and continued everything in the same manner after their marriage until their separation. VanDusen filed for divorce in 2017 and Kairis filed a counterpetition in which he sought a finding that the parties had become informally married in 1984, or alternatively, that the parties had entered into a business partnership. VanDusen did not file a verified denial of the existence of a partnership as required by Rule 93(5) of the Rules of Civil Procedure.

At the beginning of the bench trial, the trial court made a finding that a business partnership existed due to VanDusen's failure to file a verified denial. Nevertheless, the court required the parties to present evidence to prove when the partnership was formed, the terms of the partnership, and the existence of any partnership property. The trial court ultimately entered a judgment that the parties were not informally married but had entered into a business partnership in 1995. The court also found that the real estate purchased between 1995 and 2008 was property of the partnership.

The court of appeals began by observing that it was not asked to determine if a business partnership ever existed between the parties due to VanDusen's failure to properly deny the existence of a partnership. Instead, it was called upon to determine whether or not the evidence supported the trial court's finding that a partnership was created in 1995. The court noted that "[A]n association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name." *Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P.*, 593 S.W.3d 732, 737 (Tex. 2020) (quoting Tex. Bus. Orgs. Code § 152.051(b)). It further explained that the Texas Business Organizations Code sets forth five factors that a court should review in determining whether a partnership exists: (1) receipt or right to receive a share of profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing: (A) losses of the business; or (B) liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business. Tex. Bus. Orgs. Code § 152.052(a). According to the court, whether a partnership exists must be determined by an examination of the totality of the circumstances. Evidence of none of the factors will preclude the recognition of a partnership, and even conclusive evidence of only one factor will also normally be insufficient to establish the existence of a partnership. Conclusive evidence of all five factors, however, establishes a partnership as a matter of law. For cases on the "continuum" between these two extremes, the court observed that whether an arrangement is considered a partnership will often present a question of fact.

After explaining the legal framework, the court of appeals concluded that there was legally insufficient evidence of a business partnership formed in 1995:

VanDusen argues that the evidence was insufficient for the trial court to have found that the partnership was established in 1995 because the elements required to form a partnership did

not exist at that time. The evidence presented at trial relating to what occurred prior to 1995 was that VanDusen was assaulted outside of her residence and had her car stolen twice in the early 1990's which led to VanDusen and Kairis deciding to find land outside of Houston to get out of the city. In 1995, Kairis located and VanDusen purchased a tract in her name only that referred to her as a "sole" purchaser. VanDusen paid for everything relating to that property, including the purchase price and all taxes. Kairis testified that the intent was for VanDusen to "work hard" in Houston and for him to work on the property because it was overgrown with weeds and the house was in disrepair, including problems with the foundation. Kairis moved to that tract in 1995 or 1996 after making the house livable.

While Kairis testified that the parties' intent was for him to work on the property, there was no evidence presented that the parties were intending to use that property for the purpose of operating a business of any kind in 1995. There was no evidence presented regarding the right to receive a share of profits of a business, any intent to be partners in a business, any agreement regarding sharing losses or liability for claims owed to any third parties of any potential business, or an agreement to contribute property to a business. There was no evidence presented that a farming or ranching operation or any other business was even contemplated in 1995, and no reference to any operable business was made until the miniature pigs were purchased around 2002 and VanDusen began taking an individual loss from the pigs on her tax returns. We find that the evidence was legally insufficient for the trial court to have determined that a business partnership was formed in 1995. ... Neither party has requested this Court to determine whether, and if so, when the evidence established that the partnership was formed, so we will not do so.

The court then turned to the issue of partnership property and concluded that the evidence was legally insufficient for the trial court to have found that the real property purchased between 1995 and 2008 was partnership property:

In her third and fourth issues, VanDusen complains that the evidence was legally and factually insufficient to support the trial court's finding that the real property purchased beginning in 1995 was property of the partnership pursuant to the Business Organizations Code. Section 152.102(c) of the Business Organizations Code, entitled "Classification as Partnership Property", states:

- (a) Property is partnership property if acquired in the name of:
  - (1) the partnership; or
  - (2) one or more partners, regardless of whether the name of the partnership is indicated, if the instrument transferring title to the property indicates:
    - (A) the person's capacity as a partner; or
    - (B) the existence of a partnership.
- (b) Property is presumed to be partnership property if acquired with partnership property, regardless of whether the property is acquired as provided by Subsection (a).
- (c) Property acquired in the name of one or more partners is presumed to be the partner's property, regardless of whether the property is used for partnership purposes, if the instrument transferring title to the property does not indicate the person's capacity as a partner or the existence of a partnership, and if the property is not acquired with partnership property.
- (d) For purposes of this section, property is acquired in the name of the partnership by a transfer to:
  - (1) the partnership in its name; or
  - (2) one or more partners in the partners' capacity as partners in the partnership, if the name of the partnership is indicated in the instrument transferring title to the property.

TEX. BUS. ORGS. CODE § 152.102.

In its findings of fact, the trial court made a finding that at the time that each tract of real property was acquired, the parties intended for the real property purchased to be partnership property regardless of the source of the purchase money or in whose name the property was purchased. VanDusen complains that there was legally and factually insufficient evidence for the trial court to have made this finding.

It is undisputed that each of the tracts of real property were purchased by VanDusen individually, were titled in her name only with no reference to a partnership, and all initial payments for the property were paid by VanDusen. Kairis contends that because he presented some competing evidence that the property was partnership property, the presumption that the property was not partnership property was of no effect. VanDusen argues that the above facts conclusively establish that the property was not property of the partnership pursuant to Section 152.102 of the Business Organizations Code and that there is no presumption in the statute otherwise that applies in this circumstance. We disagree with VanDusen's assertion that no presumption applies. Section 152.102(c) uses the term "presumption" for property owned by a person that is not considered partnership property. To say that there is no presumption because she bought the property in her name and paid for it disregards what appears to be the clear intent of the statute. We find that there was a presumption that the property was not partnership property but was VanDusen's property. See TEX. BUS. ORGS. CODE § 152.102(c) ...

It was Kairis's burden to rebut this presumption and to prove that each of the tracts of real property were partnership property. At a minimum, the property acquired in 1995 was improperly characterized as partnership property because we have found that no partnership existed as of that time. Kairis argues that his testimony that he worked on the properties for years without compensation and that he would never have done so if he had thought that he did not own the property equally with VanDusen might be sufficient contradictory evidence to eliminate the presumption. However, there was no testimony as to the purpose for which any of the other tracts of real property were purchased at the time of their purchase, except one on which Kairis stated that VanDusen wanted to raise chickens and plant an orchard, although there was no evidence that this was for business or personal purposes or that either of these things ever took place. There was no testimony regarding a partnership business purpose for the properties by either Kairis or VanDusen given at the time of each purchase to support the trial court's finding of fact. Kairis had arranged for the purchases of each of the tracts and completed them using a power of attorney given to him by VanDusen yet he did not include a mention of a partnership on any of the deeds. All of the payments made on the property were made by VanDusen with the exception of the one-time payment in 2005 of either \$15,000 or \$30,000 from funds that were potentially attributable to Kairis that VanDusen applied to the tract of property purchased in 2002. There was no evidence that VanDusen intended for the real property to be partnership property when it was purchased. We do not find that the evidence was legally sufficient to support the trial court's findings that at the time of their purchase, the properties purchased between 2002 and 2008 were intended by both of the parties to be property of a partnership.

#### **N. Bankruptcy**

*Green v. Tow (In re Garrison Municipal Partners, LP)*, Civil Action No. H-17-3567, Bankruptcy No. 14-32867, 2021 WL 1398971 (S.D. Tex. Mar. 17, 2021).

The court held that a claim by a withdrawn limited partner against the partnership for payment of the amount owed for the partner's interest under the terms of the partnership agreement resembled a redemption and should not have been subordinated under Section 510(b) of the Bankruptcy Code.

Green was a limited partner in a limited partnership whose partnership agreement provided that a limited partner could voluntarily withdraw his interest at the end of each fiscal quarter. Green gave written notice of his intent to withdraw effective December 31, 2013. In May of 2014, the partnership filed for Chapter 7 bankruptcy. Green filed a claim for a general unsecured debt, and the bankruptcy court subordinated the claim under Section 510(b) of the Bankruptcy Code, which provides:

A claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security.

The position of the trustee and the bankruptcy court was that the claim was merely a breach of contract claim because the partnership violated the limited partnership agreement by not paying the withdrawal request on time, and the claim was not independent of the equity interest because it arose from the purchase of the security interest. Further, the trustee and the bankruptcy court took the position that the claim could not be a redemption because a redemption would require either that the debtor take action, such as issuing a promissory note, or that the provision be self-executing.

The district court held that Green's claim most closely resembled a redemption claim, reasoning that once the deadline to pay Green had passed, what was originally an equity interest became a fixed debt. According to the court, the debt interest was sufficiently separate from the original limited partnership interest because Green no longer had the benefit of the equity interest in that he no longer had any right to the income, gains, and losses of the partnership. Green could only claim the fixed amount he should have been paid. The amount of his debt became fixed at the time of withdrawal and could no longer change in value like an equity interest would. The court found it irrelevant that a separate promissory note was not issued by the partnership. The withdrawal provision was self-executing, and the liability became fixed after the deadline to pay it passed. The partnership only had discretion as to how and by what means that liability could be paid. The court commented further that Green and the partnership "went through the trouble when creating the partnership agreement to design it as more than just a simple cash loan—to the benefit of all parties. Allowing [the partnership] unilaterally to change the functioning of the agreement years later goes against common business sense."

In sum, because Green's claim had converted from an equity interest to a fixed debt interest, the bankruptcy court erred in subordinating the claim under 11 U.S.C. § 510(b).

## **O. Diversity Jurisdiction**

The Fifth Circuit Court of Appeals and federal district courts continue to hold that the citizenship of a partnership or LLC is determined by the citizenship of each of its partners or members. (If the partners or members are themselves partnerships, LLCs, or corporations, their citizenship must be alleged in accordance with the rules of that entity, and the citizenship must be traced through however many layers of members or partners there may be.) The cases applying this principle are too numerous to include in this paper, but recent opinions addressing somewhat novel or unsettled issues in this context are included below.

*Williams v. Pipe Pro, LLC*, No. 6:20-CV-00057, 2021 WL 951933 (S.D. Tex. Mar. 12, 2021).

The court noted that the issue of a master limited partnership's citizenship has not been directly addressed by the Fifth Circuit, but the court concluded that the Tenth Circuit and a fellow judge in the Southern District of Texas reached the correct conclusion in previously holding that the citizenship of a master limited partnership is determined by the citizenship of its members or "unitholders." Because there was sworn testimony that the master limited partnership in this case "had shareholders" [which the court equated to unitholders or members] across the United States, including citizens of Louisiana," the LLC, like the plaintiffs, was a citizen of Louisiana, and complete diversity of citizenship was lacking. It was not lost on the court that its holding effectively shields master limited partnerships that are citizens of every state from diversity jurisdiction, but the court noted that the Supreme Court has acknowledged that the law in this area is "technical, precedent bound and unresponsive to policy considerations raised by the changing realities of business organization"

*Hise Real Estate Investments v. Great Lakes Insurance SE*, No. 4:20-CV-820-SDJ, 2021 WL 217264 (E.D. Tex. Jan. 21, 2021).

The court noted that the Fifth Circuit has not expressly held that a party may plead the citizenship of an opposing party "upon information and belief" but that other circuits have so held, and the court concluded that "when a defendant has diligently investigated publicly available sources and determined that no partner of a

plaintiff partnership is likely a citizen of the same state as the defendant, the defendant may affirmatively state the citizenship of a partnership upon ‘information and belief.’” Accordingly, the court held that the defendant’s amended notice of removal adequately pled the citizenship of the limited partnership plaintiff by affirmatively alleging that the limited partnership’s general partner is a corporation incorporated in Texas and maintaining its principal place of business in Texas, and that “[u]pon information and belief, based on an extensive review of the real property records and relevant documents regarding the insurance policy at issue, counsel for [the defendant] believes the limited partner of [the limited partnership] ... is Franklin R. Hise, who is domiciled in Texas.”

## **P. Statute of Limitations**

*Nguyen v. Estate of Thin Thi Ta*, No. 19-10934, 2020 WL 4873199 (5th Cir. Aug. 19, 2020).

The Fifth Circuit affirmed the grant of summary judgment on statute of limitations grounds because a breach-of-partnership-agreement claim had a four-year limitations period.

In 1982, Nguyen’s mother, Ha Thi Thu Thuy, entered into a partnership with Ta Van Viet to establish a business in Vietnam named “Snow White.” Viet died in 1989, and Thuy purchased his business interests from his heirs, the defendants. One of those heirs, Ngo Thi Ngoan, purported to evict Thuy from Snow White’s manufacturing facility in November 2012. Ngoan held onto the business’s assets. Despite Thuy’s requests, none of the heirs agreed to return the property.

In November 2012, Thuy also entered into a dispute-resolution process operated by the local Vietnamese government. That process was unsuccessful. Thuy later assigned her interest in Snow White (including its assets, and any claims against defendants) to Nguyen. In September 2018, Nguyen brought this lawsuit in federal district court.

The district court granted summary judgment to defendants. Among other things, the district court found that Nguyen’s claims were untimely. The court held that Texas’s statute of limitations applied to Nguyen’s Vietnamese-law causes of action—a holding the parties did not dispute on appeal. The Fifth Circuit agreed that the statute of limitations had expired:

The longest statute of limitations applicable to Nguyen’s claims is the four-year period for contract actions. *See* TEX. CIV. PRAC. & REM. CODE 16.004(a). In Texas, “[i]t is well-settled law that a breach of contract claim accrues when the contract is breached.” As Nguyen concedes, the breach of the partnership agreement—Thuy’s eviction from Snow White’s facility by Ngoan—took place in November 2012. That is when the contract claims accrued. Those claims therefore became time-barred in November 2016, nearly two years before Nguyen filed this lawsuit.

Nguyen offers various reasons why the limitations period was tolled and his claims are still timely. None has merit.

He first notes that equitable tolling is available when “a claimant actively pursue[s] his judicial remedies but filed a defective pleading during the statutory period, or where a complainant was induced or tricked by his adversary’s misconduct into allowing filing deadlines to pass.” But he does not claim that he filed a defective pleading during the four-year period, or that he was tricked into filing late.

Nguyen also insists that the partnership contract governing Snow White required the parties to submit their dispute to the local Vietnamese government’s dispute-resolution procedure. In Nguyen’s view, this either delayed accrual until after the Vietnamese procedure was finished or tolled the limitation period during that procedure. But the contract provides only that the parties must “[f]ollow strictly all current laws and rulings of the State and of the local government.” Even assuming that this clause, as a matter of Vietnamese law, required submission to the local government’s dispute-resolution procedure, there is no contractual provision that tolls the limitation period while the proceedings were ongoing. And although Texas law provides for the tolling of a limitation period when the plaintiff files a *lawsuit*, *see Sun v. Al’s Formal Wear of Houston, Inc.*, 14-96-01516-CV, 1998 WL 726479, at \*6 (Tex. App.—Houston [14th Dist.] Oct. 15, 1998, no pet.), Nguyen cites no Texas-law authority for tolling during non-judicial dispute resolution.

Finally, Nguyen asserts that the cause of action against the defendants other than Ngoan accrued in 2017 (rather than 2012) when they refused to hand over the property in contravention of a Vietnamese court order. But Nguyen alleged in the district court that “all Defendants” had refused to return Snow White and its assets during the pendency of the Vietnamese proceedings “[f]rom 2013 until 2018.” Therefore, even assuming that the refusal to hand over property created a cause of action separate from the 2012 breach-of-contract claim, that separate cause of action accrued when it first occurred in 2013. Nguyen offers no basis in law—Vietnamese or Texa[s]—for the court to conclude that the 2017 refusal restarted or tolled the limitation period. This putative separate cause of action therefore became time-barred in 2017, four years after it accrued and one year before Nguyen filed his lawsuit.

#### **Q. Service of Process**

*Comako Int’l, Inc. v. Delorme*, Civ. A. No. 7:19-CV-00385, 2020 WL 3525477 (S.D. Tex. Jan. 22, 2020) (“A corporation, partnership, or association, when served within a judicial district in the United States, must be served ‘by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process—and if the agent is one authorized by statute and the statute so requires—by also mailing a copy of each to the defendant’ or by serving the entity in accordance with state law. FED. R. CIV. P. 4(h)(1).”).

*Just Industrial Servs. LLC v. CEDA Specialty Servs. LP*, Civ. A. No. H-18-1255, 2019 WL 11254355 (S.D. Tex. Feb. 11, 2019) (Although the court issued this opinion in 2019, it is included in this year’s update because it did not appear in the Westlaw database until recently.).

“Remaining CEDA Defendants contend Just Industrial failed to properly serve process on CEDA Specialty [a limited partnership]. Just Industrial contends it properly served CEDA Specialty under § 17.021 of the Texas Civil Practice and Remedies Code. Section 17.021(a) applies in ‘an action against an individual, partnership, or unincorporated association that arises in a county in which the individual, partnership, or association has an office, place of business, or agency for transacting business in this state ....’ Tex. Civ. Prac. & Rem. Code § 17.021(a). Section 17.021(a) permits service on the ‘agent or clerk employed in the office, place of business, or agency ....’ *Id.*

It is undisputed CEDA Specialty is a partnership under § 17.021(a). Just Industrial states it properly served CEDA Specialty under § 17.021(a) by serving Utsey. Remaining CEDA Defendants state CEDA Specialty does not have an office, place of business, or agency for transacting business in Texas, and Utsey is not an agent or clerk employed in such an office, place of business, or agency. Remaining CEDA Defendants explain Utsey is a director of CEDA Inc., which is not a party to this lawsuit. Remaining CEDA Defendants cite to the Churchill Affidavit, which states CEDA Specialty’s headquarters are in Alberta, Canada and further states CEDA Specialty has not authorized Utsey or CEDA Inc. to accept service on CEDA Specialty’s behalf. Just Industrial does not cite to any evidence to dispute the Churchill Affidavit. The Court finds Just Industrial fails to meet its burden to show it properly served CEDA Specialty. Thus, the Court finds Just Industrial failed to properly serve CEDA Specialty. Having found Just Industrial failed to properly serve Remaining CEDA Defendants, the Court turns to the remedy.

...

If a plaintiff fails to properly effect service of process, the Court has discretion to dismiss the case without prejudice or to quash the prior attempt at service and afford another opportunity for service. Under Rule 4(m), service must be made within ninety days after the complaint is filed, but the Court may extend the time for service upon a showing of good cause. Because the petition was filed on February 21, 2018, the ninety-day period to effect proper service has expired. However, Just Industrial’s attempt to serve Remaining CEDA Defendants by serving Utsey, a director of CEDA Inc., indicates a good-faith attempt to effect service of process on Remaining CEDA Defendants. Further, Remaining CEDA Defendants do not contend late service would be futile or impose undue hardship. The Court finds it is appropriate to extend the time for Just Industrial to serve Remaining CEDA Defendants. Accordingly, the motion to dismiss for insufficient service of process is denied without prejudice, Just Industrial’s attempt at service is quashed, and the time for serving Remaining CEDA Defendants is extended for sixty days from the date of this Order.”



## R. Pro Se Representation

**Chaves v. Cogent Medical Laboratory, LLC**, SA-19-CV-00861-ESC, 2020 WL 5096946 (W.D. Tex. Aug. 28, 2020) (“The record in this case establishes that Defendant failed to plead or otherwise defend against Plaintiff’s claims since the withdrawal of its counsel, as an LLC cannot represent itself pro se in this action. *See Memon v. Allied Domecq QSR*, 385 F.3d 871, 873 (5th Cir. 2004) (‘Although 28 U.S.C. § 1654 authorizes individuals to appear in federal courts pro se, the statute is silent regarding corporations. The lack of authorization in § 1654 has been interpreted as barring corporations from appearing in federal court without an attorney.’); *Lattanzio v. COMTA*, 481 F.3d 137, 140 (2d Cir. 2007) (‘Because both a partnership and a corporation must appear through licensed counsel, and because a limited liability company is a hybrid of the partnership and corporate forms, ... a limited liability company also may appear in federal court only through a licensed attorney.’) (internal citations omitted). The undersigned therefore finds that the Clerk properly entered default, and Plaintiff is entitled to default judgment because the facts alleged in Plaintiff’s Complaint state a claim upon which relief can be granted.”).

**Strauss v. Lake City Credit**, Civ. A. No. 4:19-CV-00620-SDJ-CAN, 2020 WL 4589731 (E.D. Tex. July 14, 2020).

“The Motion to Vacate submitted by pro se Defendant Gary S. Williky on behalf of Defendant Lake City Credit should be denied. As stated in the Court’s prior recommendation, Defendant Williky cannot represent the interests of Defendant Lake City Credit in this action. Defendant Lake City Credit is a limited liability company. ‘28 U.S.C. § 1654 states that ‘in all courts of the United States the parties may plead and conduct their own cases personally or by counsel as, by the rules of such courts, respectively, are permitted to manage and conduct causes therein.’ ‘Courts have uniformly interpreted this statute to mean that corporations, partnerships, or associations are not allowed to appear in federal court other than through a licensed attorney.’ ‘Under both Texas and federal law, [t]he rule is well settled that a corporation can appear in a court of record only by an attorney at law.’ Stated differently, a corporation or other artificial entity may not appear pro se or be represented by a non-attorney.

Defendant Lake City Credit—a corporate entity—may not appear in federal court unless represented by licensed counsel. Defendant Gary Williky is not a licensed attorney. Because Defendant Williky is not a licensed attorney, he cannot make an appearance on behalf Defendant Lake City Credit. To permit the filing made by Defendant Williky on behalf of Defendant Lake City Credit to stand as properly filed would functionally permit Defendant Williky to represent Lake City Credit. “The Court cannot permit this action to proceed with a non-lawyer asserting legal positions on behalf of a separate legal entity.” Moreover, Defendant Lake City Credit has had ample time to engage counsel and has engaged counsel to represent it in other similar matters pending in other federal courts.”

**Reagan v. Brown**, Civ. A. No. 3:18-CV-877-G-BH, 2020 WL 3052513 (N.D. Tex. April 23, 2020), report and recommendation adopted, 2020 WL 3051447 (N.D. Tex. June 8, 2020) (“In the federal courts of the United States, ‘parties may plead and conduct their own cases personally or by counsel.’ 28 U.S.C. § 1654. Individuals who are not ‘licensed to practice law may not represent the legal interests of others’ in federal court, however. It is well-established that corporations are fictional legal persons who can only be represented by licensed counsel. The rationale for this long-standing rule applies equally to ‘all artificial entities,’ such as partnerships and associations. Even if the person seeking to represent the artificial entity is its president and major stockholder or has some other close association with it, the only proper representative is a licensed attorney. When this type of party declines to hire counsel to represent it, the court may dismiss its claims if it is a plaintiff, or strike its defenses if it is a defendant.”).

## S. ERISA

**Data Marketing Partnership, LP v. United States Department of Labor**, Civ. A. No. 4:19-cv-00800-O, 2020 WL 5759966 (N.D. Tex. Sept. 28, 2020).

The district court determined that the Department of Labor was enjoined from (1) refusing to acknowledge the ERISA-status of a limited partnership’s health plan and (2) refusing to recognize the limited partners as working owners of the partnership.

Data Marketing Partnership (“DMP”) was a Texas limited partnership that specialized in the production and sale of its limited partners’ (“Limited Partners”) electronic data to third party purchasers. LP Management Services, LLC (“LPMS”) was the general partner of DMP. This case arose out of an adverse advisory opinion issued by the Department of Labor in response to a request by LPMS. LPMS requested confirmation from the Department that the partnership’s proposed group health plan was governed by the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1002(1) (ERISA) as a single-employer welfare benefit plan and that DMP’s Limited Partners were “participants” as defined by ERISA. In response, the Department’s opinion concluded that the Plan was not governed by any title of ERISA, the limited partners were not “participants,” and that one common-law employee was not a sufficient basis for the Plan to cover any number of Limited Partners. Plaintiffs DMP and LPMS filed this lawsuit to challenge the Department’s opinion.

The court first analyzed whether the Limited Partners were “working owners.” For that status, the Limited Partners must (1) have an equity ownership right of any nature in a business enterprise and (2) be actively engaged in providing services to that business. With respect to an equity ownership right, the court noted that the Department of Labor’s definition of working owner required an equity ownership right of any nature. According to the court, that definition was met: “Here, the Limited Partners obtained an ownership interest through the execution of a joinder agreement, periodically vote on how to organize and market the aggregated ‘data bank,’ and exercise management responsibilities over the sale of this data bank to third parties. Because the Limited Partners have an ownership interest ‘of any nature’ ... the Limited Partners are owners.” With respect to active engagement, the court concluded that the Limited Partners were actively engaged in providing services to the partnership:

Plaintiffs are correct that the Limited Partners are “involved in the activities in which the business engages for profit.” (The Limited Partners “provide personal services for the partnership by contributing electronic data that individually and collectively is a material, income-producing factor for the partnership.”) The Limited Partners download specific software on their device, the software collects data, and the data is then aggregated with the other partners’ data to form a data bank owned by the partnership. The Limited Partners then collectively decide what to do with that data bank on behalf of the partnership. ...

The Limited Partners are not passive owners in the way that a passive owner in a publicly traded corporation will receive distributions without having any say in business operations. Therefore, whether the Department considers the Plaintiffs’ business enterprise “legitimate” or “meaningful” is irrelevant because the Limited Partners are not merely passive owners under the Department’s own test. The Department simply does not agree that the services are a legitimate business enterprise, which is not a consideration required by law. The Court will not impose an extra-textual view of what services or industry in which business enterprises must engage to qualify for ERISA coverage. The Limited Partners are actively engaged in the partnership’s business. Accordingly, the Court finds that the Limited Partners are working owners because the Limited Partners have an equity ownership interest of any kind and are actively engaged in [the] partnership’s business.

The court then considered whether the Limited Partners were “bona-fide partners.” Under ERISA regulations, a partner must be a “bona-fide partner” to establish an employment relationship between the partner(s) and the partnership. 29 C.F.R. 2590.732(d)(2)-(3). Whether an individual is a bona-fide partner is determined based on “all the relevant facts and circumstances, including whether the individual performs services on behalf of the partnership.” The Department’s opinion categorized the Limited Partners as “merely consumers purchasing health coverage in exchange for premiums and an agreement that the partnership can track their personal activities on their personal devices.” Plaintiffs argued that the Limited Partners “provide personal services for the partnership by contributing electronic data that individually and collectively is a material, income-producing factor for the partnership.” According to the court, the bona-fide partner analysis simply requires a more-than-pretexual relationship between the employer and employee. The court observed that it had already concluded that the Limited Partners were working owners who were actively engaged in the business. Given that the bona-fide partner standard was a lower threshold, the court concluded that the Limited Partners were bona-fide partners of DMP.

Finally, the court determined that ERISA stated no limit to the number of working owners that may participate in a plan alongside at least one common-law employee: “ERISA’s ‘one or more common-law employees’

regulation unambiguously means that so long as one common-law employee is covered by the plan, it is an ERISA plan in which an unlimited number of working owners may participate. But once the Plan covers a single common-law employee, ERISA imposes no ratio requirement on the number of working owners that may participate. Therefore, the Department's Opinion is incorrect to specify the number of working owners eligible for the Plan beyond that set out by regulation. The Court concludes that the presence of a single common-law employee may extend ERISA coverage to any number of working owners."

Because the Limited Partners were working owners and bona-fide partners, the court concluded that they may participate in the single employer welfare benefit plan set up by DMP, so long as DMP employed at least one common-law employee. The Department's opinion was set aside as arbitrary and capricious under the Administrative Procedure Act and contrary to law under ERISA.

## **T. Receivership**

*In re Hallmark*, \_\_ S.W.3d \_\_, 2020 WL 5186615 (Tex. App.—Eastland 2020, no pet.).

Because a Texas partnership is a "domestic entity" under the Texas Business Organizations Code (TBOC), the court of appeals concluded that the receivership provisions set out in the TBOC provided the exclusive statutory basis for appointing a receiver for a Texas partnership. The court of appeals further concluded that the trial court's order appointing a receiver constituted a rehabilitative receivership, and as such, the trial court was without authority to enter it.

The decedent, Michael Allen Hallmark, was a partner in the Hallmark Ranch partnership with his siblings, Appellant Marvin Lee Hallmark and Appellee Katherine ("Kathy") Hallmark. The independent executrix of Michael's estate, Appellee Rachael Holloway, instituted the underlying suit as an "ancillary" action to the probate proceeding for the purpose of obtaining a declaratory judgment to declare the Estate's rights in the partnership. She named Marvin and Kathy as defendants to the declaratory judgment action based upon their status as partners of the Hallmark Ranch partnership.

Kathy filed a cross-claim against Marvin and the Hallmark Ranch partnership. She asserted that Marvin had engaged in mismanagement in operating the partnership, and she sought the appointment of a receiver. The trial court granted Kathy's request to appoint a receiver and indicated that the appointment was pursuant to § 64.001(a)(3) of the Texas Civil Practice and Remedies Code and, alternatively, § 11.403 of the Texas Business Organizations Code. Marvin appealed.

The court of appeals began its analysis by noting that "[r]e receivership is an extraordinarily harsh remedy and one that courts are particularly loathe to utilize." Even if a specific statutory provision authorizes a receivership, the court observed that a receiver should not be appointed if another remedy exists, either legal or equitable.

The court then proceeded to consider whether the trial court had jurisdiction to enter the receivership order. According to the court, the jurisdictional issue concerned the authority of a county court at law, sitting as a probate court, to enter an order for a receivership of a Texas partnership. Under § 11.402(b) of the TBOC, only a district court has jurisdiction (a) to appoint a receiver for the property and business of a domestic entity for the purpose of rehabilitating the entity as provided by Section 11.404, or (b) to appoint a receiver to liquidate a domestic entity under Section 11.405. Marvin asserted that the trial court's order appointing a receiver constituted a rehabilitative receivership under Section 11.404 and that, as such, the trial court did not have jurisdiction to enter it. The court of appeals agreed:

The resolution of this jurisdictional issue is complicated by the fact that there are two sets of statutes that appear to permit the appointment of a receiver for a Texas partnership: Section 64.001(a)(3) of the Civil Practice and Remedies Code and Chapter 11, subchapter I of the Business Organizations Code. *See* CIV. PRAC. & REM. § 64.001(a)(3) (West 2008); BUS. ORGS. §§ 11.401–414. ...

Section 11.401 of the Business Organizations Code provides that "[a] receiver may be appointed for a domestic entity or for a domestic entity's property or business only as provided for and on the conditions set forth in this code." BUS. ORGS. § 11.401; *see also id.* § 1.002(18) (defining "domestic entity" under the Business Organizations Code as "an organization formed under or the internal affairs of which are governed by this code"). It is undisputed that the partnership is a domestic entity.

In *King Commodity Co. of Texas v. State*, the Dallas Court of Appeals interpreted substantially similar language in Section 11.401's predecessor statute. 508 S.W.2d 439, 445–46 (Tex. Civ. App.—Dallas 1974, no writ). The court rejected the State's argument that the similar language of the predecessor statute did not make the statute exclusive. Writing for the court, Justice Guittard stated that the statutory language "could hardly be more explicit or more clearly mandatory." The court further concluded that Section 64.001's predecessor statute was a more general statute governing receiverships and that it applies to receiverships that were not subject to Section 11.401's predecessor statute.

We interpret the mandatory language of Section 11.401 in the same manner. It explicitly provides that a receiver for a domestic entity may only be appointed "as provided for and on the conditions set forth in this code." BUS. ORGS. § 11.401. While Section 64.001(a)(3) provides that a court may appoint a receiver "in an action between partners," this statute must yield to the receivership provisions set out in the Business Organizations Code because of the mandatory, exclusive language of Section 11.401.

We disagree with Kathy's contention that the trial court was permitted to issue the receivership order under Section 64.001 because it was sitting as a probate court. We note that some appellate courts have addressed the appointment of a receiver for a domestic entity by a probate court under Section 64.001. However, these cases did not address the exclusivity language in Section 11.401 regarding domestic entities. Accordingly, these authorities do not support Kathy's position. ...

Having determined that the receivership provisions in the Business Organizations Code govern the trial court's receivership order, we must next determine which provisions of the code apply to the trial court's receivership order. Marvin asserts that the trial court's receivership order creates a rehabilitative receivership under Section 11.404 because the order appoints a receiver for the partnership's property and business. Conversely, the trial court's conclusions of law cited Section 11.403 as a basis for the receivership. Section 11.403 is a receivership for specific property. Kathy and Holloway assert that the trial court's receivership order is properly characterized as a receivership for specific property under Section 11.403. As noted previously, the characterization of the receivership order as a rehabilitative receivership under Section 11.404 or a receivership for specific property under Section 11.403 is significant from a jurisdictional standpoint because a rehabilitative receivership can only be ordered by a district court. *See* BUS. ORGS. § 11.402(b)(1).

In her pleading seeking the appointment of a receiver, Kathy quoted the language set out in 11.404(a)(1)(B) when she alleged that "[t]he governing persons of the partnership entity are deadlocked in the management of the entity's affairs, the owners or members of the entity are unable to break the deadlock, and irreparable injury to the partnership is being suffered or is threatened because of the deadlock." She further alleged that Marvin's actions as the governing person of the Hallmark Ranch partnership were "illegal and oppressive" and that Marvin had "misapplied or wasted" partnership property. *See* BUS. ORGS. § 11.404(a)(1)(C), (D). Thus, Kathy relied upon the grounds for a rehabilitative receiver under Section 11.404 in her application for a receiver. However, she also alleged that the property of the partnership was "in danger of being lost, removed or materially injured," which is a ground set out in Section 11.403(b)(1).

The trial court's Order Appointing Receiver provided that the receiver was to "[t]ake charge of all property owned by the Hallmark Ranch [partnership.]" Simply put, a receivership for all of an entity's property is not a receivership for specific property. Among other things, the receivership order directed the receiver to "[o]perate and conduct the business of Hallmark Ranch Partnership" by authorizing him to employ individuals, purchase goods and services, enter into grazing and hunting leases with the express requirement that the hunters obtain liability insurance naming the partnership as an additional insured, gather and care for the cattle of the Hallmark Ranch partnership, and take possession of all bank accounts for the partnership. Furthermore, the receivership order prohibited Marvin, Kathy, and Holloway from interfering with the receiver's operation of the partnership, and the receiver was authorized to exclude them from the ranch.

We conclude that the receivership order’s provisions make the receivership a rehabilitative receivership because they empower the receiver to control the partnership’s “property and business.” *See* BUS. ORGS. § 11.404(a) (emphasis added). A rehabilitative receivership is one that appoints a receiver “to conserve the property and business of the domestic entity and avoid damage to interested parties.” *Id.* § 11.404(b)(1). The trial court’s receivership order creates a rehabilitative receivership because its provisions serve to conserve the property and business of the Hallmark Ranch partnership.

The trial court was without jurisdiction to consider Kathy’s and Holloway’s pleadings seeking a rehabilitative receivership under Section 11.404 because only a district court can appoint a receiver over all property and business of a domestic entity. *See* BUS. ORGS. § 11.402(b)(1). Furthermore, the trial court was without jurisdiction to enter a rehabilitative receivership order under Section 11.404.

#### **U. Texas Citizens Participation Act**

*TSA-Texas Surgical Associates, L.L.P. v. Vargas*, No. 14-19-00135-CV, 2021 WL 729862 (Tex. App.—Houston [14th Dist.] Feb. 25, 2021, no pet. h.) (mem. op.).

The court of appeals held that a dispute among partners over the buyout of the interest of one of the partners in a medical partnership was purely a matter of private contract and did not involve the provision of medical services so as to involve a matter of public concern within the scope of the Texas Citizens Participation Act.

Dr. Vargas was a thoracic surgeon and partner in the cardiovascular surgery group TSA-Texas Surgical Associates, L.L.P. (“TSA”). Vargas suffered an injury that left him unable to continue practicing medicine so he notified TSA that he intended to retire. The other partners presented Vargas with an offer to buy out his partnership interest, but Vargas rejected the offer based on his assessment that the offer was for substantially less than the fair market value of his interest and was not calculated in accordance with the partnership agreement. Vargas alleged that the attorney for the other partners threatened to squeeze him out. He also alleged that a redemption agreement that was executed by one of the other partners “as a managing partner and ... allegedly as power of attorney for ... Vargas” was ineffective and contained false statements about Vargas’s retirement date and TSA’s actions after Vargas announced his intent to retire.

Vargas sued TSA and the other partners seeking damages and other relief based on breach of contract, breach of fiduciary duty, conversion, conspiracy, money had and received, reformation of the redemption agreement, and declaratory judgment. TSA and the other partners moved to dismiss the lawsuit under the Texas Citizens Participation Act (TCPA). The trial court denied the motion, and this interlocutory appeal followed.

The court of appeals explained that the TCPA was enacted “to encourage and safeguard the constitutional rights of persons to petition, speak freely, associate freely, and otherwise participate in government to the maximum extent permitted by law and, at the same time, protect the rights of a person to file meritorious lawsuits for demonstrable injury.” Tex. Civ. Prac. & Rem. Code § 27.002. It does so by authorizing a party to file a motion to dismiss a legal action that “is based on, relates to, or is in response to a party’s exercise of the right of free speech, right to petition, or right of association.” *Id.* § 27.003. If the movant satisfies its initial burden to establish by a preponderance of the evidence that the action is based on the movant’s right of free speech, right to petition, or right of association, then the burden shifts to the nonmovant to establish by clear and specific evidence a prima facie case for each essential element of the claim in question. If the nonmovant does so, then the burden shifts back to the movant to establish by a preponderance of the evidence each essential element of a valid defense. *Id.* § 27.005.

Relying on the Texas Supreme Court’s recognition that the provision of medical services by a health care professional constitutes a matter of public concern, the appellants in this case argued that they met their initial burden to establish by a preponderance of the evidence that Vargas’s claims were based on, related to, or in response to the exercise of free speech because the claims purportedly involved communications regarding the provision of medical services. The court of appeals rejected this argument, stating that the matters in this case were not a matter of public concern but rather involved “a private contract dispute affecting only the fortunes of the partners.” According to the court, “The alleged representations were made to a limited business audience concerning a business dispute among the partners related to Vargas’s withdrawal from the partnership. Because the statements are not relevant to a wider audience of potential patients, the statements were not made ‘in connection with a matter of public concern.’”

The court next addressed whether the appellants met their initial burden to establish by a preponderance of the evidence that Vargas's claims were based on, related to, or in response to the exercise of the right of association. The exercise of the right of association was defined in the version of the TCPA applicable to this case as "a communication between individuals who join together to collectively express, promote, pursue, or defend common interests." The court had previously defined the word "common" in the TCPA to mean "of or relating to a community at large: public." The court stated that the only communications at issue in Vargas's claims were based on his allegations that the appellants (1) breached the partnership agreement and breached their fiduciary duties by making false statements and denying Vargas access to records, (2) wrongfully assumed and exercised control over Vargas's partnership interest, (3) sought to deprive Vargas of his partnership interest, and (4) attempted to fraudulently induce Vargas to surrender his interest in the venture for less than its value. The court characterized these communications as being related to disagreements about Vargas's withdrawal from the partnership and thus as relating to a private transaction between private parties rather than a matter of "common interest." Thus, the court concluded that the communications did not constitute an exercise of the right of association protected by the TCPA.

*Jordan v. JP Bent Tree, LP*, No. 05-19-01263-CV, 2020 WL 6128230 (Tex. App.—Dallas Oct. 19, 2020, pet. denied) (mem. op.).

The sole manager of two general partners brought a Texas Citizens Participation Act (TCPA) motion to dismiss claims brought against him by certain limited partners. The trial court denied the motion and the court of appeals affirmed.

The appellee limited partners alleged that Mark Jordan, the sole manager of two general partners, cheated the limited partners out of substantial amounts of money that were owed to them and allowed his affiliated company to bilk the partnerships through excessive and improper charges. They also alleged that, despite the overbilling, Jordan and his affiliated entities negligently managed the properties. Jordan and his affiliated entities were sued for breach of fiduciary duty and other actions.

In response, Jordan filed a TCPA motion to dismiss. The trial court denied the motion by concluding that the TCPA did not apply to appellees' claims. The court of appeals affirmed:

The TCPA is meant "to encourage and safeguard the constitutional rights of persons to petition, speak freely, associate freely, and otherwise participate in government to the maximum extent permitted by law and, at the same time, protect the rights of a person to file meritorious lawsuits for demonstrable injury." TEX. CIV. PRAC. & REM. CODE § 27.002. The TCPA "protects citizens ... from retaliatory lawsuits that seek to intimidate or silence them." Section 27.005(b) of the TCPA provides:

Except as provided by Subsection (c), on the motion of a party under Section 27.003, a court shall dismiss a legal action against the moving party if the moving party shows by a preponderance of the evidence that the legal action is based on, relates to, or is in response to the party's exercise of (1) the right of free speech; (2) the right to petition; or (3) the right of association.

TEX. CIV. PRAC. & REM. CODE § 27.005(b). Thus, the TCPA permits a defendant to move for dismissal of a legal action that is "based on, relates to, or is in response to a party's exercise of the right of free speech, right to petition, or right of association." *See id.* § 27.003(a)....

In his TCPA motion, Jordan argued that appellees' claims "focus upon allegations and proceedings in [a] [f]ederal criminal proceeding" against him. [Appellees' petition stated that "On May 10, 2018, the United States issued a 30-page indictment against Mark Jordan and his wife Laura Jordan (f/k/a Laura Mackza). The indictment charged Mr. Jordan and his wife with, among other things, wire fraud, and bribery."...] [Appellees] argue the TCPA does not apply because their lawsuit involves a business dispute about Jordan's mismanagement of partnerships that run commercial buildings, not any exercise by Jordan of his right to petition....

Jordan argues he satisfied his burden under section 27.005(b) because appellees' petition refers to the parties' prior lawsuit as a related action and includes information about Jordan's federal judicial proceeding.

Jordan ignores a key component required for the exercise of a right to petition, namely, a communication under section 27.001(4). *See* TEX. CIV. PRAC. & REM. CODE § 27.001(4) [defining “exercise of the right to petition” as “a communication” pertaining to enumerated items]. Contrary to Jordan’s argument, a nonmovant’s reference to a judicial proceeding in a petition does not necessarily establish that a movant has engaged in any communication constituting an exercise of a right to petition under section 27.001(4) or that the nonmovant’s claims are based on such communication.

Based on this record, we conclude Jordan has failed to satisfy his burden under section 27.005(b) because we are simply left to guess about what communications Jordan engaged in, if any, and thus cannot determine that Jordan exercised his right to petition as defined in the TCPA or that appellees’ claims are based on, related to, or in response to any such exercise. *See* TEX. CIV. PRAC. & REM. CODE § 27.005(b).

***Palladium Metal Recycling, LLC v. 5G Metals, Inc.***, No. 05-19-00482-CV, 2020 WL 4333538 (Tex. App. —Dallas July 28, 2020, no pet.) (mem. op.).

The court of appeals affirmed the trial court’s denial of Palladium’s Texas Citizens Participation Act (TCPA) motion to dismiss. The court concluded that Palladium failed to show that the claims against it were related to Palladium’s exercise of its rights of association or free speech.

Palladium, 5G Metals, Inc., and 4G Metals, Inc. (5G Metals and 4G Metals are “Appellees”) entered into an oral joint venture agreement. Under the agreement, Palladium acquired scrap metal through various demolition projects. Once trucking services were arranged, the scrap would be delivered to Appellees’ yard. Appellees would then pay Palladium a premium over market price for the scrap.

According to Appellees’ pleadings, this oral joint venture partnership began in August 2009 and concluded in November 2018, when Palladium sent Appellees a notice to dissolve the business. The lawsuit involved actions alleged to have been taken by Palladium and two individuals, Jason Riley and Connor St. Charles, in the time leading up to or following the partnership dissolution, which Appellees allege interfered with or deprived them of certain business opportunities.

Appellees alleged that in January 2017, 4G Metals and Riley executed a written employment agreement under which Riley worked for 4G Metals as a manager and agreed to protect 4G Metals’ proprietary information. Riley also agreed to avoid competing with 4G Metals post-employment. Appellees also alleged that Palladium had them hire St. Charles, the son of Palladium’s principal, and that from May 2018 to October 2018, St. Charles worked in Appellees’ scrap yard and learned Appellees’ “entire business end-to-end.”

On December 18, 2018, following Palladium’s notice of dissolution, Appellees sued Palladium, Riley, and St. Charles. Appellees alleged that Palladium breached the partnership agreement, breached its fiduciary duties, tortiously interfered with an existing contract or, alternatively, with prospective business relations, engaged in common law misappropriation, and aided and abetted Riley’s and St. Charles’s wrongdoing. As to Riley and St. Charles, Appellees alleged that they tortiously interfered with an existing contract or, alternatively, with prospective business relations, and they aided and abetted Palladium’s wrongdoing.

On February 18, 2019, Palladium and St. Charles filed a TCPA motion to dismiss. They sought to have the trial court dismiss Appellees’ claims against them and asserted that Appellees’ legal action was based on, related to, or was in response to the exercise of their rights of association and free speech. The trial court ultimately signed a written order granting the TCPA motion as to St. Charles and denying it as to Palladium.

On appeal, Palladium argued that the trial court erred in not granting its TCPA motion to dismiss. The court of appeals began by noting that the TCPA is meant “to encourage and safeguard the constitutional rights of persons to petition, speak freely, associate freely, and otherwise participate in government to the maximum extent permitted by law and, at the same time, protect the rights of a person to file meritorious lawsuits for demonstrable injury.” Tex. Civ. Prac. & Rem. Code § 27.002. The TCPA “protects citizens ... from retaliatory lawsuits that seek to intimidate or silence them.” The statute allows a defendant to move for dismissal of a legal action that is “based on, relates to, or is in response to a party’s exercise of the right of free speech, right to petition, or right of association.” Tex. Civ. Prac. & Rem. Code § 27.003(a). (The court also observed that the TCPA was amended effective September 1, 2019. Because the underlying lawsuit was filed before that date, however, the law in effect before the amendment applied.)

The court then addressed Palladium’s argument that Appellee’s claims implicated Palladium’s right of association. The court disagreed with Palladium’s position:

Under the TCPA, the “exercise of the right of association” is defined as “a communication between individuals who join together to collectively express, promote, pursue, or defend common interests.” TEX. CIV. PRAC. & REM. CODE § 27.001(2). “ ‘Communication’ includes the making or submitting of a statement or document in any form or medium, including oral, visual, written, audiovisual, or electronic.” *Id.* § 27.001(1). In *Dyer [v. Medoc Health Services, LLC]*, 573 S.W.3d 418 (Tex. App.—Dallas 2019, pet. denied), we held that the exercise of the right of association requires that the “nature of the communication between individuals who join together must involve public or citizen’s participation.” *Dyer*, 573 S.W.3d at 426. Then, in *Erdner [v. Highland Park Emergency Center, LLC]*, 580 S.W.3d 269 (Tex. App.—Dallas 2019, pet. denied), we applied that principle again in a case involving the establishment of a freestanding emergency room and claims of breach of fiduciary duty and aiding and abetting the breach, claims similar to those involved here. *Erdner*, 580 S.W.3d at 271–72, 275. We concluded in *Erdner* that the TCPA movants failed to satisfy their initial TCPA burden regarding their right of association because the communications they relied upon were “private communications relating to establishing a business to open a [freestanding emergency room]” and “did not involve public or citizen’s participation.” *Erdner*, 580 S.W.3d at 275 (citations omitted).

We reach a similar conclusion here. In its brief, Palladium argues that appellees’ claims “implicate the right of association because they are dependent upon communications made in furtherance of a common purpose” on the theory that appellees’ allegations depend on communications between Riley, Connor St. Charles, and Peter St. Charles (on behalf of Palladium), and on communications between them and trucking vendors to exclude appellees from participation in certain contracts, including a public highway demolition project in Dallas. Palladium cites paragraphs eighteen, twenty-two, thirty-five, forty-two, and sixty-three of appellee’s petition and paragraph six of Desai’s affidavit in its argument, but most of these paragraphs lack any communications at all, and none refer to any public or citizen participation.

At oral argument, we questioned Palladium about any public or citizen participation in its communications as required by *Dyer* and *Erdner*, and Palladium failed to identify any, focusing its answer instead on the alleged commonality of interest between Palladium, Riley, St. Charles, and trucking vendors in participating in the public highway demolition project.

The TCPA’s purpose of curbing strategic lawsuits against public participation is not furthered by a construction finding a right of association based simply on communications between parties with a shared interest in a private business transaction. Because Palladium has not shown [that] appellees’ claims are based on any communications involving public or citizen participation, we conclude that Palladium has not satisfied its initial burden of establishing that appellees’ claims are covered by the TCPA’s protections regarding the right of association.

Palladium also argued that the TCPA applied because Appellee’s claims implicated Palladium’s exercise of its right of free speech. For purposes of the TCPA, the court observed that the “exercise of free speech” means a communication made in connection with a matter of public concern. Tex. Civ. Prac. & Rem. Code § 27.001(3). The TCPA defines a “matter of public concern” to include an issue related to “health or safety; environmental, economic, or community well-being; the government; a public official or public figure; or a good, product, or service in the marketplace.” *Id.* at § 27.001(7). “The phrase ‘matter of public concern’ commonly refers to matters ‘of political, social, or other concern to the community,’ as opposed to purely private matters.” In *Creative Oil [& Gas, LLC v. Lona Hills Ranch, LLC]*, 591 S.W.3d 127 (Tex. 2019), the court stated, “A private contract dispute affecting only the fortunes of the private parties involved is simply not a ‘matter of public concern’ under any tenable understanding of those words.” *Creative Oil*, 591 S.W.2d at 135.

Unfortunately for Palladium, the court concluded that Appellee’s claims were not related to Palladium’s exercise of free speech:



At oral argument, Palladium based its free speech argument, in part, on a prior restraint theory not raised in its briefs, arguing that certain relief appellees requested and obtained through a temporary restraining order operated as a prior restraint on speech which thus implicated its exercise of the right of free speech under the TCPA. However, as Palladium’s counsel conceded, the prior restraint issue was not included in its briefs, and as a result, we conclude the prior restraint issue was inadequately briefed and was waived on appeal. *See* TEX. R. APP. P. 38.1(f), (I) (appellant’s brief “must state concisely all issues or points presented for review” and “must contain a clear and concise argument for the contentions made, with appropriate citation to authorities and to the record”).

In its briefs, Palladium argues that appellees’ claims involve communications between Riley, Connor St. Charles, and Peter St. Charles (on behalf of Palladium) and trucking vendors who were transporting scrap metal on public highways for a highway demolition project. As it did on its right to association argument, Palladium cites paragraphs eighteen, twenty-two, thirty-five, forty-two, and sixty-three of appellee’s petition and paragraph six of Desai’s affidavit, but these paragraphs lack any communications regarding matters of public concern as opposed to private pecuniary interests and thus do not implicate the TCPA’s protection of Palladium’s exercise of the right of free speech.

In *Goldberg [v. EMR (USA Holdings) Inc.]*, 594 S.W.3d 818 (Tex. App.—Dallas 2020, pet. filed)], another TCPA case involving scrap metal recycling, we stated:

Even though Defendants’ business of purchasing and selling scrap metal may have many beneficial effects and involve matters of health or safety, and environmental, economic, or community well-being, the communications in this case did not involve those matters. Instead, they concerned Defendants’ offers to buy or sell scrap metal. The communications did not discuss the benefits of recycling, nor did the communications seek to promote health or safety, or environmental, economic, or community wellbeing. Instead, they were private communications regarding private commercial transactions for the purchase and sale of a commodity, scrap metal. Plaintiffs’ claims are related to Defendants’ use of Plaintiffs’ confidential information to make purchases and sales. Plaintiffs’ claims are not related to any communications by Defendants concerning the beneficial effects of recycling provided by the scrap-metal industry.

*Goldberg*, 594 S.W.3d at 830. Like the communications in *Goldberg*, the communications here do not concern the benefits of recycling or seek to promote health, safety, or environmental, economic, or community well-being. As we did in *Goldberg*, we conclude here that Palladium has failed to prove by a preponderance of the evidence that appellees’ claims are based on, relate to, or are in response to its exercise of the right of free speech.

Appellees also argued that the trial court’s order granting the TCPA motion as to St. Charles should be reversed. The court of appeals noted, however, that Appellee’s request was not properly before the court. The court observed that “[i]nterlocutory appeals are only available from orders denying TCPA motions, not from orders granting them,” and it stated that “even if their request could be raised here, our consideration of it would remain improper under the circumstances, as appellees did not file a notice of appeal.”

### **III. Recent Texas Cases Involving Limited Liability Companies**

#### **A. Nature of Limited Liability Company**

*United States ex rel. Haight v. RRSA (Commercial Division), LLC*, Civ. A. No. 3:16-CV-1975-S, 2020 WL 6163139 (N.D. Tex. Oct. 20, 2020) (finding that a presentment claim under § 3729(a)(1)(A) of the False Claims Act (FCA) was sufficiently pled against RRSA Commercial, an LLC, and stating the following as part of the analysis: “The FCA applies to ‘any person’ who knowingly causes a false claim to be made, and a ‘person’ may include a business entity, such as a limited liability company like RRSA Commercial.”).

**Gonzales Nursing Operations, LLC v. Smith**, No. 04-20-00102-CV, 2020 WL 5646482 (Tex. App.—San Antonio Sept. 23, 2020, pet. denied) (mem. op.) (“Gonzales concedes that Texas Health and Safety Code section 285.071 ‘has not been referenced in the instant case.’ However, because we must sua sponte evaluate our own jurisdiction, we note the Legislature has provided that a ‘hospital district management contractor’ is considered a governmental unit under some circumstances. See TEX. HEALTH & SAFETY CODE ANN. § 285.072. However, the Legislature specifically limited the application of that statute to ‘a nonprofit corporation, partnership, or sole proprietorship that manages or operates a hospital or provides services under contract with a hospital district that was created by general or special law.’ TEX. HEALTH & SAFETY CODE ANN. § 285.071. Under the plain language chosen by the Legislature, a limited liability company cannot be a hospital district management contractor. Here, Gonzales’s contract with GHS specifically identifies it as a limited liability company, and Gonzales presented no evidence to controvert that recital. For that reason, Gonzales cannot qualify as a hospital district management contractor—and therefore a governmental unit—under section 285.072.”).

**Williams v. Community Bank, Ellisville**, No. 19-60595, 2020 WL 4036466 (5th Cir. July 16, 2020).

“According to 12 C.F.R. § 1026.36, ‘a contract or other agreement for a consumer credit transaction secured by a dwelling ... may not include terms that require arbitration...’ ‘Consumer credit means credit offered or extended to a consumer primarily for personal, family, or household purposes.’ ‘[T]he adjective ‘consumer’, used with reference to a credit transaction, characterizes the transaction as one in which [ (1) ] the party to whom credit is offered or extended is a natural person, and [ (2) ] the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes.’

The Williamses argue that their loan was a consumer loan—and, thus, subject to 12 C.F.R. § 1026.36 and 15 U.S.C. § 1602(i)—because their purpose in taking out the loan was personal. According to the Williamses, the purpose of the loan was to build a personal residence on the 23 acres of vacant land. Although these arguments may satisfy the second element of ‘consumer’ as defined in 15 U.S.C. § 1602(i), they do not satisfy the first. The purpose of the loan may have been personal, as the Williamses allege, but the loan was not offered or extended to a natural person. The undisputed terms of the loan agreement indicate that Community Bank extended credit to CAAAW, LLC—a business entity, not a natural person. Indeed, Carria Williams and Dennis Williams specifically signed the agreement in their capacity as manager and member of CAAAW, LLC, respectively. Because CAAAW, LLC is a business entity and not a natural person, the loan agreement in this case does not meet the first element of ‘consumer’ as defined in 15 U.S.C. § 1602(i) in reference to a consumer credit transaction. Accordingly, because the loan agreement in this case cannot be considered a consumer credit transaction, neither 12 C.F.R. § 1026.36 nor 15 U.S.C. § 1602 render the Williamses’ claims unarbitrable.”

**See also cases included below under “Attorney’s Fees”** holding that Tex. Civ. Prac. & Rem. Code § 38.001 (in cases filed prior to its amendment effective September 1, 2021) does not authorize recovery of attorney’s fees against a limited liability company because the statute only permitted recovery against an “individual” or a “corporation.”

**See also cases included below under “Pro Se Representation”** holding that an LLC, as an artificial entity, is not permitted to appear pro se.

**B. Limited Liability of Member or Manager; Personal Liability of Member or Manager Under Agency or Other Law**

**Corsi v. Infowars, LLC**, A-20-CV-298-LY, 2021 WL 2115272 (W.D. Tex. May 25, 2021).

The magistrate judge recommended dismissal of the plaintiffs’ defamation claims against an alleged co-owner of two LLCs with the following explanation:

To the extent Plaintiffs attempt to hold David Jones liable for any alleged defamatory actions of other defendants as an alleged owner of the limited liability companies InfoWars and Free Speech Systems, this argument also fails. Under Texas law, owners of limited liability companies are not liable for the torts of the entity, unless the plaintiff can allege some basis for piercing the corporate

veil. *See Hong v. Havey*, 551 S.W.3d 875, 885 (Tex. App.—Houston [14th Dist.] 2018, no pet.); *Bates Energy Oil & Gas v. Complete Oilfield Svcs.*, 361 F.Supp. 3d 633, 665 (W.D. Tex. 2019). Here, Plaintiffs include no allegations that indicate an intention to proceed against David Jones as an owner on an alter-ego theory of liability. Given the lack of any allegations that David Jones personally engaged in defamatory conduct, or allegations supporting a basis to pierce the corporate veil or to hold David Jones liable on a theory of conspiracy, Plaintiffs’ defamation claims against David Jones should be dismissed without prejudice.

***Spicer v. Maxus Healthcare Partners, LLC***, 616 S.W.3d 59 (Tex. App.—Fort Worth 2020, no pet. h.).

Addressing a split in the courts of appeals, the court in this case concluded that Section 21.223 of the Business Organizations Code did not require a showing that an LLC member used the LLC to commit fraud for her personal benefit where the claimant was not relying on veil piercing to hold the member liable but was attempting to hold the member directly liable for fraudulent misrepresentations made in connection with an asset purchase agreement entered into by the LLC.

This dispute arose out of the sale of a home healthcare business. The purchaser of the business obtained a multi-million dollar judgment against the LLC seller for breach of contract and against the LLC and its owner for fraud. The court’s lengthy opinion provides a detailed account of the background, negotiation, and aftermath of the transaction, and the court describes quite a saga. Factors contributing to the drama included the Medicare regulatory environment in which the business operated, the owner’s sloppy accounting and business practices, a \$3 million liability for unpaid payroll taxes, and the purchaser’s failure to obtain professional accounting and legal advice in connection with the purchase of the business. The summary below is a much abbreviated version of the court’s description of the events leading up to the lawsuit in this case.

At the center of this saga was Texas RHH, LLC (“Texas RHH”), doing business as Renew Home Health. Misty Brady formed Texas RHH in 2006 after purchasing a Medicare provider number, and Brady grew Texas RHH to the point where it serviced about 600 patients and employed about 150 people by December 2012. Brady also acquired Zera, Inc.—which had its own Medicare provider number—in 2011, bringing in an additional 100 patients. Almost all of the patients of Texas RHH and Zera were on Medicare. Brady essentially operated Texas RHH and Zera as one company. All services were marketed under the Renew Home Health banner, and all employees were on Texas RHH’s payroll. Nonetheless, Zera maintained its own Medicare provider number, and all Renew Home Health patients in Granbury were treated under Zera’s number.

Brady did not pay Texas RHH’s payroll taxes from 2006 to 2011. Instead of paying the delinquent taxes, Brady used the revenue Texas RHH generated to grow the business and cover personal expenses (including Dallas Cowboys season tickets). In 2009, Brady’s tax litigation attorney made a voluntary disclosure to the IRS on behalf of Brady (who, as the person responsible for withholding and payment of RHH’s payroll taxes, was personally liable for the unpaid taxes in addition to RHH). After the voluntary disclosure, the IRS instituted a continuous levy on Texas RHH’s Medicare revenue, garnishing 15% of RHH’s revenue—more than \$1.3 million—over three years.

As the IRS started exerting more pressure in 2011, Brady began to explore a sale of Texas RHH. To this end, she met Cory Mertz—a broker for a home healthcare merger-and-acquisition firm—who encouraged her to better organize her books. Mertz introduced Brady to an accountant—Richard Furtek—who agreed to help Brady get the business’s financial affairs in order.

In Brady’s own words, Texas RHH’s books “were a mess.” Thousands of check numbers were missing from the company’s QuickBooks because Brady would shred any check she misprinted. Brady also booked reconciliation discrepancies in lump sums of up to \$49,000. Furtek agreed to organize the books but refused to guarantee their accuracy.

Angie King and Stevan Hammond wanted to enter the home healthcare market, and the fastest way to enter the Medicare home healthcare market was by acquiring an existing provider. They formed Maxus Healthcare Partners, LLC (“Maxus”) in 2012 and began searching for acquisition targets. In September 2012, King learned about Renew Home Health through Cory Mertz.

Over the course of the next few months, the parties negotiated a letter of intent and executed an asset purchase agreement for the purchase of Texas RHH’s assets by Maxus. During the negotiation and due diligence process, the principals of Maxus did not retain outside accounting or legal help. One of the reports provided to Maxus contained an entry reflecting a significant payroll tax liability, but no other document reflected Texas RHH’s cumulative tax liability, which eventually ballooned to more than \$3 million. The deal progressed with a substantial,

poorly disclosed tax liability hovering in the background, and there was also confusion regarding the scope and terms of the acquisition with respect to Zera.

Although Brady operated Texas RHH and Zera as a single unified business, they remained technically separate from Medicare's perspective. Renew Home Health serviced its Granbury patients under the Zera provider number, and Renew Home Health was prohibited by a Medicare regulation (the "Medicare 36-month rule") from conveying Zera's number before January 19, 2014. Maxus believed that it was purchasing the entire Renew Home Health organization, including both Texas RHH and Zera. The books Brady provided indicated that "Texas RHH, LLC, d/b/a Renew Home Health" operated branches in Fort Worth, Abilene, Breckenridge, Mineral Falls, and Granbury. Furthermore, the books included all Granbury expenses. In Maxus's view, the "follow on purchase" for Zera in January 2014 was a mere regulatory formality, and Maxus expected to acquire Zera for nominal consideration once the Medicare 36-month rule period expired.

Brady espoused a different view of the acquisition. According to her, Maxus was only buying Texas RHH. Zera's numbers were included in Texas RHH's books because Texas RHH had an unwritten—and admittedly undisclosed—management agreement with Zera to manage Zera's patients. According to Brady, Maxus would acquire an exclusive right to manage Zera until the Medicare 36-month rule expired followed by a right of first refusal to buy the company at fair market value.

In essence, Maxus had conducted its due diligence and valuation under two flawed premises. Looking at Renew Home Health's books, Maxus saw a company with impressive revenue and profit growth and virtually no liabilities. Yet both Brady and Furtek knew that if Texas RHH had paid its tax debt, it would have eliminated net income on either a cash or an accrual basis, and the company would have been out of business and bankrupt. After extensive negotiations, the parties signed a letter of intent for \$7.5 million in November 2012.

Within a week of signing the letter of intent, the IRS was applying additional pressure on Brady. Brady sought an abatement from the IRS's collection proceedings. In her request, Brady painted a much darker picture than she provided Maxus during negotiations. Brady told the IRS that Texas RHH was a sinking ship. The company had struggled to meet its financial obligations since its founding, was delinquent in paying necessary payments, and was so far behind on its payroll taxes that it had nearly ceased to exist as a going concern. Brady, however, did not share this dire view of the company with either Mertz or Maxus. In fact, as the parties progressed toward a finalized asset purchase agreement (APA), Brady convinced Maxus to increase the purchase price to \$8.8 million.

By late December of 2012, the parties had the APA ready. The APA required Maxus to pay \$6 million by wire transfer and to execute a \$2.8 million promissory note. On December 31, at 2:36 p.m., Brady sent an email with wiring instructions. Brady acknowledged that when she sent the email, Texas RHH still owed \$3 million to the IRS. Brady went to the IRS office that afternoon before anyone signed the APA, gave the IRS a certified check, and received a certificate of release of federal tax lien.

Initially, the transition went smoothly, but one of the APA post-closing deliverables was Texas RHH's QuickBooks files. As Maxus started pressuring Brady to turn over the files, Brady became progressively less cooperative. By June 2013, Brady was not returning Maxus's calls.

By June 2014, the Medicare 36-month rule had run, and Maxus could buy Zera's Medicare provider number. As Maxus began work on the Zera APA, it finally discovered Texas RHH's checkered tax history. Furthermore, the disconnect between Maxus and Brady on whether Zera was part of the original deal took center stage.

Maxus sent Brady and her lawyer an initial APA reflecting a \$100 nominal purchase price for Zera's assets. Brady's attorney replied that they disagreed that Zera was included in the Texas RHH APA, taking the position that the only relationship between Maxus and Zera was the management agreement.

Maxus and Brady's relationship was now fully soured, and the parties' adversarial behavior escalated, including Brady's seizure of control of Maxus's email server, locking Maxus's employees out of their email accounts. Maxus eventually spent around \$9,000 solving the issue.

Eventually, Maxus decided to get an accountant involved. Maxus hired Cindy Carradine, a forensic accountant with over 25 years of experience, to initially determine if Brady had disclosed the payroll tax liability in the pre-closing financial statements. But Carradine's role quickly developed into an attempt to piece Texas RHH's books back together. Carradine's staff spent over 1,150 hours reviewing Texas RHH's financial information but was still unable to provide an opinion as to the company's complete and accurate financial position. Carradine had never seen such poorly maintained books. Over 2,100 checks were missing from Texas RHH's QuickBooks. Another 300 checks were duplicated. Texas RHH had 335 cash disbursement and receipts totaling over \$1 million

that were simply not recorded in its books. Nearly 5,000 entries listed only a bare dollar amount. Finally, Brady had made at least 236 withdrawals totaling \$1.6 million from 2010 to 2012 alone.

Maxus sued. The dispute included the relevance of the tax debt with regard to the APA purchase price, what assets had been sold, whether certain APA provisions had been breached, and whether the APA included the transfer of Zera's provider number. The jury found that Texas RHH had breached multiple provisions of the APA, including its representations as to the accuracy of Texas RHH's financial statements and Texas RHH's tax liabilities, its obligation to deliver its QuickBooks files, and its obligation to transfer certain assets. Furthermore, the jury determined that Texas RHH and Brady committed fraud against Maxus and that Brady committed harmful access of Maxus's computer. The jury found that the APA did not require Texas RHH to transfer Zera's provider number to Maxus, but that Maxus detrimentally relied on Texas RHH's representation that it would do so. The jury awarded Maxus over \$2.8 million for Texas RHH's breach of the APA, over \$2.3 million for Brady's fraud, over \$9,000 for Brady's wrongful access of a computer, \$250,000 in reliance damages, and over \$1.3 million in attorney's fees.

Among the issues addressed on appeal with respect to the claims for breach of the APA were the appellants' arguments that the representations in the APA regarding the accuracy and completeness of financial information and the nonexistence of any tax liabilities were not breached and that any breach was not the cause of damages given that the tax liability was paid and the lien was released before the APA was signed on the day of the closing. The court interpreted provisions of the APA regarding the "effective time" and "closing date" and concluded that there was evidence supporting the findings that the representations in the APA were breached because the federal tax liability existed on the morning of the closing date. The court also concluded that there was evidence in support of the finding that the undisclosed tax liability resulted in damages with respect to the goodwill value and purchase price for the assets.

Also among the arguments made on appeal was Brady's argument that the trial court erred by entering judgment against Brady for fraud in her individual capacity when Maxus neither pleaded nor proved that Brady had acted primarily for her personal benefit. Brady relied on Section 21.223 of the Texas Business Organizations Code, arguing that, as the owner of Texas RHH, LLC, Brady could not be liable for misrepresentations made on Texas RHH's behalf unless Maxus pleaded and proved that she had used Texas RHH to commit fraud for her direct personal benefit. Maxus argued that Section 21.223 did not apply because (1) Maxus did not seek to hold Brady liable under any veil-piercing theory but instead sought to hold her liable for her own fraudulent conduct, and (2) Maxus was not seeking to hold Brady liable for Texas RHH's "contractual obligation" or for "any matter relating to or arising from the obligation" but instead for her own fraud. Maxus relied on *Alexander v. Kent*, 480 S.W.3d 676 (Tex. App.—Fort Worth 2015, no pet.), to support its Section 21.223 argument. The court addressed this argument as follows:

Section 21.223, which applies to LLCs via Section 101.002(a), reflects legislative limits on recovery from an individual based on a company's obligations. *See* Tex. Bus. Orgs. Code Ann. §§ 21.223(a)(2), (b), 101.002(a); *Chan v. Sharpe*, No. 02-14-00286-CV, 2015 WL 5722833, at \*4 (Tex. App.—Fort Worth Aug. 26, 2015, pet. denied) (mem. op.) ("To pierce the corporate veil, and thus disregard the corporate form, a plaintiff must show that the shareholder used the corporation to 'perpetrate an actual fraud ... primarily for the direct personal benefit' of the shareholder." (quoting Tex. Bus. Orgs. Code Ann. § 21.223(b))); *see also Ritchie v. Rupe*, 443 S.W.3d 856, 869 (Tex. 2014) (stating that "[f]raudulent or illegal actions by a corporation's directors may result in disregard of the corporate form" (citing Tex. Bus. Orgs. Code Ann. § 21.223(b))); *PHC-Minden, L.P. v. Kimberly-Clark Corp.*, 235 S.W.3d 163, 175 (Tex. 2007) (noting that fraud is vital to piercing the corporate veil under Section 21.223).

Under Section 21.223, a company's owner cannot be held liable to the company or to the company's obligees with respect to "any contractual obligation of the [company] or any matter relating to or arising from the obligation on the basis that the [owner] is or was the alter ego of the [company] or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory" unless the obligee shows that the owner "caused the [company] to be used for the purpose of perpetrating and did perpetrate actual fraud on the obligee primarily for the direct personal benefit" of the owner. Tex. Bus. Orgs. Code Ann. § 21.223(a)(2), (b). If Section 21.223 applies, then it "preempts any other liability imposed for that obligation under common law or

otherwise” unless the owner expressly agreed to be personally liable to the obligee for the obligation or “is otherwise liable to the obligee for the obligation under this code or other applicable statute.” *Id.* §§ 21.224–.225; *Willis v. Donnelly*, 199 S.W.3d 262, 272–73 (Tex. 2006) (holding that ratification is a “similar theory” of derivative liability covered by Section 21.223).

A split has arisen in the courts of appeals regarding whether Section 21.223 preempts an individual’s direct tort liability in addition to his or her vicarious liability under a piercing-the-veil or related theory. *See Bates Energy Oil & Gas v. Complete Oilfield Servs.*, 361 F. Supp. 3d 633, 664–72 (W.D. Tex. 2019). As the federal district court noted in *Bates*, “Texas has long had two methods for holding individual corporate agents or officers personally liable when they are acting within the course and scope of their employment or role as corporate agents—piercing the corporate veil or direct individual liability” and “recent cases [involving Section 21.223] have muddled [the] distinction” between these two methods. *Id.* at 664, 667. The court concluded that Section 21.223’s language applied only to claims holding an owner vicariously liable for a contract-related corporate obligation in both contract and tort and to claims seeking to hold an owner liable for a corporate obligation on the basis of other “classic veil piercing” scenarios under Texas common law. *Id.* at 672–73.

Appellants refer us to *TecLogistics, Inc. v. Dresser-Rand Group*, a cross-appeal of a judgment on a jury verdict on breach of contract and fraud in which our sister court considered Section 21.223’s application. 527 S.W.3d 589, 599–600, 603 (Tex. App.—Houston [14th Dist.] 2017, no pet.). *TecLogistics*’s president had created false invoices to bill Dresser Rand. *Id.* at 592–93, 596, 597–98. At trial, Dresser Rand submitted a proposed jury question regarding the president’s individual liability for common law fraud, and the court considered whether the proposed question was raised by the pleadings and evidence. *Id.* at 595.

The court held, among other things, that the trial court did not abuse its discretion by refusing the proposed question, reasoning that Section 21.223 had entirely replaced the common law and that neither statutory exception applied. *Id.* at 591, 598–99. The court noted that because *TecLogistics*’s president was the only person involved in creating and tendering the false invoices to Dresser Rand, she was the human agent through which *TecLogistics* had committed actual fraud. *Id.* Thus, because the court concluded that Section 21.223(a)(2)’s requirements were met, *TecLogistics*’s president was shielded when Dresser Rand (1) had failed to allege in its pleadings that she had acted primarily for her direct personal benefit, (2) had presented no such evidence of her acting for her direct personal benefit at trial, and (3) had proposed no jury question that would have permitted such a finding. *Id.* at 598–99, 603.

Maxus relies on *Alexander* to support its argument that Brady is directly and individually liable for fraud. In *Alexander*, we stated that the general rule in Texas “has always been” that a “corporation’s employee is personally liable for tortious acts which he directs or participates in during his employment” and that a corporate agent can be held individually liable for fraudulent statements or knowing misrepresentations even when made in the capacity of a corporate representative. 480 S.W.3d at 697–98.

In *Alexander*, Kent (the plaintiff and later appellee) hired K.B. Alexander Co. (KBA), a construction company of which Alexander was president and sole stockholder. *Id.* at 680. Kent sued KBA for breach of contract and Alexander individually for fraud based on false payment applications misrepresenting that subcontractors had been paid. *Id.* at 680, 682–83. Kent nonsuited KBA after it declared bankruptcy and proceeded on his fraud claim against Alexander. *Id.*

Although Alexander argued that he could not be held individually liable because he was not a party to the Kent–KBA contract and had signed the contract and pay applications only in his capacity as KBA’s president, we concluded that because the action involved holding Alexander liable for his own fraudulent statements, there was no need to pierce the corporate veil under a vicarious liability theory. *See id.* at 697–98; *cf. Chan*, 2015 WL 5722833, at \*5 (holding that when each of the appellant’s claims sought to impose personal liability on his fellow shareholders for obligations owed by their company Wan Fu Foods, Inc., Section 21.223(b) imposed a burden on the appellant to prove actual fraud).

Maxus sued Brady for fraud based on her acts and omissions throughout the due diligence and negotiation process that led to Maxus's overpayment for Texas RHH's assets. Because Maxus's fraud claim is based on Brady's direct liability for fraudulent acts, we decline Appellants' invitation to follow our sister court's interpretation of Section 21.223. *See Alexander*, 480 S.W.3d at 697–98. We overrule this portion of Appellants' first issue.

Brady also argued that there was no evidence of misrepresentation or omission, no evidence of materiality or justifiable reliance, and no evidence that Maxus suffered damages. Maxus responded that the evidence was legally sufficient to support the jury's findings and that the "red flags" to which Brady pointed were not the type of "red flags" that would render Maxus's reliance unjustifiable. The court reviewed the elements of common-law fraud and rejected Brady's contentions. The court stated that the record was replete with examples of Brady's misrepresentations and omissions with regard to the financial information that she provided to Maxus. According to the court, the jury could determine that Brady had intended for Maxus to rely upon that information, which stood in stark contrast with her statements to the IRS. Representatives of Maxus testified that they had relied on the information that Brady had provided to them in calculating the purchase price, and multiple witnesses testified that the misrepresentations in that information were material.

The court did not repeat its analysis of the damages caused by Brady's misrepresentations in its analysis of Texas RHH's breach of contract earlier in the opinion, stating that the only remaining question was whether the Maxus team's reliance on Brady's misrepresentations and omissions was justifiable. Although the record reflected that the Maxus team opted to forego the expert assistance of an attorney or a CPA during the APA negotiations and did not run a lien search in the county records during due diligence (opting instead to rely on the representations and warranties included in the APA), the court said the jury could have found that the Maxus team had exercised reasonable diligence and were not willfully blind, relying instead on Brady's representations because she gave the Maxus team all of the information it had requested after burying the tax liabilities and problems that she had simultaneously highlighted in her dialogues with Furtek, her tax attorneys, and the IRS.

The court also concluded that the trial court did not err in entering judgment against Brady for harmful access of Maxus's computer system under Tex. Civ. Prac. & Rem. Code § 143.001(a) and Tex. Penal Code § 33.02.

***White v. Cyr (Matter of Cyr)***, 838 F. App'x 54 (5th Cir. 2020).

The court affirmed the district court's dismissal of a claim to hold the individual owner of an LLC liable based on alter ego where the plaintiff did not adequately allege any of the relevant factors identified by the court. The court affirmed the district court's dismissal of vicarious and agency liability claims against the individual owner where the plaintiff did not allege any grounds to characterize the LLC's CEO as the agent of the owner.

Dr. White agreed to provide pain management services to patients of Orthopaedic & Spine Institute L.L.C. ("OSI"). OSI agreed to pay Dr. White 50% of gross revenue collected from patients and third-party payers. When OSI failed to pay Dr. White, he sued OSI and OSI's owner, Dr. Cyr. After Dr. Cyr filed for relief under Chapter 7 of the Bankruptcy Code, Dr. White filed a claim in bankruptcy court, requesting that Dr. Cyr's debts to him be determined to be non-dischargeable under Section 523(a) of the Bankruptcy Code.

In 2014, Dr. White met with Dr. Cyr and Linda D'Spain, OSI's CEO, about affiliating with OSI. Dr. Cyr and D'Spain made several representations to Dr. White that OSI was profitable and would be able to pay him his negotiated compensation packages, that OSI had an existing management system with computerized billing, that OSI had practices and relationships with third-party payers that allowed for timely payment, that OSI's reimbursement rates were consistent with those in the community, and that OSI would timely apply for Dr. White's credentials so that he could receive prompt payment. The district court dismissed Dr. White's claim that Dr. Cyr committed fraud that gave rise to a nondischargeable debt under § 523(a)(2)(A) of the Bankruptcy Code because Dr. Cyr's alleged oral misrepresentation of his financial condition was required to be in writing to render Dr. Cyr's debt nondischargeable. The district court also dismissed Dr. White's agency and vicarious liability claims because it concluded that Dr. White did not plausibly allege that D'Spain was Dr. Cyr's agent. Dr. White argued that he pled enough facts to demonstrate that D'Spain was Dr. Cyr's agent. If D'Spain was Dr. Cyr's agent and committed fraud that can be attributed to Dr. Cyr, the resulting debt would also not be dischargeable under § 523(a)(2)(A) of the Bankruptcy Code.

To prevail on his claim that Dr. Cyr's misrepresentation regarding the profitability of his clinic gave rise to a nondischargeable debt, Dr. White was required by § 523(a)(2)(A) to allege sufficient facts to demonstrate that

this representation was “obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.” The court characterized the alleged misrepresentation as a statement respecting OSI’s financial condition, which was also in turn a statement respecting Dr. Cyr’s financial condition based on the rationale that a statement about a single asset of a debtor can be a statement respecting the debtor’s financial condition. If a statement is a “statement respecting the debtor’s financial condition,” the statement does not prevent discharge unless it meets the requirements of § 523(a)(2)(B)(i)-(iv), including the requirement that the statement be in writing. The court concluded that, even assuming the falsity of the representation, it was a statement respecting the debtor’s financial condition that was not in writing and thus was not nondischargeable under § 523(a)(2)(B).

Dr. White argued that the district court erred in dismissing his claim to pierce OSI’s “corporate” veil under an alter-ego theory. The court quoted corporate case law for the proposition that a court may pierce the corporate veil to hold the shareholders liable when the corporation is the alter ego of its owners or shareholders, but the court concluded that Dr. White failed to allege any facts supporting plausible relief based on alter ego.

Dr. White also argued that D’Spain was Dr. Cyr’s agent and that, as such, D’Spain’s alleged fraud could be attributed to Dr. Cyr, resulting in a debt would not be dischargeable under § 523(a)(2)(A). The court stated that, under Texas law, agency relationships are created by express or implied agreements by the parties, or the relationship may be based on apparent authority where the principal permits the agent to hold herself out as having authority and a reasonable person concludes that the agent has such authority. According to the court, Dr. White’s theory of agency rested on D’Spain’s purported apparent authority to act on Dr. Cyr’s behalf, but Dr. White failed to allege any facts to suggest that she had such authority. Dr. White’s only factual assertions about D’Spain related to her presence in his initial meeting with Dr. Cyr and her correspondence with Dr. White about his payments and credentials. Even assuming all of these allegations to be true, Dr. White merely detailed his interactions with D’Spain as OSI’s CEO. None of these facts suggested that she was Dr. Cyr’s agent. Absent an agency relationship, Dr. White did not plead any other grounds on which Dr. Cyr could be vicariously liable for D’Spain’s actions. Thus, the court affirmed the district court’s dismissal of Dr. White’s agency and vicarious liability claims.

***R.P. Small Corp. v. Land Department, Inc.***, 505 F. Supp. 3d 681 (S.D. Tex. 2020).

The court held that the sole owner of a corporation and a limited liability company could not be sued personally for a fraud he allegedly perpetuated on behalf of the entities.

Richard Small and Michael Mann were friends and business associates for over twenty years. Small’s company—R.P. Small Corp. (“RPS”)—was an oilfield operator. Mann provided primarily landman services, first through The Land Department, Inc. (“TLD”) and later through Cypress Rock Land Services, LLC (“Cypress”). As Small grew older, he began to rely on Mann progressively more to handle business transactions. RPS entered a variety of written and oral contracts with TLD, Cypress, and Mann. The written contracts primarily concerned landman services. The oral contracts allegedly made Mann and his entities RPS’s agent for certain projects.

The relationship of Small and Mann soured. In particular, Small believed that Mann and his entities were mismanaging the financial aspects of the work they did as RPS’s agents. According to Small and RPS, Mann and his entities double paid some invoices, failed to pay other invoices, and mismanaged the joint operating agreement payouts RPS had with its investors. As a result, RPS sued Mann and his entities, asserting claims for breach of fiduciary duty, breach of contract, and fraud.

Mann argued that the fraud claims asserted against him in his individual capacity should be dismissed. According to Mann, Section 21.223 of the Texas Business and Organizations Code prohibits suing an individual for the actions of his company unless that individual perpetrated an actual fraud for his direct personal benefit. But here, any fraud Mann perpetrated was for the benefit of TLD and Cypress, not Mann personally.

The court accepted Mann’s argument, relying on *TecLogistics, Inc. v. Dresser-Rand Group, Inc.*, 527 S.W.3d 589, 603 (Tex. App.—Houston [14th Dist.] 2017, no pet.) and *Hong v. Havey*, 551 S.W.3d 875, 890 (Tex. App.—Houston [14th Dist.] 2018, no pet.), which stand for the proposition that an officer or owner of a corporation can only be sued for common law fraud if the person perpetrated an actual fraud for the person’s direct personal benefit. Because RPS’s complaint did not allege any direct benefit to Mann personally as opposed to his entities, the court dismissed all claims asserting fraud against Mann in his individual capacity.



*Enshikar v. Zaid*, No. 14-18-00933-CV, 2020 WL 6203348 (Tex. App.—Houston [1st Dist.] Oct. 22, 2020, no pet.) (mem. op.).

“ . . . Enshikar makes various arguments that Zaid and Jumaa are individually or vicariously liable for the 2015 judgment because at the time of Enshikar’s workplace accident Advance Tire was no longer an LLC but had transformed into a different entity, either a partnership run by Zaid and Jumaa or a sole proprietorship run by Jumaa. Each of Enshikar’s issues is premised on his contention that Advance Tire had ceased its existence as an LLC at the time of his injury and no longer shielded Zaid and Jumaa personally from liability. We begin with an analysis of Advance Tire’s status as an LLC at the time of Enshikar’s accident.

Under the Business Organizations Code, a filing entity such as an LLC does not cease existing until, after required windup of the entity is complete, the entity files a certificate of termination. Tex. Bus. Orgs. Code Ann. §§ 11.101, .102; *see id.* § 1.002(22) (LLC is filing entity). This requirement may not be waived. *See* Tex. Bus. Orgs. Code Ann. § 101.054(a)(6).

Enshikar does not contest that Advance Tire was formed as an LLC and does not challenge the trial court’s findings of fact that his accident occurred on January 23, 2012 and that Advance Tire filed a certificate of termination on March 23, 2012. Because the certificate of termination was filed two months after the accident, on the date of the accident Advance Tire existed as an LLC, not a partnership or sole proprietorship that might allow for personal liability of Zaid or Jumaa. *See* Tex. Bus. Orgs. Code Ann. § 11.102. . . .

Enshikar also raises various arguments positing that the LLC terminated before the filing of the certificate of termination due to violations of the company agreement and untimely winding up of the business. We conclude the cited non-waivable provisions from the Business Organizations Code dictating when an LLC terminates its existence controls over Enshikar’s theories as to why we should consider the entity to have terminated earlier. Enshikar also argues that Business Organizations Code section 11.051(3) compels a different result. *See* Tex. Bus. Orgs. Code Ann. § 11.051(3). This section, however, concerns when winding up of an entity is triggered, and does not dictate when the entity terminates its existence. *See id.*

Even if we were to agree with Enshikar, it is unclear how it would help him collect the judgment. In his negligence lawsuit, he sued Advance Tire and served its corporate representative. He did not bring suit against a partnership or sole proprietorship doing business as ‘Advance Tire and Wheels, LLC,’ nor did he sue Zaid or Jumaa individually or as a partner or sole proprietor. It is difficult to determine how Enshikar would collect the judgment from Zaid or Jumaa on the basis of individual or vicarious liability when neither they nor the entities they purportedly operated were sued in the negligence action.”

*Gill v. Grewal*, Civ. A. No. 4:14-CV-2502, 2020 WL 3171360 (S.D. Tex. June 15, 2020) (“The Gills [members and managers of an LLC] moved for summary judgment on their declaratory judgment action whereby they claim that they cannot be liable under the Healthema/Grewal Employment Agreement. They claim that the Employment Agreement was between Healthema [the LLC] and Grewal [a member of the LLC] .... ‘Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.’ TEX. BUS. ORGS. CODE § 101.114. Nothing in the Operating Agreement abridges the limited liability of Gills with respect to the employment agreement. As Grewal has not put forward any summary judgment evidence suggesting that the Gills may be held liable for this claim, the Court grants the Gills’ motion for a declaratory judgment that they are not liable to Grewal under the Employment Agreement.”).

### **C. Authority of Member, Manager, Officer or Other Agent**

*KrisJenn Ranch, LLC v. DMA Properties, Inc. (In re KrisJenn Ranch, LLC)*, \_\_ B.R. \_\_, 2021 WL 1235411 (Bankr. W.D. Tex. 2021).

The court held that there was at least an informal fiduciary relationship between two individuals who were the managers and indirect owners of an LLC such that a loan by one of the individuals to the LLC without obtaining the approval of the other individual as required for a loan and conflict-of-interest transaction under the company agreement breached the fiduciary duty owed by the individual who made the loan. Because of a faulty assumption underlying the damages model, however, the court awarded no damages for the breach of fiduciary duty.

Larry Wright and Daniel Moore formed Black Duck Properties, LLC (“Black Duck”) to engage in the business of flipping saltwater disposal wells. Wright owned 50% of Black Duck through KrisJenn Ranch, LLC

(“KrisJenn”), and Moore owned 50% through SCMED Oilfield Consulting, LLC (“SCMED”), an entity owned by Moore. Moore and Wright also served as managers of Black Duck, along with Wright’s son-in-law, Hagan Cohle. Black Duck obtained an assignment of the right to purchase a pipeline right-of-way (ROW), and, after a long and convoluted process to find a buyer or developer, Wright and KrisJenn lent several million dollars to Black Duck to complete the purchase of the ROW. Later, Moore claimed that he was never informed of the loan and that he never authorized the loan as a then-manager of Black Duck. This opinion addressed various claims and counterclaims between and among Wright, Moore, and certain other parties, including a claim by Moore and SCMED against Wright for breach of fiduciary duty based on the allegedly unauthorized loan. Moore argued that KrisJenn’s loan to Black Duck to fund the purchase of the ROW was an unauthorized loan under Black Duck’s company agreement because it was executed without Moore’s consent, and that the loan was for Wright’s own benefit in violation of Wright’s fiduciary duties to Moore and SCMED.

After analyzing the meaning of provisions in agreements entered into by Black Duck in two different transactions obligating Black Duck to pay 20% of the net-profits received from the operation, use, maintenance, or sale of the pipeline, the court concluded that the net-profits interests were net-profits interests in Black Duck that constituted personal property and did not attach and run with the ROW. This threshold issue impacted several other claims in the case, including damages sought by Moore in connection with his breach-of-fiduciary-duty claim.

The court began its analysis of Moore’s breach-of-fiduciary-duty claim by noting that “[t]he Texas Business Organizations Code does not define or specify whether manager or member fiduciary duties exist in the context of limited liability companies.” Moore asserted that Wright, as a manager of Black Duck, owed fiduciary duties to Moore and SCMED, including duties of care, loyalty, disclosure, and a duty to refrain from self-dealing. The court concluded that, at a minimum, Wright owed Moore an informal fiduciary duty.

The court next stated that whether Wright breached his fiduciary duty depended on whether the loan to Black Duck was authorized under the terms of its company agreement. Section 4.05 of the Company Agreement stated:

If the Company does not have sufficient cash to pay its obligations, any Member(s) that may agree to do so with the Managers’ consent may advance all or part of the needed funds to or on behalf of the Company. An advance described in this Section 4.05 constitutes a loan from the Member to the Company ... and is not a Capital Contribution.

In addition, Section 6.10 of the company agreement required transactions between the LLC and an “Interested Person,” including KrisJenn, to be authorized “in good faith by the affirmative vote of the disinterested Management, even though the Persons constituting the disinterested Management is less than a quorum.” That section further provided that “[t]he contract or transaction must be specifically approved in good faith by the Management.” Thus, as a member of Black Duck, KrisJenn had authority under the company agreement to make a loan to Black Duck only with Moore’s consent in his capacity as a manager.

Wright argued that Moore’s consent was either not necessary to execute the loan to Black Duck, or consent was obtained through an email from Moore in which Moore gave Wright and Cohle full authority to sign on his behalf. The email relied upon by Wright was sent by Moore when he was not available in-person to sign one specific agreement relating to the extension of the ROW purchase closing date. At the time, Moore was in the process of moving his family to North Carolina, so Cohle signed the closing extension agreement on Moore’s behalf. Wright and Cohle signed a broadly-worded Consent of Members and Managers of Black Duck in lieu of a meeting that authorized “two of the three managers of [Black Duck] ... to execute certain agreements and documents relating to the matter or matters described on Exhibit A ... without the joinder of FRANK D. (Daniel) MOORE.” Moore argued that he never intended his email consent, which was limited in scope to the closing extension agreement, to allow the other managers, Wright and Cohle, to approve the loan to Black Duck Loan on his behalf. Moore also argued that he was not given notice of this “fake board meeting” and was never asked to provide written authorization of proxy to approve the loan to Black Duck.

The court noted that Moore was likely aware that the purchase of the ROW would be accomplished through borrowed funds, but the company agreement treated all advances from its members as loans, and loans to Black Duck and conflict-of-interest transactions required the affirmative vote and consent of Moore. Because Wright did not obtain Moore’s consent or specific approval to approve the Black Duck Loan, the loan to Black Duck was not authorized under the terms of the company agreement, and the court found that Moore’s email allowing his consent

by proxy to approve a closing-date extension did not establish Moore's specific approval of the loan to Black Duck. The court thus concluded that Wright breached his informal fiduciary duty to Moore, but Moore's damage model depended on the assumption that the net profits interests at issue in the case were valid covenants running with the land, and the court's rejection of that proposition precluded Moore's recovery of damages.

Because the Black Duck Loan was not properly authorized, Wright breached his informal fiduciary duty owed to Moore. Wright entered into an ultra vires and conflicted loan transaction without Moore's required consent. While Moore is entitled to assert his legal rights, as he did here, he must prove that he is entitled to an award of damages. Moore seeks actual damages of \$2.28 million for these alleged breaches. The damages model assumes that the Assignment Agreements contain covenants running with the land. Because the Assignment Agreements do not contain valid covenants running with the land, this model for damages is inapposite. Moore did not prove any other calculation for damages resulting from Wright's breach of fiduciary duty. As such, the Court finds that Moore is not entitled to an award of actual damages.

*Nguyen v. Nguyen*, No. 14-19-00913-CV, 2021 WL 786628 (Tex. App.—Houston [14th Dist.] Mar. 2, 2021, no pet. h.) (mem. op.).

The court concluded that two LLC members who signed a settlement agreement without indicating their capacity bound not only themselves, but the LLC, where the signatory members constituted two of the LLC's three members, there was no evidence of any other persons who possessed or exercised decision making authority for the LLC, and the agreement identified the LLC as a party to the agreement and purported to settle all claims asserted in certain proceedings that included claims asserted derivatively on behalf of the LLC. Alternatively, the court concluded that the LLC ratified the agreement by virtue of a notice of settlement that was signed by the LLC's attorney and stated that all parties reached a complete settlement.

An LLC appealed a summary judgment enforcing a mediated settlement agreement that purported to resolve all claims in certain proceedings brought by two members of the LLC against the third member. The third member sought to enforce the agreement, but the two plaintiff members argued that the agreement was not enforceable because no one signed the agreement on behalf of the LLC. The two plaintiff members signed the agreement without indicating their capacity, and there were no separate signature lines for the LLC, although the court explained that the LLC was named in the agreement as a party in the caption, which identified the plaintiff members individually and derivatively on behalf of the LLC, and in the release paragraph, which defined "party" as including "all named parties in this case."

The court based its analysis on provisions of the Texas Business Organizations Code and general agency law. The court first discussed and applied the following provisions of the Texas Business Organizations Code:

The Texas Business Organizations Code provides that "each governing person of a limited liability company and each officer of a limited liability company vested with actual or apparent authority by the governing authority of the company is an agent of the company for purposes of carrying out the company's business." Tex. Bus. Orgs. Code § 101.254(a). "Governing person" means "a person serving as part of the governing authority of an entity." *Id.* § 1.002(37). "Governing authority" is defined as:

- (1) the managers of the company, if the company's certificate of formation states that the company will have one or more managers; or
- (2) the members of the company, if the company's certificate of formation states that the company will not have managers.

*Id.* § 101.251

The Business Organizations Code also describes the circumstances when the act of a limited liability company's governing person or agent binds the company:

- (b) An act committed by an agent of a limited liability company described by Subsection (a) for the purpose of apparently carrying out the ordinary course of business of the company, including the execution of an instrument, document, mortgage, or conveyance in the name of the company, binds the company unless:
  - (1) the agent does not have actual authority to act for the company; and

(2) the person with whom the agent is dealing has knowledge of the agent's lack of actual authority.

*Id.* § 101.254(b).

The court interpreted the agreement to include the LLC as a party, and the agreement did not differentiate between the plaintiffs individually and as representative members of the LLC. There was no indication in the agreement that the plaintiffs intended to sign only on their own behalf, such as a blank signature line for the LLC, and the court stated that no one other than the plaintiffs could have signed on the LLC's behalf to settle its claims asserted derivatively against the defendant. The court stated that the plaintiff members asserted the rights of the LLC derivatively, thus exercising decision-making authority on the LLC's behalf, and the defendant member relied on the plaintiffs' "dual capacities" in support of his summary judgment argument that the LLC assented to the agreement. As members with decision making power, the court characterized the plaintiff members as "governing persons" and agents of the LLC. Thus, under Tex. Bus. Orgs. Code § 101.254(b), the plaintiffs' signatures bound the LLC unless (1) the plaintiffs did not have actual authority and (2) the defendant member knew that they did not have actual authority. Because neither prong was satisfied, the court concluded that the plaintiffs had authority to sign the agreement and that their signatures bound the LLC.

The court also stated that its conclusion was consistent with the general agency principle that a disclosed principal is a party to a contract made by its agent within the scope of the agent's authority, citing Restatement (Second) of Agency § 147 (1958) and Restatement (Third) of Agency § 6.01 (2006).

The court rejected the plaintiffs' argument that the defendant did not prove that the plaintiffs were part of the LLC's governing authority in the absence of evidence in the record as to whether the LLC was managed by members or managers. The court acknowledged that a Texas LLC is either member-managed or manager-managed and that the certificate of formation must indicate whether an LLC will be managed by members or managers. Although the record did not contain the certificate of formation, the court stated that all of the evidence in the record established that no persons other than the plaintiff members possessed and exercised the requisite decision making authority for the LLC. Alternatively, assuming *arguendo* that the record did not conclusively show that the plaintiffs were the "governing persons" or agents of the LLC, the court stated that the LLC was bound to the agreement based on ratification. According to the court, the notices of settlement filed with the trial court after execution of the settlement agreement constituted a ratification of the settlement agreement because the notices stated affirmatively that the "*parties* have reached a *complete* settlement of this case at mediation" (and further stated that the "lawsuit will be dismissed as to all parties and claims" without indicating that any parties or entities were excluded from the settlement), and the notices were signed by the LLC's counsel, who also signed the settlement agreement.

***In re Saddles Blazin, LLC***, No. 09-20-00209-CV, 2021 WL 377247 (Tex. App.—Beaumont Feb. 21, 2021, no pet. h.) (mem. op.).

The court held that the trial judge abused his discretion by ordering a manager-managed limited liability company to produce a member for a deposition when the member was not personally served with a subpoena.

Saddles Blazin, LLC ("Saddles") leased commercial real estate from KRG Portofino, LLC ("Portofino"). Brian Kelley executed the lease on behalf of Saddles. At the time, Kelley was both a manager and member of Saddles. After litigation between Saddles and Portofino ensued, Portofino served notice on counsel for Saddles to produce Kelley for deposition. Saddles argued that Portofino was required to provide Kelley personal notice as Kelley was neither a director, manager, or governing person nor an expert for the company. Portofino responded that the trial judge had the discretion to compel the production because Portofino had produced evidence that supported an implied finding that Kelley was a governing person and agent of Saddles, subject to the company's control.

Saddles was formed in Nevada in 2013. Its original filings in Nevada reflected that it would be a manager-managed LLC with Kelley and Donald Wollan as its managers. When the company registered in Texas in 2014, it identified Kelley and Donald Wollan as its governing persons. In an affidavit, Wollan stated that Kelley resigned from Saddles in December 2018 and is now a passive minority investor with a ten percent interest. Wollan further stated that he drafted the governing documents for Saddles, and those documents lack a mechanism requiring a minority member's attendance at a deposition. The 2019 annual filing with the Nevada Secretary of State by Saddles identified Donald Wollan and Christopher Wollan as the sole managers for the company. The company's 2019 Texas Franchise Tax Public Information Report included Kelley in its list of officers, directors, members,

general managers or managers without identifying which role Kelley maintained in the company. Because the face of the document does not specify whether Kelley is a manager or a member, the Texas franchise tax report neither refutes nor contradicts the Nevada filing.

Under Tex. R. Civ. P. 199.3, a party may compel a witness to attend an oral deposition by serving the witness with a subpoena. If the witness is retained by, employed by, or otherwise subject to the control of a party, however, service of the notice of oral deposition upon the party's attorney has the same effect as a subpoena served on the witness. The court stated that "control" of a nonparty witness for purposes of Rule 199.3 requires control of the same kind, class, or nature as that a party would have over an employee or a retained expert. Portofino's justification for compelling Kelley's attendance at a deposition through notice served on counsel of record for Saddles was based on Kelley's status as a governing person by virtue of his status as a member of the limited liability company. Under the Business Organizations Code, a governing person of a limited liability company is an agent of the company for purposes of carrying out the company's business. Tex. Bus. Orgs. Code § 101.254(a). "Governing person" is "a person serving as part of the governing authority of an entity." *Id.* § 1.002(37). "Governing Authority" is defined as "the managers of the company, if the company's certificate of formation states that the company will have one or more managers[.]" *Id.* § 101.251.

Because there was no evidence that Saddles' governing documents granted Saddles the power to adversely affect Kelley's status or compensation as a member if he refused to attend the deposition, the court held that the evidence failed to establish that Kelley was subject to the control of Saddles, and the trial court abused its discretion by denying the motion to quash the notice of deposition of Kelley filed by Saddles and ordering Kelley to appear for deposition. Further, Saddles lacked an adequate remedy by appeal and the court thus conditionally granted the petition for a writ of mandamus.

*United States ex rel. Haight v. RRSA (Commercial Division), LLC*, Civ. A. No. 3:16-CV-1975-S, 2020 WL 6163139 (N.D. Tex. Oct. 20, 2020) (finding that a presentment claim under § 3729(a)(1)(A) of the False Claims Act (FCA) was sufficiently pled against RRSA Commercial, an LLC, and stating the following as part of the analysis: "The FCA applies to 'any person' who knowingly causes a false claim to be made, and a 'person' may include a business entity, such as a limited liability company like RRSA Commercial. However, a company such as RRSA Commercial can act only through individuals and 'cannot act or have a mental state by itself.' For purposes of evaluating scienter under the FCA, courts in this Circuit have imputed an officer's knowledge to a company when the officer was acting within the scope of the officer's authority and for the purpose of benefitting the company. Accepting Relator's alleged facts as true and viewed in the light most favorable to Relator, the Court finds that Relator has sufficiently pleaded the scienter element for Corey S. Sanchez, Jon R. Seymore, and Ronald Nichols. Furthermore, the Court finds scienter may be imputed to RRSA Commercial because Relator has pleaded sufficient facts alleging that Corey S. Sanchez, Jon R. Seymore, and Ronald Nichols were owners, officers, managers, or agents of RRSA Commercial, acting within the scope of their authority, for the purpose of benefitting RRSA Commercial, which is undisputed by the parties.").

*Autoficio, LLC v. Cimble Corp.*, Civ. A. No. 4:17-cv-00404-KPJ, 2020 WL 3209014 (E.D. Tex. June 15, 2020).

The court concluded that a genuine issue of material fact existed on whether the plaintiffs were agents of Kapexia, LLC who would be permitted to sue, in their own names, upon contracts entered into by Kapexia.

Plaintiffs Brian Whiteside and Autoficio, LLC sued Defendants Cimble Corp., Alvin Allen, and Paul Barrett for breach of contract and other actions. Kapexia, LLC was a California member-managed LLC. Whiteside was neither a member nor manager of Kapexia.

A Share Purchase and Option Agreement (SPA) was signed by Whiteside on behalf of Kapexia and by Allen on behalf of Cimble. A Memorandum of Understanding (MOU) was also entered into. Under the agreements, Kapexia was to make payments to Cimble. Less than two weeks after signing the agreements, Whiteside formed Autoficio and it was allegedly decided that Autoficio would make the payments due under the agreements to Cimble.

After payments were made to Cimble, Cimble allegedly breached the agreements. The plaintiffs sued, and the defendants filed a motion to dismiss on several grounds, including that the plaintiffs could not enforce the agreements because they could not show privity of contract (i.e., Kapexia was a party to the agreements, but not plaintiffs). The court noted that "[u]nder Texas law, [t]he general rule is that one who contracts as [an] agent cannot

maintain an action, in his own name and right, upon the contract,” but there is an exception “where the agent has an interest in the underlying contract.” An interest in the underlying contract can arise “when the agent proves he has an agreement with the principal or when the agent advances funds or makes payments under the contract.” The court found that the plaintiffs did have an interest in the agreements arising from payments made by the plaintiffs under the SPA and the MOU. Because “the parties do not dispute that Whiteside and Autoficio contributed funds due under the Agreements,” the court determined that “summary judgment is precluded on Plaintiffs’ breach of contract claim if Plaintiffs have established a genuine issue of material fact as to whether Whiteside and/or Autoficio acted as Kapexia’s agents.” Thus, the determinative question was whether Whiteside and Autoficio could be agents of Kapexia.

The court began its analysis by discussing basic agency principles:

“An agent is one authorized by another to transact some business for the principal; the relationship is a consensual one between two parties, by which one party acts on behalf of the other, subject to the other’s control.” *Jamison v. Nat’l Loan Investors, L.P.*, 4 S.W.3d 465, 468 (Tex.App.—Houston [1st Dist.] 1999, pet. denied). “Authorization to act and control of the action are the two essential elements of agency.” *Reliant Energy Services, Inc. v. Cotton Valley Compression, L.L.C.*, 336 S.W.3d 764, 783 (Tex.App.—Houston [1st Dist.] 2011, no pet.) (citing *Gonzales v. Am. Title Co.*, 104 S.W.3d 588, 593 (Tex.App.—Houston [1st Dist.] 2003, pet. denied)). “The law does not presume agency, and the party asserting agency has the burden to prove it.” *Id.* (citing *IRA Res., Inc. v. Griego*, 221 S.W.3d 592, 597 (Tex. 2007)). “An agent’s authority to act on behalf of a principal depends on words or conduct by the principal either to the agent (actual authority) or to a third-party (apparent authority).” *Id.* (citations omitted).

“Actual authority includes both express and implied authority.” *Id.* An agent’s actual authority to act on behalf of a principal depends on words or conduct by the principal to the agent. *See id.* “Express authority is delegated to an agent by words of the principal that expressly and directly authorize the agent to do an act or series of acts on behalf of the principal.” *Id.* Implied authority is “the authority of an agent to do whatever is necessary and proper to carry out the agent’s express powers.” *Reliant Energy Services*, 336 S.W.3d at 783. Therefore, implied agency exists “only as an adjunct to express actual authority; an agent that does not have express authority cannot have implied authority.” *Id.* “In order to prove actual authority, therefore, there must be evidence that either (1) the principal intentionally conferred authority on another to act as its agent, or (2) the principal intentionally, or by a want of due care, allowed another to believe that it possessed authority to act as the principal’s agent.” *Id.* Therefore, courts are to “examine the words and conduct by the principal to the alleged agent regarding the alleged agent’s authority to act for the principal.” *Id.*

“Apparent authority is the power of an agent to affect the legal relations of the principal by transactions with a third person.” *Id.* (citing *Ames v. Great S. Bank*, 672 S.W.2d 447, 450 (Tex. 1984)). As apparent authority is based on estoppel, only the conduct of the principal in leading a third party to believe that the agent has authority may be considered. *See Gaines v. Kelly*, 235 S.W.3d 179, 182 (Tex. 2007). Therefore, courts look to “acts of participation, knowledge, or acquiescence by the principal” in deciding whether the agent had apparent authority to act. *Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 672 (Tex. 1998). “Apparent authority arises either from (1) a principal knowingly permitting an agent to hold himself out as having authority, or (2) a principal’s actions which lack such ordinary care as to clothe an agent with the indicia of authority, thus leading a reasonably prudent person to believe that the agent has the authority he purports to exercise.” *Reliant Energy Services*, 336 S.W.3d at 784 (citing *Gaines*, 235 S.W.3d at 182).

The court then turned to examining whether Whiteside could be an agent of Kapexia. According to the court, the plaintiffs established a genuine issue of material fact as to whether Whiteside was such an agent:

In the Motion and at the Hearing, Defendants argue that only a member manager may sign a contract or make decisions on behalf of a California member-managed limited liability company under California law. Defendants cite to California Corporate Code Sections 17704.08(d)(2) and

17713.12(e)(2) in support of their argument. Even if California law controlled Kapexia's formation of an agency relationship, neither of these statutes appears to preclude Whiteside from acting as an agent of Kapexia. Section 17704.08(d)(2) concerns indemnification and insurance, and states that for the purpose of that subdivision, "agent" is defined as "any person who is or was a member of a member-managed limited liability company, manager of a manager-managed limited liability company, officer, employee, or other agent of the limited liability company ...." Cal. Corp. Code § 17704.08(d)(2) (emphasis added). Section 17713.12(e)(2) defines an agent of a California limited liability company as "a person or entity authorized by the limited liability company to make representations to the public about the limited liability company's financial condition and who is acting within the scope of the agency when the representations are made." *Id.* at § 17713.12(e)(2). Neither of these statutes prohibit a California limited liability company from creating an agency relationship with someone who is not a manager or a member. As the Court has found no California law precluding Kapexia from having an agent that is not a member or manager, the Court will analyze whether Plaintiffs have established a genuine issue of material fact as to whether Whiteside was an agent of Kapexia when he signed the SPA and LOC under Texas common law.

Plaintiffs have provided evidence that [Trevor] Zink [a member of Kapexia] sent an email to Barrett and Allen and copied Whiteside, which stated, "we decided to have [Whiteside] sign all the documents, so I made those changes and obtained [Whiteside's] signature." This email evinces that a member of Kapexia designated Whiteside to sign the Agreements on Kapexia's behalf. *See Reliant Energy Services*, 336 S.W.3d at 783 ("Express authority is delegated to an agent by words of the principal that expressly and directly authorize the agent to do an act or series of acts on behalf of the principal."). Hence, Plaintiffs have established a genuine issue of material fact as to whether Whiteside had express authority to sign the Agreements on Kapexia's behalf.

Additionally, Plaintiffs argue Whiteside had implied authority to sign the Agreements because he was "well-ingratiated in the business dealings" of Kapexia and Cimble. Whiteside was heavily involved in the negotiation process with the members of Kapexia, as well as with Defendants. As Barrett testified, everyone involved in the negotiations knew that Whiteside would be providing the funds due under the Agreements. These actions tend to show that Whiteside may have had implied authority to execute the Agreements as an extension of his express powers of negotiating and carrying out the Agreements. Accordingly, the Court finds that a genuine issue of material fact exists as to whether Whiteside had implied authority to sign the Agreements.

With respect to Autoficio, the court also concluded that a genuine issue of material fact existed as to whether Autoficio was an agent of Kapexia:

Defendants argue Autoficio cannot be in privity of contract with Kapexia because it was not formed until after the Agreements were signed. Plaintiffs argue Autoficio was formed at the direction, and to serve the needs, of Kapexia, and thus, Plaintiffs argue Autoficio acted as an agent in performing under the Agreements.

Here, it is undisputed that Autoficio made four payments of \$25,000.00 each to Cimble as due under the [MOU]. Cimble's bank records list each of these four payments as "Domestic Wire Deposit WIRE IN AUTOFICIO LLC." Further, Whiteside testified that he formed Autoficio at the direction of [G.B.] Conley, [Joe] Perez, and Zink when they decided investing in Cimble through Kapexia would hurt their ability to sell any product developed by Cimble. Thus, a reasonable jury could find that Kapexia intentionally conferred authority on Autoficio to act as its agent in paying the funds due under the Agreements. Therefore, the Court finds that a genuine issue of material fact exists as to whether Autoficio was an agent of Kapexia.

Because "a genuine issue of material fact exist[ed] as to whether Plaintiffs acted as agents of Kapexia," the court found that "a genuine issue of material fact exist[ed] as to whether Plaintiffs were in privity of contract with Cimble."

## D. Fiduciary Duties

*Villareal v. Saenz*, 5-20-CV-00571-OLG-RBF, 2021 WL 1986831 (W.D. Tex. May 18, 2021).

The court held that a broad release executed by two members of an LLC and the LLC in connection with one member's buyout of the other member's membership interest barred claims by the LLC and purchasing member against the selling member for breach of fiduciary duty and other causes of action that were based on conduct by the selling member before execution of the release. The court declined to dismiss claims premised on conduct of the selling member after execution of the release, noting that the interplay between the Texas LLC statute and the operating agreement was unclear as to whether the selling member continued to be a member and, as such, continued to owe fiduciary duties after the assignment of the membership interest.

In January, 2019, Jonathan Villarreal and John Saenz formed ZroBlack, LLC ("ZroBlack"), a Texas limited liability company, the purpose of which was to provide applications and services regarding cell phone data capture and erasure for both commercial and governmental use. Villarreal and Saenz each owned 50% of the LLC. Villarreal was responsible for performing the in-house coding, hardware engineering, and servicing of the technology, and Saenz was responsible for client engagement and promoting the company. Villarreal assigned his intellectual property interest in software he developed to ZroBlack.

A few months after ZroBlack was formed, it entered into a Professional Services Agreement (PSA) with a foreign customer under which the foreign customer paid \$1.5 million up front and agreed to make future payments based on an earn-out arrangement. Villarreal and ZroBlack alleged that Saenz then withdrew \$740,000 and transferred the money to his personal account, while Villarreal transferred \$740,000 to a newly formed distribution account "according to the terms of the LLC agreement." According to Villarreal and ZroBlack, the distributions to both Villarreal and Saenz constituted their salary through the end of 2019 and the \$740,000 Saenz withdrew was thus not yet earned.

Soon after Villarreal and Saenz began their consulting work under the PSA, they began to disagree about Saenz's performance as ZroBlack's CEO. Ultimately, they decided to part ways, and a lawyer prepared a document entitled "Release" that Saenz and Villarreal executed on behalf of themselves and ZroBlack on August 9, 2019. In the Release, the parties agreed that Saenz would "assign[ ] [ ] his entire interest in ZroBlack LLC to Villarreal." At the same time they executed the Release, the parties executed a document entitled "Unanimous Written Consent In Lieu of Meeting of The Members of ZroBlack LLC," which "memorialize[d]" the assignment of Saenz's "entire interest." The Release provided that Villarreal and Saenz would split future earn-out payments from the foreign customer, and they fully released each other "from all claims and demands, known or unknown" (see provision quoted below). The Release did not mention: (1) the \$740,000; (2) any company property, such as a laptop that had been acquired by Saenz in connection with his duties as CEO; or (3) ZroBlack's proprietary and trade secret information, domain name, webpage, or server.

Beginning on August 15, 2019, Villarreal requested on several occasions that Saenz release ZroBlack's domain name and return the laptop, which allegedly contained ZroBlack's proprietary trade secrets, including the code related to ZroBlack's phone-security project. Saenz allegedly refused to do so, and Villarreal received an email on August 15, 2019, from GoDaddy informing him that Saenz had, the day before, revoked Villarreal's access to the domain name. In September of 2019, Villarreal learned Saenz had allegedly deleted thousands of emails and documents on ZroBlack's email server and had taken down its webpage. According to Villarreal and ZroBlack, Saenz "blackmailed ZroBlack over the domain name, webpage, and email server, offering to sell it back to ZroBlack for \$7,000." Without access to the ZroBlack domain, Villarreal and ZroBlack contended that they were unable to update ZroBlack's credentials with various entities, agencies, and websites, which in turn prevented ZroBlack from competing for government contracts.

In 2020, Villarreal and ZroBlack sued Saenz, requesting ex parte preliminary and permanent injunctive relief. The plaintiffs alleged the following claims against Saenz: (1) violations of the federal Defend Trade Secrets Act (DTSA) and Texas Uniform Trade Secrets Act (TUTSA); (2) violations of the federal Computer Fraud and Abuse Act (CFAA); (3) violations of the federal Anti-cybersquatting Consumer Protection Act (ACPA); (4) breach of contract; (5) breach of fiduciary duty; (6) tortious interference with prospective business relations; (7) conversion; (8) violation of the Texas Theft Liability Act; and (9) fraud. The plaintiffs also sought a declaration pursuant to 28 U.S.C. § 2201 that the ZroBlack Operating Agreement and Release are void and unenforceable due to fraud and mutual mistake, and the plaintiffs brought legal malpractice and breach-of-fiduciary-duty claims against the law firm and lawyer (collectively, the "law firm") that drafted the Release and advised Villarreal and ZroBlack



on it. Saenz and the law firm filed a motion to dismiss. As further described below, in this opinion, the magistrate recommended dismissal of the plaintiffs' claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent premised on conduct allegedly committed while Saenz served as ZroBlack's CEO—conversion, fraud, breach of contract, tortious interference, violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz's refusal to return ZroBlack's laptop—and request for declaratory relief. The magistrate recommended that the plaintiffs' claims for breach of fiduciary duty and for violations of the CFAA and ACPA—insofar as premised on Saenz's alleged conduct after the parties executed the Release—should remain, at least at this juncture.

The court first addressed the impact of the Release on the plaintiffs' claims against Saenz. Paragraph 7 of the Release provided, in relevant part:

Each party hereby fully releases the other Parties from all claims and demands, known or unknown. Each Party understands that, as to claims that are known to that Party when the release is signed, any statutory provisions that would otherwise apply to limit this general release are hereby waived. Each Party also understands that this release extends to claims and demands that are not known at the time this release is signed.

The court states that “[a] ‘broadly worded general release[ ]’ that is unlimited to a specific cause of action or occurrence—such as the one at issue here—is typically valid and enforceable under Texas law,” and “a release of ‘any and all’ claims applies to ‘all possible causes of action.’” The court understood the Release to be a “complete bar” against claims existing at the time of its execution. Thus, it barred most, but not all, of the plaintiffs' claims because most of the facts on which the plaintiffs premised their claims against Saenz existed at the time the Release was executed. According to the court, that some or all of the plaintiffs' claims might not have accrued for statute-of-limitations purposes was distinguishable from whether the claims existed at the time. In any event, the court pointed out that the parties released not only all known and unknown claims but also all known or unknown demands. At the time of the Release, the plaintiffs could have demanded return of the laptop, return of the \$740,000, a declaration that the ZroBlack Operating Agreement was void for fraud, and a transfer of the ZroBlack domain. On the other hand, accepting the allegations in the complaint as true, the Release did not preclude claims premised on Saenz's later revocation of Villarreal's access to the domain and deletion of documents on the server because these events allegedly occurred after the parties executed the Release. Furthermore, any claims or demands surrounding these occurrences would not have existed at the time. Additionally, as conceded by Saenz, the Release could not bar the plaintiffs' claims for breach of the Release.

The court next rejected the plaintiffs' contentions that the Release should be set aside due to mutual mistake, fraud, or considerations of public policy. The plaintiffs alleged no facts to plausibly suggest mutual mistake and did not adequately explain or allege how Saenz's alleged fraudulent inducement of the ZroBlack Operating Agreement several months before execution of the Release could bear on the validity of the Release, which the plaintiffs did not argue was induced by fraud. Nor were there any plausible allegations that the terms of the Release were themselves the product of fraud or misrepresentation by the law firm. Thus, the plaintiffs' claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent predicated on Saenz's conduct as ZroBlack's CEO—conversion, fraud, breach of the company agreement, and violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz's refusal to return the laptop—and for declaratory relief were barred by the Release.

The court next turned to the merits of the plaintiffs' claims that were not barred by the terms of the Release. With respect to the plaintiff's claim for breach of contract based on the terms of the Release and Unanimous Consent, the court found no plausible basis had been pled for breach of contract. Pursuant to the Release and Unanimous Consent, Saenz “assign[ed] [ ] his entire interest in ZroBlack LLC” to Villarreal pursuant to Article VII of the ZroBlack Operating Agreement. The documents did not define the term “interest” and did not indicate an intent to otherwise obligate Saenz to return any alleged company funds, property, or trade secrets, including the \$740,000 and laptop. Nevertheless, the plaintiffs asserted that these items of property would necessarily be included within Saenz's assignment and that Saenz thus breached the agreements by refusing to return them. The court stated that there was only one reasonable interpretation of Saenz's “entire interest in ZroBlack LLC,” as that phrase was used in the documents, and that interpretation was that Saenz assigned his membership interest in the company itself. The court stated that “[t]his interest is defined under Texas law to exclude any supposed personal ‘interest’

he had in company property.” The court made clear that it was not suggesting that Saenz’s mere status as a member of ZroBlack meant that he owned any kind of “interest” in any specific property of the company that he would have the power to assign when acting in an individual capacity to execute the Release, citing Tex. Bus. Orgs. Code § 101.106(b) (“A member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company”). According to the court, “That Villarreal believed—or believes now in hindsight—that Saenz’s ‘interest’ in ZroBlack LLC included an assignable personal ‘interest’ in the company’s property isn’t helpful to Villarreal’s position. The plain language in both agreements is at odds with any such subjective belief.” Thus, the court concluded that the breach-of-contract claim should be dismissed.

The court found that the plaintiffs’ claims that Saenz violated his fiduciary duties by maintaining dominion and control over ZroBlack’s domain and email server to the company’s detriment after the parties executed the Release should survive dismissal at this juncture based on the possibility that Saenz, as a member who assigned his membership interest, might nevertheless still be a member who owed fiduciary duties to ZroBlack. The court explained as follows:

Citing case law on partnerships, Saenz contends that his fiduciary duties to ZroBlack ceased once he assigned his interest in the LLC to Villarreal. *See* Dkt. No. 41 at 21. But under Texas law, “[a] member of a limited liability company may not withdraw or be expelled from the company.” Tex. Bus. Org. Code § 101.107. Further, “an assignor member does not cease to be a member merely by assigning the member’s interest.” Miller & Ragazzo, 13 Tex. Prac., Texas Methods of Practice § 59:2 (3d ed. 2021) (citing *id.* § 101.111(a)). At the same time, the Operating Agreement refers to an assignor as an “exiting member” without defining that term or discussing its implications. *See* Dkt. No. 33-3 at 9. Ultimately, Saenz hasn’t addressed the interplay between Texas law on LLCs and the language in the Operating Agreement. Accordingly, on the present briefing, the Court can’t conclude as a matter of law that Saenz didn’t owe ZroBlack any fiduciary duties after he assigned his interest in the company to Villarreal.

After concluding that the plaintiffs’ claims for post-Release violations of CFAA and ACPA should not be dismissed at this juncture, the court addressed the plaintiffs’ claim against the law firm who drafted the Release and concluded that requiring the plaintiffs to litigate those claims in state court would not raise fairness or comity issues and that there was no justification for the exercise of supplemental jurisdiction over those claims.

***Chase v. Hodge***, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021).

The magistrate concluded that the plaintiff did not have standing to pursue breach-of-fiduciary-duty claims that alleged harm to an LLC because the plaintiff was never a member of the LLC, as indicated by his complaint that he was never made a member when he was promised an ownership interest in the LLC, and even if he were a member, he would not have standing to bring the claims individually because a claim of harm to the entity must be brought directly or derivatively by the entity suffering harm.

In this dispute about the ownership of Helping Hands Capital, LLC (“Helping Hands” or the “Company”), a Texas limited liability company that makes non-recourse loans to cover living expenses for parties involved in personal injury claims and suits, Dean Chase, a Florida citizen, asserted claims against Ryan Hodge, an attorney licensed in and residing in Kansas and the sole member of Helping Hands. Hodge also asserted claims against Hodge’s former spouse, Stephanie, and Helping Hands. Chase filed the suit in Travis County district court, and the defendants removed it to federal court based on diversity. Hodge sought to be dismissed based on lack of personal jurisdiction, and Hodge and Helping Hands sought dismissal of claims based on failure to state a claim.

Chase alleged that Hodge, Chase, and another individual (Guedri) who was not a party, decided to start a business to provide loans to litigants that would be secured by future recoveries in lawsuits. At the time, the three men were partners in a separate business that provided case expense loans. Chase claimed that Hodge, acting as an attorney for Chase and Guedri, formed the new entity, and that the parties agreed to treat it as an equal partnership in which each owned one third of the company and would share profits in thirds. In 2013, Hodge formed Helping Hands, listing himself on the certificate of formation as the managing member and making no mention of Chase or Guedri in the filing.

From 2013 through 2016, the Company typically reinvested profits into the Company, but funds were occasionally distributed to the three partners on the one-third basis initially agreed upon. In 2016, Guedri tendered his interest back to the Company, and Chase alleged that Hodge acknowledged to Chase in writing that going forward they were “50/50 partners.” In 2016 and 2017, distributions to Hodge and Chase were allegedly made on a 50/50 basis. According to Hodge and Chase, they worked together cooperatively until early 2018, when Chase began to press for more financial information and Hodge eventually sent a communication to Chase advising that Chase’s interest in the Company was an “economic benefit only” and not “legal ownership.” Chase contended that Hodge asserted for the first time in 2018 that the Company was “owned 100% by a trust” and that Hodge had no ownership in Helping Hands himself. Chase alleged that Hodge began excluding Chase from the business during this time frame in the spring of 2018. According to Chase, he tried to resolve the issues with Hodge throughout 2019 until Hodge emailed Chase in September of 2019 and offered to buy Chase’s “interests” in Helping Hands for \$25,000, or otherwise he would “transfer” his money out of Helping Hands and sell the assets and wind down the Company. Chase argued this offer was patently disingenuous, because the Company had made and received millions of dollars in loans over the past two years.

Chase asserted claims against Hodge for (1) breach of fiduciary duty; (2) breach of contract; (3) violations of the Texas Securities Act; (4) common law and statutory fraud; (5) a declaration of Chase’s rights in Helping Hands; and (6) the appointment of a receiver. He sued Helping Hands for (1) violations of the Texas Securities Act; (2) knowing participation in breach of fiduciary duty; (3) statutory fraud; (4) a declaration of Chase’s rights in Helping Hands; and (5) appointment of a receiver. Chase asserted that Hodge was involved in a hotly contested divorce and that Hodge may be wasting or transferring assets and revenues of the Company in an effort to hide the money from both Chase and Hodge’s ex-wife, Stephanie Hodge, also named as a defendant in the case. According to Chase, Hodge engaged in a consistent scheme of self-dealing, usurpation of corporate opportunities, and wasting of company assets. In turn, Hodge and Helping Hands asserted that Chase was never a member of Helping Hands, that he was compensated similarly to a contractor, and that he was not entitled to relief on his claims. Additionally, Helping Hands argued that Chase failed to name Chase First Chance Trust II, the sole member of the Company, as a party.

The court first addressed Hodge’s motion to dismiss on the basis that the court lacked personal jurisdiction over Hodge and concluded that Hodge had sufficient minimum contacts to support the exercise of personal jurisdiction and that considerations of fairness did not preclude exercise of jurisdiction.

The court next addressed motions to dismiss by both Hodge and Helping Hands for failure to state a claim under Rule 12(b)(6). Turning to Chase’s claims for breach of fiduciary duty, the court listed numerous counts in which Chase asserted acts of usurpation of business opportunities from Helping Hands, self dealing, transfers of assets, manipulation of the books, and failure to provide information.

Hodge argued that six of the ten alleged acts constituting a breach of fiduciary duty described harm to Helping Hands and not Chase individually and that these six claims must be dismissed based on the principle that “a shareholder may not sue directly for breaches of duties by officers and directors of a company, as those injuries are suffered by the corporation and thus a suit to recover those damages may only be brought as a derivative suit on behalf of the corporation,” citing both corporate and LLC case law. The court agreed that the harms alleged in those six instances were suffered by Helping Hands and not Chase and must be brought in a derivative action, if at all. The court characterized the issue of standing in a case in federal court as a “threshold jurisdictional question” under Article III that must raise *sua sponte* when necessary. The court explained the rationale for dismissing the claims that rested on harm to Helping Hands as follows:

According to the allegations in the First Amended Complaint, Chase is not an owner or member of Helping Hands, LLC. Dkt. No. 54 at 2 (stating, “Hodge then formed Helping Hands Capital, LLC, as a Texas limited liability company on March 28, 2013. Hodge was listed on the Certificate of Formation as the Managing Member of Helping Hands ... the initial Company Agreement listed Hodge as 100% owner of the 10,000 member units.”). Indeed, the essence of Chase’s complaint is that he was never made a member of the LLC although he was promised an ownership interest. Thus he asks that the Court declare he was in fact a partner in Helping Hands and entitled to all profits, payments, and rights attendant to that partnership. However, as the First Amended Complaint states, Chase is not a named member of Helping Hands and any interest he may have in it is outside its status as an LLC. As a result, though Chase may have other claims

through which he can seek to recover against Hodge for these actions, he has no standing to sue Hodge for Hodge allegedly breaching his fiduciary duty to Helping Hands.

And even if he were a member of the LLC, Chase would still not have standing to bring these claims. A claim of harm to a corporate entity must be brought, directly or derivatively, by the entity suffering the harm. See *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990); *Eye Site, Inc. v. Blackburn*, 796 S.W.2d 160, 161 (Tex. 1990) (stating if a wrong has been done to the corporation, it is the corporation which must be compensated for the wrong, and even if also wronged an individual may not recover personally – no direct individual action is possible). The harms alleged in (a), (d), (g), (h), (i), and (j) above were suffered by Helping Hands and not Chase, and must be brought in a derivative action, if at all.

The court also found that Chase failed to adequately plead an injury to either Helping Hands or himself for alleged acts of transferring ownership of Helping Hands to a Nevada trust and transferring proceeds from an SBA loan to a Nevada entity and then back to Helping Hands. The Court found that Chase did not have standing to bring these breach-of-fiduciary-duty claims because he failed to assert the requisite injury to himself necessary to support these claims.

With regard to the claim that Hodge refused to provide Chase information about the business and stopped paying him, the court stated:

Hodge argues that as the managing member of Helping Hands, he does not owe Chase a fiduciary duty and this claim should sound in contract rather than tort. The Court agrees. See *Gill v. Grewal*, 2020 WL 3171360, at \*20 (S.D. Tex. June 15, 2020) (stating that in Texas, members in a limited liability company do not owe a formal fiduciary duty to one another) (citing *Guevara v. Lackner*, 447 S.W.3d 566, 580 (Tex. App.—Corpus Christi 2014, no pet.)); *Higher Perpetual Energy, LLC v. Higher Power Energy, LLC*, 2018 WL 3020328, at \*9 (E.D. Tex. June 18, 2018) (holding that under Texas law, a formal fiduciary relationship does not exist between managers and members of an LLC).

The last breach-of-fiduciary-duty claim addressed by the court related to Chase’s allegation that Hodge breached a fiduciary duty to him when Hodge omitted Chase’s name from the corporate formation documents of Helping Hands, LLC. Chase pled that “unbeknownst to Plaintiff [Hodge] named himself the 100% owner of Helping Hands and deliberately omitted Plaintiff from Helping Hands’ corporate documents.” The court stated that this claim could only be against Hodge in his alleged capacity as Chase’s attorney since Helping Hands did not exist at the time this occurred, and Hodge was not yet the managing member of Helping Hands. Chase pleaded that Hodge “served as Plaintiff’s attorney in Texas in connection with the formation and launch of the business that became Helping Hands.” Hodge argued that this claim should be dismissed because Chase made inconsistent allegations in his original petition. The court stated that the allegation in the original complaint that Chase knew he was omitted from the formation documents was troubling, and cast doubt on the veracity of the current allegation, but it did not mandate dismissal of the current allegation.

***KrisJenn Ranch, LLC v. DMA Properties, Inc. (In re KrisJenn Ranch, LLC)***, \_\_ B.R. \_\_, 2021 WL 1235411 (Bankr. W.D. Tex. 2021).

The court held that there was at least an informal fiduciary relationship between two individuals who were the managers and indirect owners of an LLC such that a loan by one of the individuals to the LLC without obtaining the approval of the other individual as required for a loan and conflict-of-interest transaction under the company agreement breached the fiduciary duty owed by the individual who made the loan. Because of a faulty assumption underlying the damages model, however, the court awarded no damages for the breach of fiduciary duty.

Larry Wright and Daniel Moore formed Black Duck Properties, LLC (“Black Duck”) to engage in the business of flipping saltwater disposal wells. Wright owned 50% of Black Duck through KrisJenn Ranch, LLC (“KrisJenn”), and Moore owned 50% through SCMED Oilfield Consulting, LLC (“SCMED”), an entity owned by Moore. Moore and Wright also served as managers of Black Duck, along with Wright’s son-in-law, Hagan Cohle. Black Duck obtained an assignment of the right to purchase a pipeline right-of-way (ROW), and, after a long and convoluted process to find a buyer or developer, Wright and KrisJenn lent several million dollars to Black Duck

to complete the purchase of the ROW. Later, Moore claimed that he was never informed of the loan and that he never authorized the loan as a then-manager of Black Duck. This opinion addressed various claims and counterclaims between and among Wright, Moore, and certain other parties, including a claim by Moore and SCMED against Wright for breach of fiduciary duty based on the allegedly unauthorized loan. Moore argued that KrisJenn's loan to Black Duck to fund the purchase of the ROW was an unauthorized loan under Black Duck's company agreement because it was executed without Moore's consent, and that the loan was for Wright's own benefit in violation of Wright's fiduciary duties to Moore and SCMED.

After analyzing the meaning of provisions in agreements entered into by Black Duck in two different transactions obligating Black Duck to pay 20% of the net-profits received from the operation, use, maintenance, or sale of the pipeline, the court concluded that the net-profits interests were net-profits interests in Black Duck that constituted personal property and did not attach and run with the ROW. This threshold issue impacted several other claims in the case, including damages sought by Moore in connection with his breach-of-fiduciary-duty claim.

The court began its analysis of Moore's breach-of-fiduciary-duty claim by noting that "[t]he Texas Business Organizations Code does not define or specify whether manager or member fiduciary duties exist in the context of limited liability companies." Moore asserted that Wright, as a manager of Black Duck, owed fiduciary duties to Moore and SCMED, including duties of care, loyalty, disclosure, and a duty to refrain from self-dealing. The court concluded that, at a minimum, Wright owed Moore an informal fiduciary duty, reasoning as follows:

Texas courts recognize formal and informal fiduciary relationships. *Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992). In the absence of a formal fiduciary duty, members and managers of an entity may owe informal fiduciary duties to one another. See *Bazan v. Muñoz*, 444 S.W.3d 110, 118 (Tex. App.—San Antonio 2014, no pet.). For example, Texas courts have held that "the nature of the relationships between shareholders in a limited liability company sometimes gives rise to an informal fiduciary relationship between them." *Id.* Wright does not dispute that he owed fiduciary duties to SCMED and Moore as co-participants in Black Duck, and the Court finds that at least an informal fiduciary relationship existed between Wright, SCMED, and Moore based on their past dealings and the personal relationship of trust and confidence between Wright and Moore.

The court next stated that whether Wright breached his fiduciary duty depended on whether the loan to Black Duck was authorized under the terms of its company agreement. Section 4.05 of the Company Agreement stated:

If the Company does not have sufficient cash to pay its obligations, any Member(s) that may agree to do so with the Managers' consent may advance all or part of the needed funds to or on behalf of the Company. An advance described in this Section 4.05 constitutes a loan from the Member to the Company ... and is not a Capital Contribution.

In addition, Section 6.10 of the company agreement required transactions between the LLC and an "Interested Person," including KrisJenn, to be authorized "in good faith by the affirmative vote of the disinterested Management, even though the Persons constituting the disinterested Management is less than a quorum." That section further provided that "[t]he contract or transaction must be specifically approved in good faith by the Management." Thus, as a member of Black Duck, KrisJenn had authority under the company agreement to make a loan to Black Duck only with Moore's consent in his capacity as a manager.

Wright argued that Moore's consent was either not necessary to execute the loan to Black Duck, or consent was obtained through an email from Moore in which Moore gave Wright and Cohle full authority to sign on his behalf. The email relied upon by Wright was sent by Moore when he was not available in-person to sign one specific agreement relating to the extension of the ROW purchase closing date. At the time, Moore was in the process of moving his family to North Carolina, so Cohle signed the closing extension agreement on Moore's behalf. Wright and Cohle signed a broadly-worded Consent of Members and Managers of Black Duck in lieu of a meeting that authorized "two of the three managers of [Black Duck] ... to execute certain agreements and documents relating to the matter or matters described on Exhibit A ... without the joinder of FRANK D. (Daniel) MOORE." Moore argued that he never intended his email consent, which was limited in scope to the closing

extension agreement, to allow the other managers, Wright and Cohle, to approve the loan to Black Duck Loan on his behalf. Moore also argued that he was not given notice of this “fake board meeting” and was never asked to provide written authorization of proxy to approve the loan to Black Duck.

The court noted that Moore was likely aware that the purchase of the ROW would be accomplished through borrowed funds, but the company agreement treated all advances from its members as loans, and loans to Black Duck and conflict-of-interest transactions required the affirmative vote and consent of Moore. Because Wright did not obtain Moore’s consent or specific approval to approve the Black Duck Loan, the loan to Black Duck was not authorized under the terms of the company agreement, and the court found that Moore’s email allowing his consent by proxy to approve a closing-date extension did not establish Moore’s specific approval of the loan to Black Duck. The court thus concluded that Wright breached his informal fiduciary duty to Moore, but Moore’s damage model depended on the assumption that the net profits interests at issue in the case were valid covenants running with the land, and the court’s rejection of that proposition precluded Moore’s recovery of damages.

Because the Black Duck Loan was not properly authorized, Wright breached his informal fiduciary duty owed to Moore. Wright entered into an ultra vires and conflicted loan transaction without Moore’s required consent. While Moore is entitled to assert his legal rights, as he did here, he must prove that he is entitled to an award of damages. Moore seeks actual damages of \$2.28 million for these alleged breaches. The damages model assumes that the Assignment Agreements contain covenants running with the land. Because the Assignment Agreements do not contain valid covenants running with the land, this model for damages is inapposite. Moore did not prove any other calculation for damages resulting from Wright’s breach of fiduciary duty. As such, the Court finds that Moore is not entitled to an award of actual damages.

*Rex Performance Products, LLC v. Tate*, No. 02-20-00009-CV, 2020 WL 7776795 (Tex. App.—Houston [14th Dist.] Dec. 31, 2020, pet. filed) (mem. op.).

The court of appeals concluded that the trial court erred in granting summary judgment in favor of two executives of an LLC on the LLC’s claims for breach of fiduciary duty in connection with an undisclosed deal made by the executives with the purchaser of the LLC’s assets for payments of “super bonuses” to the executives.

Rex Performance Products, LLC (“Rex”), a Michigan limited liability company, produced polyethylene foam, a common protective packaging material. James Tate was Rex’s CEO, and Michael Cuffia was the Director of Operations. Tate and Cuffia collectively owned about 30% of Rex. Both were active in Rex’s day-to-day operations. The largest membership interest in Rex, approximately 63%, was held by Williamette Holdings, LLC (“Williamette”), an entity equally owned by John Ballinger, Rob Story, and Rex Hansen. Hansen was also the sole member of Maxwell Morgan, LLC, which provided Rex with substantial financing. Ballinger and Story were not active in the business of Rex for the most part.

Pregis Performance Products (“Pregis”)—a larger competitor—offered to buy substantially all of Rex’s assets in November 2016. Negotiations between the two companies followed. Tate led negotiations on Rex’s behalf. Early in the process, Tate started to express concern that the expected payout from the deal did not reflect the time, effort, and sacrifices each individual had devoted to the company. In Tate’s view, he, Hansen, and Cuffia had performed the heavy lifting, but Tate’s anticipated payout roughly matched Ballinger’s and Story’s while Cuffia’s payout was approximately half.

Rex and Pregis started negotiations at a \$24 million purchase price. As discussions progressed, the price steadily decreased. Tate eventually informed Rex’s other members that Pregis was adamant on a \$17 million best offer. Rex’s members agreed to the sale.

Unbeknownst to Rex’s other members, Tate had negotiated for a \$1.5 million “super bonus” payable to Rex’s executive team (Tate, Cuffia, and two others). This “super bonus” was to remain separate and confidential from the rest of the deal. Tate even went so far as to warn Pregis’s representative—Bettegowda—that he had told Rex’s members that \$17 million was Pregis’s best offer.

About one month before the deal closed, Tate’s side deal came to light. Hansen met with Rex’s executive team to discuss firing an employee for cause. To support the potential firing, Tate agreed to let an IT specialist search his emails. The search revealed Tate’s and Bettegowda’s “super bonus” discussions.

The “super bonus” revelation left Rex’s members in a bind. Confronting Tate might spur his exit. Although Cuffia was always seen as Tate’s natural successor, the emails revealed that Cuffia was complicit in the scheme.

The company had started hitting its sales objectives, but it was still burning cash fast, and the members needed to sell Rex quickly. Rex's other members concluded that their best option was not to confront Tate and to close the deal while preserving their rights as best they could.

Perhaps sensing that there was trouble in the kingdom, Tate and Cuffia made multiple demands that Rex grant them full releases for any and all liability related to the sale before they would sign the asset purchase agreement. The other Rex members countered with a limited release that preserved liability for a breach of loyalty, to no avail. On February 21, 2018—the eve of the deal's closing date—a virus infected Tate's computer, infecting his email. The next day, Tate signed the deal without demanding a liability release.

Three days after the sale closed, Rex sued Tate, Cuffia, Bettgowda, and Pregis. Bettgowda and Pregis both made a special appearance which was granted. Thus, all that remained—in Texas at least—were Rex's claims against Tate and Cuffia. Rex pursued a litany of causes of action against the duo arising from the “super bonus” payments including breach of fiduciary duty and conspiracy. Rex also asserted that Tate had breached his fiduciary duties by downloading a virus onto his computer so as to destroy any record of his misdeeds. Tate and Cuffia filed general denials and asserted numerous affirmative defenses, including waiver and ratification.

After discovery, Tate and Cuffia moved for both traditional and no evidence summary judgment. In particular, the pair argued that Rex could not hold them liable for failing to disclose the “super bonus” payments because Rex already knew about the payments prior to the deal's closing, Rex had either waived or ratified any alleged breach of fiduciary duty related to the “super bonus,” and that, in any event, there was no evidence of damages. Additionally, Tate argued that there was no evidence that he downloaded the virus onto his computer. After a hearing, the trial court granted the motion. Rex appealed.

The court of appeals relied on corporate case law in its discussion of the fiduciary duties owed by Tate and Cuffia as follows:

Corporate officers and directors owe a fiduciary duty to the corporation that they serve. *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963); *Grinnell v. Munson*, 137 S.W.3d 706, 718 (Tex. App.—San Antonio 2004, no pet.). A corporate fiduciary is under an obligation not to usurp corporate opportunities for personal gain, and equity will hold him accountable to the corporation for his profits if he does so. *Int'l Bankers*, 368 S.W.3d at 577. The responsibility of the corporate fiduciary includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation. *Id.*

As this court has noted before, it is without question that corporate officers and fiduciaries are “held ‘in official action, to the extreme measure of candor, unselfishness, and good faith.’ ” *Cardwell v. Wilson Trophy Co. of Fort Worth-Dallas, Inc.*, 622 S.W.2d 651, 653 (Tex. App.—Fort Worth 1981, writ ref'd n.r.e.) (citing *Int'l Bankers*, 368 S.W.2d at 577). The duty of loyalty dictates that a corporate officer or director must act in good faith and must not allow his personal interest to prevail over that of the corporation. *Loy v. Harter*, 128 S.W.3d 397, 407 (Tex. App.—Texarkana 2004, pet. denied).

Directors and officers of a corporation must make full disclosure of their personal interest in a transaction that they are negotiating for the corporation. *Gen. Dynamics v. Torres*, 915 S.W.2d 45, 49 (Tex. App.—El Paso 1995, writ denied). A transaction in which a corporate fiduciary derives personal profit is subject to the closest examination, and the form of the transaction will give way to the substance of what actually occurred. *Int'l Bankers*, 368 S.W.2d at 577.

With respect to the contention of Tate and Cuffia that they had no duty to disclose, the court noted that the summary judgment evidence indicated that Rex did not have a complete picture of Tate's and Cuffia's misdeeds until after litigation discovery. The fact that Rex had discovered enough to realize it likely had a claim against Tate and Cuffia did not equate to full knowledge. Even assuming that Rex did have full knowledge of the extent of Tate's and Cuffia's self-dealing, neither party disputed that Rex did not obtain that knowledge until after Tate and Cuffia had negotiated the “super bonus” arrangement. An after-the-fact disclosure of the facts that form the basis of a breach-of-fiduciary-duty claim does not restore the parties to the position they occupied before the breach.

Furthermore, the court said that even if there was knowledge regarding some facts of the failure-to-disclose claim, the failure to disclose was not the only breach of fiduciary duty alleged by Rex. Rex's petition also asserted that Tate and Cuffia breached “a duty not to usurp corporate opportunities for personal gain; a duty of utmost good

faith in the officer[s'] relations with the corporation; a duty of full disclosure of any personal interest the officer or director has in the subject matter of a contract the officer or director negotiates with the corporation; a duty of loyalty; and a duty to use uncorrupted business judgment for the corporation.” Tate and Cuffia did not move for summary judgment on all of the alleged breaches of their fiduciary duty; their motion focused on the allegations relating to “failure to disclose.” Because a motion for summary judgment must stand or fall on the grounds it specifically and expressly sets forth, the trial court erred in granting the motion.

Next, the court turned to the waiver or ratification argument. The court’s analysis of both affirmative defenses turned on two key factors. First, full knowledge of the facts surrounding the transaction is a key element of both waiver and ratification. Second, the asset sale and the “super bonus” retention payments were two separate—though parallel—transactions.

As the court had noted during its failure-to-disclose analysis, the summary judgment evidence did not support a determination that Rex had full knowledge of the “super bonus” payments. Both waiver and ratification require such a determination. While Hansen learned before the closing of the asset sale that there might be a super bonus paid, he testified that he did not learn that the retention bonus agreement had been executed until after the closing of the sale. Additionally, both waiver and ratification are premised on acts that Rex would have taken inconsistent with its claims against Tate and Cuffia. The summary judgment evidence—including both Bettegowda’s and Tate’s depositions—consistently characterized the asset sales agreement for substantially all of Rex’s assets and the “super bonus” retention payments paid to Tate and Cuffia as distinct, separate agreements. When Tate and Cuffia signed their retention payment agreements, they were not doing so on behalf of Rex or pursuant to Rex’s authority. Rather, the payments were a separate agreement between Pregis and the pair as individuals. Thus, Rex did not take any act inconsistent with its claims against Tate and Cuffia. The trial court erred by determining as a matter of law that Rex had either waived or ratified Tate and Cuffia’s misdeeds.

The court next rejected the argument that there was no evidence of Rex’s damages. First, the record contained multiple emails indicating that the price offered by Pregis for Rex decreased from at least \$18 million to \$17 million. Thus, some evidence of at least \$1 million in actual damages was readily identifiable. In addition, Rex sought fee forfeiture and profit disgorgement for the “super bonus” payments, and these remedies were not the subject of the summary judgment motion. A party seeking forfeiture and equitable disgorgement need not prove damages as a result of the breach of fiduciary duty. In any event, the court concluded that Rex presented more than a scintilla of evidence showing that it had been damaged in connection with its claim for actual damages.

Finally, the court turned to the trial court’s decision to grant Tate summary judgment on Rex’s assertion that Tate breached his fiduciary duties by downloading a computer virus onto Rex’s servers. The summary judgment record lacked any evidence indicating that Tate downloaded the virus. When Tate moved for summary judgment, Rex merely pointed to the suspicious circumstances surrounding the virus but attached no summary judgment evidence in support of its contentions. Thus, the court determined that summary judgment against Rex was proper as to this aspect of Rex’s claim.

***Straehla v. AL Global Services, LLC***, 619 S.W.3d 795 (Tex. App.—San Antonio 2020, pet. denied).

The court of appeals held that a Texas LLC alleged its claim for knowing participation in a breach of fiduciary duty with sufficient specificity to survive a motion to dismiss under the Texas Citizens Participation Act.

After Hurricane Maria struck Puerto Rico in September 2017, the Puerto Rico Electric Power Authority hired Cobra Acquisitions LLC (“Cobra”) to rebuild its utility grid. In turn, Cobra hired AL Global Services, LLC (“AL Global”) to provide security and logistics support for the project. AL Global subcontracted a portion of its work to Espada Logistics & Security, LLC (“Espada Logistics”). In August 2018, Cobra ended its contract with AL Global and entered into a contract with Espada Carribean, LLC (“Espada Carribean”) for the work that AL Global had previously performed. AL Global had three members: Jim Jorrie, Craig Charles, and Julian Calderas. The owners of Espada Logistics and Espada Carribean were Jim Jorrie and his ex-wife, Jennifer Jorrie.

AL Global sued Jim Jorrie for breach of fiduciary duty, alleging that he usurped the company’s business opportunity. Additionally, AL Global sued two Cobra executives, Kinsey and Arty Straehla, asserting that they assisted Jim Jorrie in his misdeeds. Kinsey and Straehla moved to dismiss the case under the Texas Citizens Participation Act (TCPA), arguing that the lawsuit was based on their exercise of free speech and right to association. The trial court denied the motions, and Kinsey and Straehla appealed.

A motion to dismiss under the TCPA triggers a three-step burden shifting mechanism. First, the movant has the burden to show—by a preponderance of the evidence—that the legal action is based on, relates to, or is in



response to the movant’s exercise of free speech, association, or petition rights. If the movant meets this burden, the nonmovant has the burden of establishing—by clear and specific evidence—a prima facie case for each essential element of its claim. If the nonmovant meets its burden, the burden shifts back to the movant to establish each essential element of a valid defense to the nonmovant’s claim by a preponderance of the evidence.

Consistent with this framework, the court first determined that Kinsey and Straehla could show that the suit was based on their exercise of the right to free speech. Specifically, AL Global alleged that Kinsey and Straehla actively communicated and generated plans with Jim Jorrie to divert work from AL Global to the Espada companies. The court held that these communications were, at least “tangentially,” on “a matter of public concern” because rebuilding Puerto Rico’s utility system was an issue related to the “environmental, economic, or community well-being” of the island and its residents. Thus, the court next turned to whether AL Global could establish a prima facie case for knowing participation in a breach of fiduciary duty against Kinsey and Straehla by clear and specific evidence (noting that “evidence” for this purpose includes pleadings).

The court outlined the elements of a knowing participation claim as: (1) the existence of a fiduciary duty owed by a third party to the plaintiff; (2) the defendant knew of the fiduciary relationship; and (3) the defendant was aware of his participation in the third party’s breach of its duty. As such, the court recognized that knowing participation in a breach of fiduciary duty is necessarily a derivative claim that requires an underlying breach of fiduciary duty. Thus, AL Global’s claim against Kinsey and Straehla turned on its ability to establish a claim against Jim Jorrie.

The court first observed that the Texas Business Organizations Code does not directly address the duties that a manager or member owes the LLC but contemplates that duties may exist by providing that “[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.” Tex. Bus. Orgs. Code § 101.401. The court noted that it did not have the AL Global LLC agreement in the record, but the court stated that it presumed, “based on the assumption inherent in section 101.401 of the Business Organizations Code that, Jorrie owed the same fiduciary duties that a corporate executive or partner would owe a corporation or partnership, unless the LLC agreement shows otherwise.” Thus, the court concluded that Jorrie “owed a duty of loyalty to [AL Global] and a duty not to usurp corporate opportunities.”

The court then determined that there was sufficient evidence to establish a prima facie case of breach of a fiduciary duty against Jim Jorrie, describing a sequence of events from the fall of 2017, when AL Global pursued and secured its contract with Cobra, until August 2018, when Cobra entered into a contract with Espada Carribean for the security and logistics work that AL Global had been performing.

As described by the court, the record showed that Jennifer Jorrie began an intimate relationship with Ken Kinsey, a senior Vice President at Cobra, shortly after work on the contract began, and Jim Jorrie appointed Jennifer Jorrie as the project manager for Espada Logistics, a role in which she would work closely with Kinsey. After becoming project manager, Jennifer was assigned to work from Cobra’s headquarters in Puerto Rico at Kinsey’s request. About this time, Jennifer formed Espada Carribean as a Puerto Rican LLC. Jennifer installed Jim Jorrie as CEO of Espada Carribean and assigned him a 67% interest in the company. Although AL Global tasked Jim Jorrie with securing a Puerto Rican security services license for AL Global, Jorrie instead secured the license for Espada Carribean, which enabled Espada Carribean to legally provide security services in Puerto Rico. In March of 2018, Jorrie attempted to renegotiate AL Global’s subcontract with Espada Logistics in order to increase Espada Logistics’ payment. Charles and Calderas refused, and Jorrie sought to use Jennifer Jorrie’s relationship with Kinsey as leverage, stating in an email to the other AL Global members that Jennifer’s relationship with Kinsey was “immensely valuable” and that, “[w]hether we like the origin or nature of that relationship, it remains undisputed that he is protective of her interests.” Two days later, Jim Jorrie—acting on AL Global’s behalf—executed an amendment to the Cobra contract that provided the agreement would continue after August 15, 2018, only if certain conditions were met. In April, Jorrie continued to press the issue of changing the profit-sharing arrangement between AL Global and Espada Logistics, and Jorrie also informed the other members of AL Global that Jennifer’s relationship with Kinsey had changed and that Kinsey had raped her. After the April meeting of the members, there was evidence that Espada Carribean was negotiating a new contract directly with Cobra. Several communications in July reflected Espada Carribean’s pursuit of a contract directly with Cobra, and AL Global alleged that Jorrie threatened Cobra that if it did not contract directly with the Espada companies, Jennifer Jorrie would publicly allege that Kinsey raped her. When AL Global contacted Cobra in July 2018 to inquire about an extension of the contract, Cobra responded that it was engaged in a Request for Proposal process to evaluate bids,

but no process actually occurred, and Cobra never assessed whether contracting directly with Espada Carribean would actually save money. On August 16, 2018, Cobra signed a contract with Espada Carribean to perform the work previously performed by AL Global.

Viewed in a light most favorable to AL Global, the court concluded that this evidence showed that Jorrie placed his own interests ahead of AL Global in order to secure a direct contract between Cobra and Espada Carribean, thus breaching his fiduciary duty of loyalty and usurping AL Global's business opportunity.

Next, the court turned to whether Kinsey and Straehla were knowing participants in Jorrie's alleged fiduciary duty breach. The court determined that they were. The court observed that evidence in the record—including two signed contracts—identified Jim Jorrie as an AL Global "Manager." The court determined that Kinsey and Straehla's extensive business experience was sufficient to support an inference that they were aware that Jorrie owed AL Global fiduciary duties. As to whether Kinsey and Straehla were knowing participants in Jorrie's breach of fiduciary duty, the court noted the suspicious circumstances surrounding Cobra's abrupt pivot from contracting with AL Global to directly dealing with Espada Carribean. The court determined that a reasonable factfinder could infer that this suspicious change was executed to favor Jorrie. As a result, the court determined that AL Global could establish a prima facie case of knowing participation in a breach of fiduciary duty against Kinsey and Straehla.

Finally, the court determined that neither Kinsey nor Straehla had established a defense to AL Global's prima facie knowing participation case. Thus, the court affirmed the trial court's decision to deny Kinsey and Straehla's TCPA motions to dismiss.

***Valley Ridge Roofing and Construction, LLC v. Silver State Holdings (In re Silver State Holdings)***, Case No. 19-41579-MXM, Adversary No. 19-4043-MXM, 2020 WL 7414434 (Bankr. N.D. Tex. Dec. 17, 2020).

Based on the provisions of the Texas Business Organizations Code and agency law, the court held that the sole member of an LLC owed the LLC—but not its creditors—fiduciary duties, and the member breached his duties of care and loyalty by causing another entity owned by the member to acquire and foreclose a lien on the LLC's property.

Richard Morash was the sole member of 7901 BLVD 26, LLC ("7901"), which owned real property in North Richland Hills. The property was subject to three liens: a Tarrant County ad valorem tax lien, a deed of trust held by Frost Bank, and a third-priority lien held by the City.

7901 leased the property to a high-end shooting range, which subsequently went out of business and defaulted on its lease. Additionally, a storm significantly damaged the building's roof. 7901 contracted to have Valley Ridge repair the roof, and 7901 disputed the contract balance after the work was done. The parties went to arbitration, and Valley Ridge received a judgment in its favor. Valley Ridge abstracted its judgment, giving it a fourth-priority lien against the property.

As Valley Ridge attempted to collect its judgment, Morash formed Silver State Holdings ("Silver State"), which acquired the City's third-priority lien and promptly foreclosed on the property. Silver State credit bid its debt owed at the foreclosure sale, wiping out Valley Ridge's junior lien.

After discovering Silver State's maneuver, Valley Ridge filed an involuntary bankruptcy petition against 7901. Silver State filed its own bankruptcy shortly thereafter and sold the property to a third party. After satisfying the Tarrant County and Frost Bank liens, approximately \$577,000 of the sales proceeds remained in the court's registry. Valley Ridge filed an adversary proceeding seeking the turnover of the remaining sales proceeds. In particular, Valley Ridge asserted that Morash's Silver State maneuver was a fraudulent transfer and that the transfer breached his fiduciary duties to 7901's creditors.

The court first analyzed the foreclosure and transfer of the property to Silver State as a voidable preference and as actual and constructive fraudulent transfers under the Bankruptcy Code and Texas Business and Commerce Code. The court concluded that the transfer was a voidable preference under Section 547 of the Bankruptcy Code and that the elements of an actual fraudulent transfer under Sections 544 and 548(a)(1)(A) of the Bankruptcy Code and Section 24.005(a)(1) of the Texas Business and Commerce Code were met. The court also determined that the elements of a constructive fraudulent transfer under Section 24.006(b) of the Texas Business and Commerce Code were all present, but Valley Ridge's constructive fraudulent transfer claims failed under Section 548(a)(1)(B) of the Bankruptcy Code and Section 24.006(a) of the Texas and Business and Commerce Code because 7901 is presumed to have received a reasonably equivalent value at the regularly conducted, noncollusive foreclosure sale.

The court next determined that Morash owed 7901 fiduciary duties. Although the Texas Business Organizations Code does not directly address the duties that a member or manager owes a limited liability company, the court noted that fiduciary-duty considerations underlie the statutory provisions. For example, the Business Organizations Code contains provisions addressing contracts between an LLC and its governing persons, permitting the renunciation of a domestic entity's business opportunities, allowing governing persons to rely on various types of information while discharging their duties, and permitting the LLC's company agreement to expand or restrict the scope of fiduciary duties. Based on these provisions and the status of Morash as an agent, the court concluded that he owed the LLC fiduciary duties as a default rule. Because the parties did not provide 7901's company agreement for the record, there was no evidence to indicate that 7901 had departed from the default rule.

The court relied on case law in the corporate context to describe Morash's duty of loyalty:

The duty of loyalty holds officers and directors to an "extreme measure of candor, unselfishness and good faith," particularly where there is an interested transaction.[footnote omitted] Interested transactions include those in which officers or directors derive personal profit as well as those which deprive the corporation of an opportunity to profit.[footnote omitted] A transaction between a fiduciary's company and another company in which the fiduciary has a significant financial interest is also an interested transaction.[footnote omitted] In such a situation, an officer or director must not allow his personal interests to prevail over the interests of the corporation. [footnote omitted] "A director who diverts profits from the corporation in violation of his fiduciary relationship is personally liable even though the profits are acquired by an agency controlled by the director." [footnote omitted] The burden is on the officer or director to establish the fairness of the transaction.

The court concluded that Morash breached his fiduciary duties of loyalty and care by causing Silver State to purchase the property when the property could have been sold for the benefit of 7901, which needed the asset to pay its creditors, including Valley Ridge. Morash failed to prove the fairness of the transaction involving the foreclosure and transfer of the property to Silver State, and the evidence affirmatively reflected that the transaction was not fair to 7901 and that Morash knew as much.

The court held that Morash owed his fiduciary duties to 7901, not 7901's creditors. Under Texas law, officers and directors of operating corporations owe their duties to the corporation, not the corporation's creditors. The court saw no reason why the same rule should not apply to managers of limited liability companies. Because 7901 was not yet defunct, the court concluded that Morash did not owe duties to its creditors.

The court concluded that Texas law did not allow Silver State and Morash to be jointly and severally liable on conspiracy and aiding and abetting theories for the actual fraudulent transfers, relying on the analysis in *Official Stanford Investors Comm. v. Traurig*, in which the District Court for the Northern District of Texas concluded that Texas law does not provide for secondary liability for fraudulent transfers through conspiracy, aiding and abetting, and similar secondary-liability theories.

Valley Ridge also sought to hold Silver State and Morash jointly and severally liable on conspiracy and aiding and abetting theories for Morash's breaches of fiduciary duty. The elements of civil conspiracy are: (1) two or more persons, (2) an object to be accomplished, (3) a meeting of minds on the object or course of action, (4) one or more overt unlawful acts, and (5) damages proximately resulting from those acts. Because the evidence showed that Morash and Silver State had a collective objective to breach Morash's fiduciary duties to 7901 by fraudulently transferring the property to Silver State through the foreclosure, the court concluded that the elements of a civil conspiracy were present. Aiding and abetting requires: (1) the existence of a violation by the primary (as opposed to the aiding and abetting) party, (2) knowledge of this violation on the part of the aider and abetter, and (3) substantial assistance by the aider and abetter in the achievement of the primary violation. Because the evidence showed that Morash violated his fiduciary duties to 7901 by causing the fraudulent transfer of the property to Silver State, and Silver State had intimate and direct knowledge of this violation and actively participated in the violation, the court concluded that the elements of aiding and abetting were present. The court agreed with Morash and Silver State that "[a]s a general rule, a corporation cannot conspire with itself through its agents," but the court stated that there was substantial evidence that Morash was acting not just for 7901 and Silver State, but also in his individual capacity. For example, despite the waiver by 7901 of its attorney-client privilege with its attorneys regarding the transactions at issue, 7901's attorney refused to answer questions at trial regarding communications with Morash

about the assignment of the City's lien and intent to foreclose on the property to wipe out historical liens (which occurred before the formation of Silver State) because those communications were with Morash, individually, and not as an agent of 7901 or Silver State.

*CyberX Group, LLC v. Pearson*, Civ. A. No. 3:20-CV-2501-B, 2020 WL 5500236 (N.D. Tex. Sept. 11, 2020).

The court denied the plaintiffs' motion for temporary restraining order on the ground that the plaintiffs failed to demonstrate a substantial likelihood of success on the merits of their claims.

Defendant Christopher Pearson established CyberX, LLC ("CyberX") in 2013 to develop and market software for multi-level-marketing ("MLM") companies. At least until 2017, Pearson was the sole owner of CyberX. In early 2017, Plaintiff David Lindsey entered into a relationship with Pearson and CyberX wherein Lindsey's healthcare companies, Agentra, LLC and MyHealthPass, LLC, issued monthly payments to CyberX in amounts between \$11,000 and \$30,000. In return, CyberX modified its MLM software to fit the needs of healthcare services and provided the software to Agentra and MyHealthPass.

In January 2018, Pearson emailed Lindsey, expressing his desire to form a separate entity, CXG, with ownership to be split 70/20/10, respectively, between Lindsey, Pearson, and Troy Van Zile—an Agentra employee involved with the software development at CyberX. On March 22, 2018, Pearson and Lindsey signed a handwritten agreement on a single sheet of paper (the "March 22 Agreement"), indicating the ownership division of CXG and seemingly designating Pearson as the sole owner of CyberX. On July 10, 2018, Lindsey, Pearson, and Van Zile executed a more formal and detailed "Company Agreement of CyberX Group LLC" ("Company Agreement"). Section 3.6(B) of the Company Agreement provided that "[e]ach Member shall hold in strict confidence any information that it receives concerning [CXG] that is identified as being confidential (and if that information is provided in writing, that is so marked) and may not disclose it to any Person other than another Member, except for [exceptions listed]. Section 4.12 of the Company Agreement provided that "each Manager, Member and officer of [CXG] at any time and from time to time may engage in and possess interests in other business ventures of any and every type and description, independently or with others, save and except for ones in competition with [CXG], with no obligation to offer to [CXG] or any other Member, Manager, or officer the right to participate therein."

Pearson served as CXG's president for two years after CXG's formation. During his time as president, Pearson oversaw the development of software, culminating in a product that Plaintiffs refer to as "Healthcare 212." CXG executed two contracts to provide this software to American Workers Insurance Services, Inc. ("AWIS") and Coterie Advisory Group, Inc. ("Coterie").

After the success of Healthcare 212, Lindsey and Pearson planned for development of a second version ("HC 2.0"), which was originally promised to Lindsey by Fall 2019. Pearson did not deliver HC 2.0. According to Plaintiffs, Pearson was not working on HC 2.0, but was instead developing new MLM software for CyberX based on the ideas and designs that had been developed for Healthcare 212. Defendants contend, however, that Pearson did not deliver HC 2.0 because Lindsey failed to fund the project as promised. According to Defendants, CXG was in such financial distress that it had terminated all of its employees by the middle of 2020. The relationship between Lindsey and Pearson soured and they decided to part ways.

Subsequently, Pearson and CyberX, through their attorney, delivered a letter on August 10, 2020 (the "August 10 Letter"), claiming sole ownership of any software developed during the existence of CXG and urging CXG to release AWIS and Coterie from their contracts with CXG. The relevant portion of the August 10 Letter stated: "[CyberX and Pearson] anticipate that AWIS and Coterie will eventually decide to transition to a contract with [CyberX and Pearson] simply because they will eventually need assistance that [CXG and Lindsey] do not have the expertise to provide. We do not want to reach a deal with [AWIS and Coterie] only for a dispute to arise.... [Releasing AWIS and Coterie] will leave AWIS and Coterie free to immediately terminate their contracts with [CXG] during the period if they wish, or to stay with [CXG] if they prefer."

In response, Lindsey and CXG commenced a lawsuit against Pearson and CyberX. They also filed a motion for a TRO on August 25, 2020, seeking, in essence, to prohibit Defendants from (1) disclosing CXG's trade secrets; (2) transferring or licensing CXG's intellectual property; (3) accessing or modifying CXG's software or other intellectual property; (4) soliciting CXG's clients; (5) directly competing with CXG; (6) entering or removing any personal property from CXG's offices; and (7) accessing CXG's bank account.

The court denied the motion for a TRO. It first rejected Plaintiffs' request for a declaratory judgment that "all intellectual property relating to the Healthcare Platform, including all copyrights, trade secrets, trademarks,

documents, and works in progress are the sole property of CXG.” Plaintiffs argued that CXG’s ownership originated from Lindsey’s ownership interest in CyberX and its software assets, as well as from CXG’s independent ownership of software developed after CXG’s formation. The court disagreed, concluding that Plaintiffs had not sufficiently shown that any voluntary transfer of ownership ever occurred or that CXG was a software development company rather than a software marketing company. This claim, therefore, may not serve as the basis for a TRO.

The court then turned to Plaintiffs’ contention that they were likely to succeed on their breach of contract claim for violations of sections 3.6 and 4.2 of the Company Agreement. The court disagreed with Plaintiffs’ estimates of their chances of success:

First, Plaintiffs claim that Pearson violated the confidentiality provision, Section 3.6(B) .... Plaintiffs claim that “[b]y asserting dominion over, among other things, CXG’s trade secret assets, it is clear that [Defendants] intend to disclose or license those secrets to third parties[.]” Plaintiffs do not, however, indicate which trade secrets, aside from intellectual property in the software—over which Plaintiffs have not established ownership—are at risk of wrongful disclosure. Moreover, Plaintiffs do not allege that any at-risk trade secrets were identified as being confidential as required by Section 3.6(B). At the hearing, Plaintiffs pointed to a boilerplate “Confidentiality Notice” found at the end of CXG emails, which states that the email message and attachments “may contain confidential and privileged information.” This evidence does little to bolster Plaintiff’s claim that Pearson breached Section 3.6(B), as Plaintiffs have not shown that Pearson disclosed these emails or their attachments to a third party. Accordingly, Plaintiffs have not demonstrated a substantial likelihood of success on their claim for breach of Section 3.6(B).

Second, Plaintiffs claim that Pearson violated Section 4.12, which prohibits members from engaging in other business ventures in competition with CXG. As the sole evidence of Pearson’s breach, Plaintiffs point to the August 10 Letter from Defendants’ attorney, interpreting the letter as “Pearson’s stated intention to co-opt CXG’s current clients[.]” This intent is not apparent from the letter itself. To the contrary, the letter expressly states that Defendants wish to avoid conducting business with AWIS and Coterie in a way that would lead to a dispute with CXG. At the hearing, Defendants explained that this letter was intended to advise CXG to release AWIS and Coterie from their contracts because, from Defendants perspective, CXG could not meet its clients’ needs without Pearson and CyberX. Plaintiffs do not provide any other evidence of Defendants’ intent to solicit CXG’s clients. Accordingly, Plaintiffs have not demonstrated a breach of Section 4.12. Plaintiffs, thus, are unlikely to succeed on their claim for breach of contract.

Finally, Plaintiffs claimed that Pearson breached his fiduciary duty to CXG. The court noted that “[u]nder Texas law, a formal fiduciary relationship exists between a principal and its agent.” It observed that “[w]hen a fiduciary relationship exists, the employee has a duty to act primarily for the benefit of the employer, not to compete against the employer in matters connected with her employment, and to deal fairly with the employer in all transactions between them.” Plaintiffs alleged that Pearson served as CXG’s president and that, as president, he owed CXG a fiduciary duty that he ultimately breached because “he has not dealt fairly with the company, has competed with the company in its primary business, and has misappropriated company assets.” The court concluded that while Plaintiffs may have demonstrated the existence of a fiduciary duty, they offered little evidence to show that Pearson breached his duty:

Plaintiffs do not allege any unfair dealings other than Pearson’s alleged wrongful competition with CXG and misappropriation of CXG assets. As evidence for his wrongful competition with CXG, Plaintiffs again point to the August 10 Letter. As previously discussed, this letter does not sufficiently demonstrate that Pearson competed with, or intends to compete with, CXG. Additionally, Plaintiffs have not successfully demonstrated that Pearson misappropriated CXG’s assets. The allegedly misappropriated assets are the intellectual property in the software as well as payments made from CXG to CyberX, which Defendants claim were agreed-upon service fees. As discussed, Plaintiffs have not sufficiently demonstrated that CXG owns the software and, therefore, Pearson’s use cannot be considered misappropriation. Further, as discussed, Plaintiffs have not shown that CXG was a development company rather than a

marketing company that paid CyberX a fee to sell CyberX's software. If CXG is a marketing company, then the service payments to CyberX would not have been misappropriated. Plaintiffs, therefore, cannot sufficiently demonstrate that Pearson has misappropriated any of CXG's assets, competed with CXG, or otherwise breached his fiduciary duty.

In sum, Lindsey and CXG have not established a likelihood of success on the merits of any claim. First, there is insufficient evidence to succeed on Plaintiffs' claim of ownership in the intellectual property related to the software at issue. Second, Plaintiffs fail to demonstrate that Pearson breached the Company Agreement and thus cannot likely succeed on their breach-of-contract claim. Lastly, Plaintiffs have not demonstrated that they are likely to succeed on their claim for breach of fiduciary duty.

***Heatley v. Red Oak 86, L.P.***, \_\_ S.W.3d \_\_, 2020 WL 4745553 (Tex. App.—Dallas 2020, no pet.).

The court of appeals affirmed the trial court's granting of equitable forfeiture as a remedy for breach of fiduciary duty.

Appellants Michael D. Heatley and Heatley Capital located an opportunity to invest in land in Royse City near I-30. Heatley Capital found the opportunity and performed its initial due diligence, and another of Heatley's companies, HC Land Company, formed a partnership and presented the opportunity to investors. Royse City/I-30, LLP ("Royse City") was formed as a single purpose entity to serve as a vehicle for the investment and was later converted into an LLC with the same general ownership and management structure.

Another of Heatley's companies, HC Developers, was the managing member of Royse City. Class A members had an ownership interest commensurate with the investor's initial capital contribution. Class B members were given a 30% interest in Royse City's after-payout profits (i.e., profits remaining after all Class A investors recouped their capital contributions) and were not required to make capital contributions.

HC Developers had a 1% interest in Royse City's after-payout profits. Heatley Capital would receive an organization fee from Royse City and an additional annual management fee. Heatley and Bryan Crow, a Heatley Capital employee, executed the Royse City formation agreement on behalf of HC Developers. Heatley and Crow also personally invested as Class A members. Charles Johnson acquired a 5% interest in Royse City as a Class A member, and Red Oak, a family partnership controlled by Jason Dodd, obtained a 3.5678% interest as a Class A member. HC Land Company was Royse City's only Class B member.

Under the terms of the formation agreement, HC Developers, as managing member, was empowered to issue annual assessments to Class A investors to cover Royse City's operating costs and debt servicing. Class A investors were required to pay those assessments within 30 days or they would be subject to having their ownership interests either diluted or forfeited.

Royse City purchased the land in November 2006 for nearly \$4.7 million (\$5.5 million after fees), approximately \$2.9 million of which was financed through a five-year loan. Johnson and Red Oak did not pay their 2008 and 2009 fees, citing concerns with the property and the bank loan. Heatley agreed that they did not have to pay the assessment until the issues were addressed. Johnson tried to get his concerns addressed throughout 2009, and he eventually decided that he wanted out of the investment.

During this time, Dodd also became concerned about the investment. Dodd spoke to Heatley only once or twice during 2009. During a conversation on December 1, 2009, Heatley discussed the fact that Dodd had not yet paid Red Oak's 2009 assessment, but assured him that Red Oak's interest would not be forfeited for failing to pay the assessment as long as Dodd "work[ed] on getting it in."

In early 2010, Crow, Dodd, and Johnson asked Heatley to set up a partnership meeting to discuss plans for Royse City, the details of the loan, and the partnership's accounting. After many delays, the meeting was eventually held at the end of April 2010. During this meeting, the bank loan, partnership accounting, and plans to market the property were discussed. Heatley also disclosed his involvement in ongoing litigation with Crow, which Crow had initiated in August 2008. Some Royse City members insisted that Johnson and Red Oak should have their interest forfeited for failure to pay the assessments. After the meeting, Johnson and Dodd were sent letters notifying them that if their shares of the 2008 and 2009 assessments were not received by May 12, 2010, their interest in Royse City would be forfeited and divided among the remaining partners. Johnson, who was out of the country, never received the letter. He only received an email from Heatley on May 11 informing him of the next day's deadline. Neither Johnson nor Dodd paid their assessments.

Crow obtained a temporary restraining order (TRO) prohibiting the Heatley-controlled entities from forfeiting any investors' interest. Crow and Heatley agreed to settle their claims before the TRO's expiration date, and the trial court signed the order dissolving the TRO on May 25. On May 26, Johnson and Red Oak sought their own TRO, asserting in their original petition: (1) breach of fiduciary duty based on alleged mismanagement, nondisclosure, and self-dealing; (2) minority-shareholder oppression based on the managing member's decision to forfeit rather than dilute their interests; and (3) breach of contract based on the managing member's purported failure to give Johnson and Red Oak valid notice of a required capital contribution before declaring their interests forfeited. Johnson and Red Oak also sought a declaratory judgment stating that the operating agreement's forfeiture provision was an unlawful penalty under Texas law. The trial court granted the TRO and later a temporary injunction. Heatley claimed that the injunction had no effect because Johnson's and Red Oak's membership interests were forfeited in the period between the dissolution of Crow's TRO and Johnson's and Red Oak's TRO.

Royse City sold the property at a substantial profit, in large part because of Heatley's "strategic default" plan. Evidence showed that in 2009, Heatley and his entities engaged Danny Yoo, a banking consultant, to advise them on negotiating with banks holding notes on their properties. Yoo advised the "strategic default" to bring Wells Fargo to the negotiating table, which allowed a Yoo-controlled intermediary entity to acquire the Royse City note from the bank at a discount. This savings, along with the sale of the land at \$8 million, resulted in more than \$2.1 million in after-payout profits. Johnson and Red Oak, whose interests had been forfeited, neither recouped their investment nor shared in the profits.

Heatley recouped his initial \$80,000 investment and more than \$68,000 for an 85% profit. HC Land Company profited by more than \$326,000, and HC Developers profited by more than \$22,000. Heatley Capital, though neither a member nor the nominal manager of Royse City, received more than \$963,000 in various fees over the course of the investment.

Johnson and Dodd testified that they were never informed about the "strategic default" plan to repurchase the note at a discount, despite their specific inquiries in 2009 and at the April 2010 meeting. Heatley claimed he did not inform Johnson or Dodd of the plan because at the time it was not yet "fully formed," despite evidence presented to the contrary. Both Dodd and Johnson stated that if the plan had been shared with them, they would have most likely paid their assessments and participated in the plan.

The Heatley parties moved for partial summary judgment against claims asserted in Johnson's and Red Oak's second amended petition, which was granted by the trial court. Johnson and Red Oak had filed a third amended petition before the trial court's ruling, but the trial court based its ruling on the second amended petition. Heatley's later motion to strike the third amended petition was not ruled on, and although Heatley later noted that it was "not fully clear" which of Red Oak's claims were pending, both parties presented their evidence at trial as if all claims were pending.

At trial, the jury ultimately determined the following: (1) Heatley Capital owed a fiduciary duty to Johnson and Red Oak; (2) all three Heatley parties breached their fiduciary duties to Johnson and Red Oak in the management of Royse City; (3) neither Johnson nor Red Oak suffered monetary damages proximately caused by the Heatley parties' breaches of fiduciary duties; (4) none of the Heatley parties was unjustly enriched at the expense of Johnson; and (5) both Johnson and Red Oak failed to pay assessments properly made by Royse City's manager.

Neither side objected to the verdict and the trial court entered a take-nothing judgment. Johnson and Red Oak moved for judgment notwithstanding the verdict, requesting equitable relief. They asked for HC Capital to forfeit all fees received in connection with the Royse City land deal, and they asked for the court to hold Heatley, HC Capital, and HC Developers jointly and severally liable for the forfeiture. After hearing the motion, the trial court entered an amended judgment and awarded equitable forfeiture against the Heatley entities in the amount of Johnson's and Red Oak's contributions to Royse City, plus pre- and post-judgment interest and costs of court.

The Heatley parties appealed and contended that the trial court had abused its discretion by awarding equitable forfeiture, by holding Heatley and HC Developers jointly liable for forfeiting fees paid to HC Capital, and by awarding prejudgment interest to Johnson and Red Oak. The court of appeals reviewed the trial court's equitable forfeiture determination for abuse of discretion.

Under the factors listed in *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999), a trial court may order fee forfeiture as equitable relief when normal damage measures do not adequately address a breach of fiduciary duty. In ruling on a request for forfeiture the court must determine three elements:

[1] whether a “violation is clear and serious, [2] whether forfeiture of any fee should be required, and [3] if so, what amount.” In making that determination, the court must consider non-exclusive factors: “[t]he gravity and timing of the breach of duty”; “the level of intent or fault”; “whether the principal received any benefit from the fiduciary despite the breach”; “the centrality of the breach to the scope of the fiduciary relationship”; “any threatened or actual harm to the principal”; “the adequacy of other remedies”; and “[a]bove all” whether “the remedy fit[s] the circumstances and work[s] to serve the ultimate goal of protecting relationships of trust... These “several factors embrace broad considerations which must be weighed together and not mechanically applied.”

In examining the Heatley parties’ first complaint that Red Oak and Johnson failed to request a jury question regarding the Heatley parties’ level of intent when breaching their fiduciary duties, the court found that the Heatley parties did not adhere to Texas Rules of Civil Procedure 272, 274, and 278. The Heatley parties failed to properly object to the lack of such a question or submit the questions in “substantially correct wording” to the court, and in failing to do so, waived the error.

The Heatley parties next argued that the trial court abused its discretion in granting partial forfeiture because: (1) there was no evidence regarding the gravity or centrality of the breaches of duty; (2) there was no evidence that the Heatley parties acted intentionally, recklessly, or with gross negligence; (3) the Heatley parties received no benefit from breaching their fiduciary duties; and (4) the jury had found that the Heatley parties were not unjustly enriched and that their breaches of fiduciary duty caused no harm to appellees (i.e., Red Oak and Johnson). Addressing each of these arguments in turn, the court ultimately concluded that there was evidence submitted regarding the gravity of the breaches of duty, the evidence supported a finding that the breach was a knowing one, and that even in the absence of an additional benefit beyond the fees appellees paid or actual damages to the appellees, partial forfeiture can be an appropriate remedy. The appeals court found that the trial court’s decision was not arbitrary or unreasonable and reflected careful attention to the *Burrow* factors. Therefore, the trial court did not abuse its discretion.

The Heatley parties next contended that the trial court abused its discretion by awarding forfeiture to Red Oak because the trial court initially granted summary judgment against Red Oak’s claim that Heatley and his entities breached their fiduciary duties. However, as the Heatley parties acknowledged at the trial, it was “not fully clear” which of the claims in the third amended petition, if any, were resolved by the trial court’s partial summary judgment. The court of appeals discussed the ability of a trial court to change or modify a partial summary judgment at any time before its plenary power expires, and while the trial court in this case may not have explicitly withdrawn the partial summary judgment, it was implicitly modified or withdrawn to the extent that it was inconsistent with the trial court’s final findings of fact and conclusions of law. However, the court of appeals also acknowledged that when a trial court reverses course on issues decided as a matter of law prior to trial, it must allow the parties the opportunity to litigate the issues at trial. In this case, owing to the fact that the parties proceeded as if all claims were pending, the Heatley parties were given a full and fair opportunity to litigate Red Oak’s claim for breach of fiduciary duty.

Next, the Heatley parties claimed that the trial court had abused its discretion by holding Heatley and HC Developers jointly liable for the forfeiture. The Supreme Court of Texas has held that a third party which knowingly participates in the breach of duty of a fiduciary becomes a joint tortfeasor with the fiduciary and is liable as such. The evidence supported the trial court’s finding that Heatley and HC Developers “committed the same breaches of duty in lockstep with” Heatley Capital, such that all three parties were “indistinguishable as actors.”

The Heatley parties further contended that Johnson and Red Oak waived joint liability because they did not specifically cite “knowing participation” in their request for equitable forfeiture and because they failed to obtain a jury finding on the issue of knowing participation. Here the court of appeals held that Johnson and Red Oak were not required to use “magic words” to invoke the court’s equitable power. Because the jury charge asked whether Heatley Capital had breached its fiduciary duty, as long as the evidence supported a finding of knowing participation (which the court found that it did), the judgment would not be subject to reversal based on the ground that Johnson and Red Oak failed to obtain such a jury finding.

Finally, the Heatley parties contended that the trial court erred by granting prejudgment interest, but they failed to preserve the issue by objecting to the prejudgment-interest award in the trial court.

The judgment of the trial court was affirmed.



***Katz v. Intel Pharma, LLC***, Civ. A. No. H-18-1347, 2020 WL 3871493 (S.D. Tex. July 9, 2020).

The district court denied a summary judgment motion on breach of fiduciary duty by concluding that agency-law principles supported the proposition that a managing member of an LLC owed a fiduciary duty to the LLC. The court also concluded that, even if the LLC had its certificate revoked, a derivative action could still be maintained.

Terry Katz alleged that he owned a 25% interest in Landon Suggs' nutritional supplement company, Intel Pharma, LLC ("Intel"), based on an oral contract with Suggs. Katz eventually brought a derivative claim on behalf of Intel asserting that Suggs had breached his fiduciary duties to Intel by transferring its assets to other entities. In response, Suggs alleged that Katz was not a member because there was no oral contract. In an earlier opinion and order, the court denied Suggs' motion for partial summary judgment on this argument, as it found that the record showed a fact question on whether a valid oral contract existed. In this opinion, Suggs moved for summary judgment on the breach of fiduciary duty claim by arguing (1) that he owed Katz no fiduciary duty, and (2) that because Intel no longer existed, Katz had no standing to bring a derivative claim on its behalf.

Suggs argued that, under Texas law, a controlling member in an LLC does not owe a fiduciary duty to a minority member. The court pointed out that Katz had not alleged that a fiduciary duty was owed to him. Instead, Katz's claim was derivative and based on a breach of fiduciary duty owed to Intel. Suggs did not dispute that he served as Intel's managing member, but the court was troubled because "[t]he parties have not provided, and the court has not found, a case expressly stating that under Texas law, an LLC's managing member owes the company fiduciary duties as a matter of law." The court observed that "[t]he Texas Business Organization Code is silent as to an LLC member's fiduciary duties, except to state that '[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.'" Tex. Bus. Orgs. Code § 101.401. Based on agency-law principles, however, the court found support for the proposition that Suggs did owe fiduciary duties to Intel:

.... The cases support finding that Suggs owed Intel Pharma fiduciary duties based on agency-law principles. *See, e.g., Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002) (under Texas law, "agency is also a special relationship that gives rise to a fiduciary duty"); *In re Hardee*, No. 11-60242, 2013 WL 1084494, at \*3-4 (Bankr. E.D. Tex. Mar. 14, 2013) (the LLC's managing member had the power to transact on the LLC's behalf, making him the LLC's agent and causing the member to owe a fiduciary duty to the company).

Intel Pharma's operating agreement also supports finding that Suggs, as its managing member, acted as the company's agent. The agreement provides that "[t]he Members, within the authority granted by the Act and the terms of this Agreement shall have the complete power and authority to manage and operate the Company and make all decisions affecting its business and [affairs]." (Docket Entry No. 69-1 at 23). The agreement does not "expand or restrict" fiduciary duties that Suggs owed to Intel Pharma.

Suggs also argued that Intel no longer existed and that, correspondingly, Katz's alleged membership interest no longer existed. The court noted that, under Texas law, "an LLC member must have and maintain [membership] status in order to have standing to prosecute derivative claims on the entity's behalf." According to the court, however, Suggs did not explain why Intel ceased to exist. Assuming that it was because the Secretary of State revoked Intel's certificate, the court still found that a derivative action could be maintained:

The record does not provide details of why Intel Pharma no longer exists. Katz's Second Amended Complaint alleges that in January 2017, the Texas Secretary of State revoked Intel Pharma's certificate of formation. (Docket Entry No. 59 at 8). Assuming that to be true, and that it caused a dissolution, Katz could still bring a derivative claim on the company's behalf. Under the Texas Business Organizations Code, a domestic business entity continues in existence for three years after termination or dissolution, for limited purposes. TEX. BUS. ORG. CODE ANN. § 11.356 (West 2006). One purpose is for "prosecuting or defending in the terminated filing entity's name an action or proceeding brought by or against the terminated entity." *Id.* § 11.356(a)(1). If the Texas Secretary of State revoked Intel Pharma's certificate and caused a dissolution, the

company would continue to exist for three years for the purpose of having a derivative claim filed on its behalf. *See Gill v. Grewal*, No. 4:14-cv-2502, 2020 WL 3171360, at \*7 (S.D. Tex. June 15, 2020) (an LLC continued to exist for three years after dissolution for the purpose of a derivative suit). Katz sued in April 2018, less than three years from when the State allegedly revoked Intel Pharma’s certificate of formation. (Docket Entry No. 1).

Suggs argues that this case is similar to *In re Lonestar Logo & Signs, LLC*. But in *Lonestar*, the record showed that the plaintiff was no longer a member of the LLC when suit was filed, because the company had redeemed the plaintiff’s interest, denying the plaintiff standing to bring a derivative claim. 552 S.W.3d at 346, 352. It was the plaintiff’s lack of current membership, rather than the LLC ceasing to conduct business, that precluded standing. *Id.* at 347–52. Here, the record shows a factual dispute material to determining whether Katz was a member of Intel Pharma. (Docket Entry No. 58 at 17).

Suggs has not shown that the undisputed record evidence warrants granting summary judgment on the claim that Suggs breached his fiduciary duty. The record fails to show that, as a matter of law, Suggs did not owe a fiduciary duty to Intel Pharma, LLC, or that Katz lacks standing to bring a derivative claim.

***Gill v. Grewal***, Civ. A. No. 4:14-CV-2502, 2020 WL 3171360 (S.D. Tex. June 15, 2020).

The court granted in part and denied in part motions for summary judgment. Among other conclusions, the court determined that TBOC § 101.463 (allowing a derivative proceeding to be brought as a direct action) does not provide an absolute right for a shareholder to recover directly for claims based on company injuries.

Jaswant Singh Gill (“J. Gill”) and Jagmohan Grewal attended college together in the late 1960s and reconnected in September 2010. Shortly after reuniting, Grewal pitched J. Gill an entrepreneurial venture wherein the proposed company would provide phone consultations to patients located in the United States by doctors based in India. The parties formed Healthema, LLC in October 2010.

On November 1, 2010, Grewal and Healthema entered into an Employment Agreement in which Healthema hired Grewal as a strategic advisor. On November 20, 2010, the parties executed the Operating Agreement. Under the terms of the Operating Agreement: (1) Grewal and JGBG, LLC (an LLC owned by J. Gill) would serve as members of Healthema; (2) members would make an initial capital contribution to the business in the agreed value of \$1 million; and (3) J. Gill would serve as Chairman; J. Gill’s son, S. Gill, would hold the position of Chief Executive Manager; and Grewal would be the Strategic Advisor to the Chairman.

On the same day, the parties signed the Organizational Resolutions of the Managers of Healthema, LLC, which specified that JGBG would own 70% of the company in exchange for its staggered \$1 million contribution, and Grewal would own 30% in exchange for his goodwill and intellectual property. (A future increase in Grewal’s equity position was contemplated after the company achieved profitability.) The Operating Agreement and Organizational Resolutions were signed in each party’s capacity as either a member or manager of Healthema.

On November 21, 2010, J. Gill and Grewal signed a one-page Addendum to the Operating Agreement wherein they reaffirmed Grewal’s 30% equity position and agreed that his interest would increase after Healthema achieved profitability. It was further agreed that during the pre-operational phase and the first three years of operations, Grewal would have the primary responsibility and authority for making operational decisions with advice from both J. Gill and S. Gill. In the event of conflicts between the Addendum and the Operating Agreement, J. Gill and Grewal agreed that the Addendum would prevail. The Addendum was signed by Grewal in his individual capacity and by J. Gill either in his individual capacity or on behalf of JGBG.

As the company began taking steps towards becoming operational, various problems arose including the inability of Indian doctors to prescribe medications to U.S. patients and the need for permits in “Special Economic Zones” (“SEZs”) in India. Grewal formed Healthema India Private Limited (“HIPL”) to gain access to permits which, according to Grewal, would require \$750,000 of Healthema’s cash contributions from JGBG to be transferred to HIPL’s accounts. The Gills objected, stating that Grewal had given himself more managerial capacity in creating HIPL than he would have had under the Operating Agreement, that the \$750,000 requirement was not on the checklist provided by the SEZ permit consultant, and that Grewal had sole access to the HIPL bank account.

The Gills subsequently attempted to renegotiate the terms of their agreement by drafting an additional memorandum of understanding (MOU) requiring the approval of J. Gill, S. Gill, or both before certain expenditures could be made. The next day S. Gill sent an email threatening to cancel their contractual relationship if Grewal did

not sign the MOU. Grewal responded stating that he would seek alternative funding and would return the funds to the Gills. He further indicated that he would like to dissolve Healthema and run the business on his own. In response, S. Gill, acting on behalf of Healthema, sent a letter to Grewal terminating his Employment Agreement and the Gills withdrew \$697,149.74 from Healthema's account. HIPL's SEZ approval was denied for lack of funding, and Grewal had to pay HIPL's employees out of pocket.

After an Indian court enjoined HIPL from disposing of any assets and ordered the deposit for the business lease to be returned to Healthema, Grewal sent a demand letter to the Gills demanding payment of his capital contribution (which Grewal argued was the value of his 30% equity stake in Healthema) and 38 months of salary. Two separate suits—an action filed by the Gills seeking a declaratory judgment and an action by Grewal alleging various damages claims—were consolidated to form this case.

After resolving some jurisdictional issues, which resulted in Healthema and Doc Call Live, LLC (a related company) being removed as parties, the court addressed motions for summary judgment on whether Grewal was entitled to bring claims on Healthema's behalf. The court observed that Texas law holds that a member of a limited liability company lacks standing to assert claims individually when the cause of action belongs to the company. However, those with ownership interests in certain business associations may bring derivative actions to afford a means by which owners who are powerless to bring a direct civil action at law against faithless directors and managers may seek to vindicate their corporate right that the corporation itself has refused to enforce. Despite this procedural mechanism, the cause of action remains vested in the company.

The Gills claimed that Grewal had abandoned all causes of action brought derivatively on behalf of Healthema. Grewal claimed that he was permitted to bring an action that may be considered derivative as a direct action under Texas Business Organizations Code § 101.463(c). This section allows a derivative proceeding brought by a member of an LLC to be treated as a direct action brought by the member for the member's own benefit. A recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the LLC if necessary to protect the interests of creditors or other LLC members.

The court found that Grewal misunderstood the role of these provisions, as the provisions did not provide an absolute right for a shareholder to recover directly for claims based on corporate injuries. A court may treat a derivative proceeding like a direct action and allow the shareholder to recover directly, but the proceeding must be derivative. Therefore, even if the court allowed Grewal to pursue causes of action which belonged to the company as a direct action belonging to him, he was still required to bring the suit as a derivative action, which he had not done. A review of the case history showed that Grewal had abandoned his derivative claims years before and that Grewal's Second Amended Counterclaim did not allege any derivative claims. Additionally, Grewal failed to comply with the heightened minimum pleading standards for derivative suits found in F.R.C.P. 23.1, which requires that the complaint (1) be verified, (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack, and (3) state with particularity the effort by the plaintiff to obtain the desired action from the directors or comparable authority. The court speculated that Grewal could not bring his suit as a derivative action and maintain diversity jurisdiction, as an LLC's citizenship is determined by the citizenship of its members. Thus, in any suit in which an LLC sues, or is sued by, one of its members, the LLC and the opposing party will hold the same citizenship.

In the alternative, Grewal argued that he could bring Healthema-related claims because Healthema no longer existed, and in certain circumstances individual shareholders can sue on causes of action that belong to a terminated entity. However, even if the court agreed that Healthema was fully dissolved, the suit must still be a derivative one, and Grewal filed his suit in his own name and not on behalf of the company. Additionally, the court was not convinced that Healthema no longer existed.

The court concluded that Grewal had not brought the suit as a derivative action. As a result, he was only entitled to recover for harms incurred individually. Similarly, he lacked standing to assert claims individually when the cause of action belonged to the company.

The court then proceeded to consider Grewal's Second Amended Counterclaim. Several causes of action were discussed, including the following:

#### A. Grewal's Breach of Contract Actions

Grewal's Second Amended Counterclaim alleged that the Gills breached the governing documents by: (1) misappropriating substantially all of Healthema's assets; (2) failing and refusing to distribute to Grewal his alleged

share of any liquidating distributions; (3) repudiating the contract and refusing continued performance unless Grewal signed one or more new agreements that would radically alter the terms of their deal; (4) preventing Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum; (5) excluding Grewal from the management and affairs of Healthema; (6) preventing Grewal from exercising his authority as a manager of Healthema; (7) failing to prudently and properly manage the company; (8) improperly delegating and/or usurping management powers and responsibilities; (9) failing and/or refusing to continue and/or allow the continuation of Healthema's business; (10) dissolving or attempting to dissolve Healthema without notice to Grewal and without the required vote; (11) expending Healthema's funds for personal benefit and/or outside business interests; and (12) committing other wrongful acts to usurp or deny Grewal's membership and management interests in Healthema.

The Gills responded that these alleged breaches fell into two categories—claims that constituted injury to Healthema, which Grewal shared in only derivatively, and claims that may constitute direct injury to Grewal that were caused by Healthema, who was no longer a defendant in the case. With the exception of claim 4, the court agreed with the Gills and granted summary judgment. The court found that Grewal could only individually maintain one of his pleaded breach of contract actions, claim 4, which alleged that the Gills prevented Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum. Unlike the other contracts, the Addendum was apparently signed by J. Gill and Grewal in their individual capacities, or by J. Gill in his capacity as an agent of JGBG. There was no suggestion that the obligation under the addendum was transferred to Healthema by adoption, assignment, novation, or otherwise; therefore, the court could not grant summary judgment as to J. Gill or JGBG on this claim.

#### B. Grewal's Breach of Fiduciary Duty Claims

Grewal also alleged an action for breach of fiduciary duty. To maintain a breach of fiduciary duty claim in Texas, the plaintiff must establish: (1) a fiduciary relationship existed between the plaintiff and defendant; (2) the defendant breached its fiduciary duty to the plaintiff; and (3) the defendant's breach resulted in injury to the plaintiff or benefit to the defendant. Texas courts recognize an informal fiduciary duty that arises from a moral, social, domestic, or purely personal relationship of trust and confidence. However, courts do not create such relationships lightly, and not every relationship involving a high degree of trust and confidence rises to the level of a fiduciary relationship. In a business transaction, a special relationship of trust and confidence must exist prior to, and apart from, any agreement which forms the basis for the suit. There was no such prior relationship with S. Gill, so the court granted summary judgment with respect to claims against him. However, Grewal claimed his and J. Gill's history of close friendship and high degree of personal trust was sufficient to establish an informal fiduciary duty. The court disagreed, finding that long-lost college friends could not be expected to place their friend's interest above their own. Mere subjective trust is not sufficient to transform a business arrangement into a fiduciary relationship. The court therefore also granted summary judgment for claims against J. Gill.

#### C. Grewal's Conversion Claim

Grewal asserted a cause of action for conversion alleging that he had the right to immediate possession of any distributions made by Healthema and that the Gills wrongfully exercised dominion over those funds. The court determined that the claim had limitations problems. Even if timely filed, however, the court found that the claim failed for lack of standing:

The Court finds Grewal does not possess standing to bring an action for conversion. Texas has a specific definition of conversion. "The unauthorized and wrongful assumption and exercise of dominion and control over the personal property of another, to the exclusion of or inconsistent with the owner's rights, is in law a conversion." *Waisath v. Lack's Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971). Under Texas Business Organizations Code § 101.106(b), "a member of a limited liability company ... does not have an interest in any specific property of the company." For this reason, any funds that were withdrawn from Healthema were converted from Healthema, not Grewal. In accord with these two legal premises, Texas courts have held that a member of an LLC may not bring a conversion action for funds that were improperly withdrawn from the LLC's bank

account. *See Ghosh v. Grover*, 412 S.W.3d 749, 755-56 (Tex. App.—Houston [14th Dist.] 2013, no pet.). As Grewal is bringing this action individually, he may not seek to vindicate Healthema’s rights to these funds.

The court noted that Grewal may have been able to argue that Healthema did not act properly in failing to pay Grewal his purported distribution to him directly, but such a claim would have to be made against Healthema, who was no longer a defendant. Therefore, the court granted summary judgment on Grewal’s conversion claim as to all counter-defendants.

The court also addressed the Gills’ First Amended Complaint. The Gills alleged that Grewal breached his fiduciary duties of obedience, loyalty, and due care as a manager and member of Healthema. The court observed that, in Texas, members of an LLC do not owe a formal fiduciary duty to one another. With respect to an informal fiduciary duty, the court did not find facts sufficient to establish one. Moreover, the Gills did not plead the claim derivatively. Healthema was not a party to the suit and the Gills could not sue on its behalf any more than Grewal could. Therefore, the Court granted the motion for summary judgment against the Gills.

The Gills also alleged that Grewal breached the terms of his employment contract with Healthema and that they could not be liable under the Healthema/Grewal Employment Agreement. Under TBOC § 101.114, unless the company agreement specifically provides otherwise, a member or manager is not liable for the debts, obligations, or liabilities of an LLC. Nothing in the Operating Agreement abridged the Gill’s limited liability with respect to the employment agreement. The court made no finding on the merits of Grewal’s breach of employment contract action against Healthema but granted the Gills’ motion for summary judgment as to the claims against them.

#### **E. LLC Property and LLC Membership Interest**

*Villareal v. Saenz*, 5-20-CV-00571-OLG-RBF, 2021 WL 1986831 (W.D. Tex. May 18, 2021).

The court held that a broad release executed by two members of an LLC and the LLC in connection with the buyout of one member’s membership interest barred claims by the LLC and purchasing member against the selling member for breach of fiduciary duty and other causes of action that were based on conduct by the selling member before execution of the release. In addition, the only reasonable interpretation of the phrase “entire interest” as used in the documents was that the assigning member assigned his membership interest in the company itself and did not purport to assign any property of the company; therefore, the member did not beach any contractual obligation to return any property of the company.

In January, 2019, Jonathan Villarreal and John Saenz formed ZroBlack, LLC (“ZroBlack”), a Texas limited liability company, the purpose of which was to provide applications and services regarding cell phone data capture and erasure for both commercial and governmental use. Villarreal and Saenz each owned 50% of the LLC. Villarreal was responsible for performing the in-house coding, hardware engineering, and servicing of the technology, and Saenz was responsible for client engagement and promoting the company. Villarreal assigned his intellectual property interest in software he developed to ZroBlack.

A few months after ZroBlack was formed, it entered into a Professional Services Agreement (PSA) with a foreign customer under which the foreign customer paid \$1.5 million up front and agreed to make future payments based on an earn-out arrangement. Villarreal and ZroBlack alleged that Saenz then withdrew \$740,000 and transferred the money to his personal account, while Villarreal transferred \$740,000 to a newly formed distribution account “according to the terms of the LLC agreement.” According to Villarreal and ZroBlack, the distributions to both Villarreal and Saenz constituted their salary through the end of 2019 and the \$740,000 Saenz withdrew was thus not yet earned.

Soon after Villarreal and Saenz began their consulting work under the PSA, they began to disagree about Saenz’s performance as ZroBlack’s CEO. Ultimately, they decided to part ways, and a lawyer prepared a document entitled “Release” that Saenz and Villarreal executed on behalf of themselves and ZroBlack on August 9, 2019. In the Release, the parties agreed that Saenz would “assign[ ] [ ] his entire interest in ZroBlack LLC to Villarreal.” At the same time they executed the Release, the parties executed a document entitled “Unanimous Written Consent In Lieu of Meeting of The Members of ZroBlack LLC,” which “memorialize[d]” the assignment of Saenz’s “entire interest.” The Release provided that Villarreal and Saenz would split future earn-out payments from the foreign customer, and they fully released each other “from all claims and demands, known or unknown” (see provision quoted below). The Release did not mention: (1) the \$740,000; (2) any company property, such as a laptop that had

been acquired by Saenz in connection with his duties as CEO; or (3) ZroBlack's proprietary and trade secret information, domain name, webpage, or server.

Beginning on August 15, 2019, Villarreal requested on several occasions that Saenz release ZroBlack's domain name and return the laptop, which allegedly contained ZroBlack's proprietary trade secrets, including the code related to ZroBlack's phone-security project. Saenz allegedly refused to do so, and Villarreal received an email on August 15, 2019, from GoDaddy informing him that Saenz had, the day before, revoked Villarreal's access to the domain name. In September of 2019, Villarreal learned Saenz had allegedly deleted thousands of emails and documents on ZroBlack's email server and had taken down its webpage. According to Villarreal and ZroBlack, Saenz "blackmailed ZroBlack over the domain name, webpage, and email server, offering to sell it back to ZroBlack for \$7,000." Without access to the ZroBlack domain, Villarreal and ZroBlack contended that they were unable to update ZroBlack's credentials with various entities, agencies, and websites, which in turn prevented ZroBlack from competing for government contracts.

In 2020, Villarreal and ZroBlack sued Saenz, alleging numerous claims based on federal and state statutes as well as common-law causes of action.

With respect to the plaintiff's claim for breach of contract based on the terms of the Release and Unanimous Consent, the court found no plausible basis had been pled for breach of contract. Pursuant to the Release and Unanimous Consent, Saenz "assign[ed] [ ] his entire interest in ZroBlack LLC" to Villarreal pursuant to Article VII of the ZroBlack Operating Agreement. The documents did not define the term "interest" and did not indicate an intent to otherwise obligate Saenz to return any alleged company funds, property, or trade secrets, including the \$740,000 and laptop. Nevertheless, the plaintiffs asserted that these items of property would necessarily be included within Saenz's assignment and that Saenz thus breached the agreements by refusing to return them. The court stated that there was only one reasonable interpretation of Saenz's "entire interest in ZroBlack LLC," as that phrase was used in the documents, and that interpretation was that Saenz assigned his membership interest in the company itself. The court stated that "[t]his interest is defined under Texas law to exclude any supposed personal 'interest' he had in company property." The court made clear that it was not suggesting that Saenz's mere status as a member of ZroBlack meant that he owned any kind of "interest" in any specific property of the company that he would have the power to assign when acting in an individual capacity to execute the Release, citing Tex. Bus. Orgs. Code § 101.106(b) ("A member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company"). According to the court, "That Villarreal believed—or believes now in hindsight—that Saenz's 'interest' in ZroBlack LLC included an assignable personal 'interest' in the company's property isn't helpful to Villarreal's position. The plain language in both agreements is at odds with any such subjective belief." Thus, the court concluded that the breach-of-contract claim should be dismissed.

***In re Huffines Retail Partners, L.P.***, 978 F.3d 128 (5th Cir. 2020).

The Fifth Circuit granted a petition for mandamus and ordered expunction of Notices of Lis Pendens based in part on the argument that a sale of LLC membership interests was not the same as a sale of the real property owned by the LLCs.

The Petitioners were members of multiple limited liability companies ("Sellers") that owned, operated, and were developing multi-family housing units in the towns of Lewisville and Rowlett, Texas. Respondents, including Atlas Apartments Acquisition, LLC ("Purchasers"), entered into multiple agreements to acquire all of the membership interests in the LLCs that possessed title to various tracts of land. The purchased interests included control of, among other properties, the Hebron 121 Station and Harmony Hill apartments, operating- and income-producing apartment buildings, member capital accounts, two ongoing construction projects, existing loans on the real property, construction loans for real property development, and a parcel of undeveloped land. The agreements memorializing these acquisitions, which were signed by Atlas and one or more of the Sellers around October 3, 2018, were titled Membership Interest Purchase Agreements and were designated as Hebron 1-4 Agreement, Hebron 5 Agreement, Hebron 6 Agreement, Harmony 1 Agreement, and Harmony 2 Agreement.

The Agreements were predicated on obtaining certain lender consents. Such consents failed to materialize, and the scheduled closing did not occur. The Agreements eventually expired by their own terms. Sellers filed suit in state court alleging breach of contract and breach of guaranty claims, and the case was removed to federal court.

Purchasers filed two Notices of Lis Pendens in the Denton County and Dallas County real property records. Sellers moved to expunge the Notices. The magistrate judge issued findings, conclusions, and recommendations

denying relief, and the district court accepted his recommendations. As a result, the district court denied Motions to Expunge Lis Pendens Notices and Motions to Cancel the notices. Sellers appealed, alleging that the existence of the Notices tied up title to approximately 102 acres of real property valued at approximately \$365 million. Sellers asked the Fifth Circuit for mandamus relief, which the court granted:

By its express terms, a “Membership Interest Purchase Agreement” was executed covering Phases 1, 2, 3 and 4—Hebron 121 Station (Hebron 1-4 Agreement), and a separate, similar “Membership Interest Purchase Agreement” covering Phase 5—Hebron 121 Station (Hebron 5 Agreement). These are not, whatever else they may be, documents simply about real estate. For instance, the “whereas” clauses identify the Hebron 1-4 transaction as a restructure of certain existing LLCs, including the creation of a new entity, followed by the new entity members, together with the LLC that owns Hebron Phase 4, becoming the “Seller” of the “Membership Interests.”

Article II describes the Purchase and Sale of “Membership Interests.” Section 2.01. In so doing, the Sellers “acknowledge” that the sale will encompass all of the Company’s rights to identified property. The property, in turn, comprises the apartment projects’ real estate parcels, but separate paragraphs of that section also include appurtenances, improvements, personalty, assumed contracts, intangible property, and tenant leases. To “acknowledge” what is owned by the selling members and their Company is not to “sell” the property alone, but to warrant that the business entity owns what is being purchased. Interpreting this acknowledgement as a freestanding real estate parcel sale is simply not what the parties contemplated or were doing.

The fact that the sale of the membership interests depended on a clean, or fixed-up title survey and policy is hardly a surprise. Similar provisions throughout the Membership Interest Purchase Agreements embody assurances and permit audits for the purchasers to verify the ownership and status of the other “property” in the business entity. Numerous schedules and exhibits and warranties effectuate the purchaser’s rights and expectations. The Hebron 5 Agreement varies in form and representations because, although also a sale of membership interests, it concerns an ongoing construction project for which separate documentation was required. Again, the existence of a title policy alone or a closing statement from a title company does not detract from the overall transactional character as a sale of entity interests.

Finally, the fact that Hebron 6 is documented purely as a real estate sale reinforces the idea that the other agreements were not mere real estate transactions. It states that “[e]ach Seller agrees to sell to Purchaser ... all of such Seller’s right, title and interest in and to ... the respective Parcels of unimproved real property, including all right, title, and interest therein, owned by Phase 6 Seller....” ...

*In re Cohen*, 340 S.W.3d 889, 892-93 (Tex. App. 2011) noted that under current law, a party may seek to overturn a lis pendens based on either (1) the pleadings’ failure adequately to assert a “real property claim,” or (2) failure to prove by a preponderance the “probable validity of the real property claim.” Tex. Prop. Code Sec. 12.0071(c). The district court here rested its conclusion on the latter proposition, as it found a genuine fact issue whether the parties’ transaction is in essence a real estate sale. We disagree with the court’s proceeding to the second statutory alternative and find the first alternative unsatisfied.

First, the Purchasers’ counterclaim is not a “real property claim.” Their counterclaim seeks recovery for multiple alleged breaches of the Membership Interest Purchase Agreements and injunctive relief that would order the sellers to complete the sales of those interests. On its face, the pleading does not “involve” the actual titles to real property or the establishment of a direct interest in real property underlying the sales contracts. Among other remedial requests, to accomplish specific performance of the Agreements, the Purchasers request an injunction to prevent the Sellers from disposing of any of the properties and assets “identified in any of the Agreements” or from permitting any lien or encumbrance to be placed on any properties or assets “identified in any of the Agreements.” Specific performance of the Membership Interest Purchase Agreements, i.e. contracts for entities that own real property, is not specific performance of a contract for deed or specific performance to transfer deeds or specific performance to recognize

ownership of real property subject to a title dispute. In fact, the only injunctive relief sought here that pertains to the real property is negative. That is, the Purchasers would prevent the Sellers from disposing of the real property to anyone else; they do not pray for the real property titles to be transferred to them.

Texas law interpreting the lis pendens statute corroborates that the Purchasers' contract-based counterclaim here, considering the pleadings alone as permitted by Cohen, did not "involve" title to real property and instead implicated the real property only "collaterally." In such situations, notices of lis pendens were held void or impermissible. Two cases construing similar transactions are virtually on point. See *In re Med Plus Equity Inv., LP*, No. 0-50-05-00404-CV, 2005 WL 1385238 (Tex. App. Jun. 13, 2005) (because claims pled "would only address an interest in the partnership, [a]n interest in the partnership is distinct from an interest in real estate which may be owned by the partnership" and lis pendens is void); *Mangione v. Jaffe*, 61 S.W.3d 591, 593 (Tex. App. 2001) (suit for specific performance of a sales contract merely affecting land, where a mall was the only partnership property, was breach of contract that did not involve a claim of an interest or right in the underlying land). Our research has found no cases to the contrary concerning this specific type of transaction. ...

For these reasons, consistent with Texas law, the lis pendens notices were void and should have been cancelled by the district court.

The Fifth Circuit also determined that mandamus was a proper vehicle to require expunction of the lis pendens notice. According to the court, allowing the Purchasers to maintain the notices of lis pendens was based on clear and indisputable errors of fact and law. Moreover, the Sellers had no other adequate means of seeking redress other than by issuance of the writ.

The dissent argued that Section 12.007(a) of the Texas Property Code allows a litigant to file a notice of lis pendens "during the pendency of an action involving title to real property." According to the dissent, Texas courts interpreting this language draw a distinction between a party who claims a direct interest in real property and one who merely asserts a collateral interest. The dissent noted that, after a full day of evidence-taking in a hearing requested by the Sellers, the magistrate judge and district court found that the pleadings, documents, and testimony together created a question of fact regarding whether the Purchasers' underlying claim asserted a direct and present interest in real property. Reviewing that same record, the dissent saw no clear or patent error. As a result, the dissent would have denied the writ.

*In re UBS Financial Services Inc.*, No. 14-20-00087-CV, 2020 WL 5902955 (Tex. App.—Houston [14th Dist.] Oct. 6, 2020, no pet.) (mem. op.).

The court of appeals conditionally granted UBS's petition for writ of mandamus and directed the trial court to vacate its January 8, 2020 order granting a request to take presuit depositions of UBS employees. The court of appeals concluded that the managing member of an LLC did not have standing to bring claims in her own name that belonged to the LLC.

Fleur Holdings LLC opened two accounts in UBS's Yield Enhancement Strategy ("YES"), which is an options overlay trading strategy that aims to generate investment income through the sale of S&P 500 Index options. Deneige Dooley is Fleur Holdings' managing member. Dooley signed the documents setting up Fleur Holdings' accounts as managing member.

In September 2019, Dooley's attorney wrote UBS, advising that he was investigating whether UBS's actions regarding the investment of his "Client's" assets in YES were actionable. Dooley was referred to as the "Client" in the letter. Dooley's attorney requested information regarding YES and also demanded that UBS preserve evidence. In addition, Dooley's attorney requested tape-recorded interviews of UBS employees Debra Pelham and Kreg Pearless.

In response, UBS's attorney advised that UBS had no obligation to produce discovery at that time and declined to do so. UBS further stated that, in the event arbitration were commenced, both parties would be subject to the discovery rules and procedures of the arbitral forum and enclosed copies of the documents signed by Dooley on behalf of Fleur Holdings.

In November 2019, Dooley filed a verified petition requesting depositions duces tecum before suit, seeking to investigate facts regarding the investment of some of Dooley's funds in YES by deposing Pelham and Pearless.



UBS objected on the grounds that (1) Dooley lacked standing because she does not own the potential claims; and (2) Fleur Holdings, through its managing member, Dooley, agreed to binding private arbitration of the potential claims, precluding the use of Rule 202.

On January 3, 2020, UBS filed an emergency motion for protection and motion to quash Dooley's subpoenas that commanded Pelham and Pearless to appear for deposition. The trial court held a hearing on January 6, 2020 and ultimately signed a January 8 order that granted Dooley's petition and allowed the depositions of Pelham and Pearless.

UBS filed a petition for writ of mandamus, asking for the January 8 order to be set aside. It argued that Dooley lacked standing to request a presuit deposition because Fleur Holdings was the owner of the accounts. The court of appeals agreed:

It is well-settled that the trial court must have subject-matter jurisdiction over the anticipated action to properly order a presuit deposition. This limitation on presuit discovery is due to a court's inherent jurisdictional limitations: "a court cannot grant relief when it lacks jurisdiction of the subject matter," so "[i]t would make no sense to insist that a court ordering discovery to perpetuate testimony for a later-filed suit to be one ... [without] subject-matter jurisdiction." "Indeed, allowing courts to authorize Rule 202 depositions for potential suits over which they lack jurisdiction would untether presuit discovery from the suit it purports to be in aid of."

"Standing is implicit in the concept of subject-matter jurisdiction, and subject-matter jurisdiction is essential to the authority of a court to decide a case." Standing is specific to each individual plaintiff and to each of the plaintiff's individual claims. Standing requires a concrete injury to the plaintiff and a real controversy between the parties that will be resolved by the court. Questions of standing are reviewed de novo.

UBS maintains that the trial court did not have jurisdiction to grant Dooley's Rule 202 petition because Dooley does not have standing to bring the Rule 202 proceeding or, if suit is ultimately brought, to pursue the claims for which discovery is sought. Specifically, UBS contends that the undisputed evidence shows that Fleur Holdings owns the YES accounts and Dooley is merely the managing member of Fleur Holdings, with no ownership interest in the accounts.

A limited liability company is a separate entity from a member or manager of the company. A member of a limited liability company does not have an interest in any specific property the company owns. Tex. Bus. Orgs. Ann. § 101.106.

A member of a limited liability company may be a party in an action brought by or against the company ... if the action is brought to enforce the member's right against or liability to the company. Tex. Bus. Orgs. Ann. § 101.113. Therefore, a member of a limited liability company lacks standing to assert claims individually when the cause of action belongs to the company.

In the September 25, 2019 letter, Dooley's counsel advised UBS that he had been hired to represent Dooley in investigating UBS's actions in managing Dooley's YES account and requested documents related to Dooley's YES account. Dooley is named as the petitioner, and the petition repeatedly refers to Dooley's YES investment, even though Fleur Holdings owns the YES accounts.

In her response to UBS's petition for writ of mandamus, Dooley asserts that the doctrine of misnomer is applicable here where Dooley was named as petitioner instead of Fleur Holdings. "[A] 'misnomer occurs when a party misnames itself or another party, but the correct parties are involved.'" Generally, courts allow parties to correct a misnomer if it is not misleading.

This case does not involve a misnomer. A similar situation was addressed by the San Antonio Court of Appeals. *See Barrera v. Cherer*, No. 04-13-00612-CV, 2014 WL 1713522 (Tex. App.—San Antonio Apr. 30, 2014, no pet.). (mem. op.). In *Barrera*, the member of a limited liability company brought a forcible detainer action in his own name even though the company owned the property. The trial court awarded the member possession of the property. On appeal, the defendants contended that the member lacked standing in the forcible detainer action because the cause of action belonged to the company. The member responded that this was an issue of misnomer. The court rejected the member's misnomer argument because the member did not have standing to assert claims individually where the cause of action belonged solely to the company.

Here, Dooley, as managing member, does not have individual standing to maintain claims against UBS for actions it may or may not have taken with regard to its management of the YES accounts owned by Fleur Holdings. Therefore there has been no misnomer because Dooley has never been the correct party to request the Rule 202 depositions.

The trial court abused its discretion by granting Dooley's petition for the Rule 202 depositions. UBS also does not have an adequate remedy by appeal.

*Sohani v. Sunesara*, 608 S.W.3d 532 (Tex. App.—Houston [1st Dist.] 2020, no pet.).

The court of appeals affirmed a trial court ruling that a member of an LLC did not have to disgorge profit distributions that he had previously received, even though the court had earlier concluded that he was not entitled to share in profits as a matter of law.

Appellants, Manisch Sohani and Anis Virani, sued appellee, Nizar Sunesara, for fraud and sought declaratory relief arising out of Sunesara's formation of three limited liability companies. Sunesara asserted a counterclaim for declaratory relief, seeking a declaration that he was a member of each LLC and was entitled to one-third of the net profits from each LLC. A jury found that (1) Sunesara was a member of each LLC and was entitled to one-third of the net profits from each LLC, (2) Sohani and Virani were estopped from denying Sunesara's membership in the LLCs, and (3) Sunesara did not commit fraud. The trial court entered judgment on the jury's verdict.

In a prior appeal (*Sohani v. Sunesara*, 546 S.W.3d 393, 410 (Tex. App.—Houston [1st Dist.] 2018, no pet.)), the First Court of Appeals affirmed the judgment, but modified it to delete the portion providing that Sunesara was entitled to one-third of the net profits from the LLCs. The court construed §§ 101.201 and 101.501(a)(7) of the Texas Business Organizations Code "as requiring a limited liability company to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and that these records establish the allocation of a member's share of the profits and losses of the company." Because Sunesara offered only his testimony at trial that he made contributions to the LLCs and did not offer any written records reflecting his contributions, the court concluded in the prior appeal that Sunesara presented no evidence that he was entitled to one-third of the profits of the LLCs. The court held that "[b]ecause Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law." As a result, the court determined that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits.

After that ruling, Sohani and Virani filed a "Motion for Disgorgement of Ill-Gotten Gains." They pointed out that, prior to litigation, Sunesara had received profit distributions from the LLCs totaling around \$17,500. They argued that, based on the holding in the first appeal that Sunesara was not entitled to profit distributions, "[i]t is now established that such distributions are ill-gotten gains or unjust enrichment," and they requested that the trial court order Sunesara to return the distributions. The trial court denied the motion, which prompted the current appeal. The court of appeals affirmed the trial court's ruling and concluded that Sunesara was not required to disgorge any earlier profit distributions:

Disgorgement is an equitable forfeiture of benefits that were wrongfully obtained. *In re Longview Energy Co.*, 464 S.W.3d 353, 361 (Tex. 2015); *Henry v. Masson*, 333 S.W.3d 825, 849 (Tex. App.—Houston [1st Dist.] 2010, no pet.) ("[D]isgorgement of profits is an equitable remedy, appropriate for causes of action such as breach of fiduciary duty."). The main purpose of forfeiture as a remedy "is not to compensate an injured principal" but to "protect relationships of trust by discouraging agents' disloyalty." The Texas Supreme Court has stated examples of when disgorgement is an appropriate remedy, including "when a fiduciary agent usurps an opportunity properly belonging to a principal," when "an agent divert[s] an opportunity from [a] principal or engage[s] in competition with the principal, [and] the agent ... profit[s] or benefit[s] in some way," and when "a person who renders service to another in a relationship of trust ... breaches that trust." *Longview Energy*, 464 S.W.3d at 361 (quoting *ERI Consulting Eng'rs*, 318 S.W.3d at 873, *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002), and *Burrow*, 997 S.W.2d at 237). Texas law limits disgorgement of profits to the amount of a fiduciary's profits obtained as a result of the fiduciary's breach of duty.

Sohani and Virani argue that because this Court held that Sunesara is not entitled, as a matter of law, to profit distributions from the LLCs, the profits distributions that he indisputably received “should not have been given to him in the first place” and were “essentially ill-gotten gains” that they are entitled to recover. Sunesara argues that no evidence was presented at trial that he wrongfully obtained the profit distributions or that he coerced or defrauded Sohani and Virani into making the distributions. He argues that the distributions were voluntary. He further argues that Sohani and Virani never pleaded that he breached a fiduciary duty and the jury never made any such findings. As a result, there are no findings that can support disgorgement as a remedy under the facts of this case. We agree with Sunesara.

Sohani and Virani did not assert a breach of fiduciary duty claim against Sunesara, and they did not recover on their fraud claim. Instead, the jury found that Sunesara did not commit fraud, and Sohani and Virani did not challenge that finding on appeal. This Court held that Sunesara was not entitled to profit distributions from the LLCs, but we disagree that that holding necessarily means that the profit distributions Sunesara received prior to suit being filed were wrongful or “ill-gotten.” Sunesara is not entitled to profit distributions, meaning that he does not have the right to demand distributions. The trial testimony, however, was that Sohani and Virani chose to give Sunesara a share of the profits from the LLCs. Under the Business Organizations Code, Sohani and Virani were not required to do this, but the fact that we later determined that Sunesara does not have an entitlement to a share of the profits does not make these distributions wrongful or ill-gotten.

In the absence of any pleadings to support a breach of fiduciary duty claim or jury findings that Sunesara breached a fiduciary duty or otherwise acted wrongfully, we conclude that Sohani and Virani were not entitled to seek post-appeal disgorgement of profits distributed to Sunesara. *See ERI Consulting Eng’rs*, 318 S.W.3d at 872–73 (stating that main purpose of disgorgement and forfeiture remedy “is to protect relationships of trust by discouraging agents’ disloyalty”); *Stephens v. Three Finger Black Shale P’ship*, 580 S.W.3d 687, 714 (Tex. App.—Eastland 2019, pet. filed) (holding that trial court erred in awarding damages in form of disgorgement when no evidence existed of relationship of trust “and a breach of the duties arising from it”). We hold that the trial court did not err by denying Sohani and Virani’s motion seeking disgorgement of profits.

***Gill v. Grewal***, Civ. A. No. 4:14-CV-2502, 2020 WL 3171360 (S.D. Tex. June 15, 2020).

“The Court finds Grewal (a member of Healthema, LLC) does not possess standing to bring an action for conversion. Texas has a specific definition of conversion. ‘The unauthorized and wrongful assumption and exercise of dominion and control over the personal property of another, to the exclusion of or inconsistent with the owner’s rights, is in law a conversion.’ *Waisath v. Lack’s Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971). Under Texas Business Organizations Code § 101.106(b), ‘a member of a limited liability company ... does not have an interest in any specific property of the company.’ For this reason, any funds that were withdrawn from Healthema were converted from Healthema, not Grewal. In accord with these two legal premises, Texas courts have held that a member of an LLC may not bring a conversion action for funds that were improperly withdrawn from the LLC’s bank account. As Grewal is bringing this action individually, he may not seek to vindicate Healthema’s rights to these funds.”

***RLI Ins. Co. v. Caliente Oil, Inc.***, 469 F. Supp. 3d 729 (W.D. Tex. 2020).

“RLI contends that the equipment at issue did not belong to Caliente and is not covered as the insured’s contractors’ equipment or under the tools endorsement because the summary judgment evidence establishes the equipment belonged to Lynx and Eldorado. Caliente argues that it had an ownership interest in the equipment because of the ‘roll up’ ....

The Court will first address the issue of ownership. The sand knockouts at issue in this suit belonged to Lynx, and Lynx was not involved in the ‘roll up’ that Caliente refers to. The light tower, flare stack, and fishing tools belonged to Eldorado. The contribution agreement, which accomplished the ‘roll up,’ transferred the membership interests of Messrs. Stevens, Beal, and Buckingham in three limited liability companies (including Eldorado) to Caliente. Critically, the contribution agreement made Caliente the sole member of the limited liability companies.

It is fundamental to the law of business organizations that a legal entity such as a corporation or a limited liability company has an existence separate and apart from that of its shareholders or members. Texas law recognizes that a limited liability company is a legal entity that is distinct from its members, and members do not have interests in the property of the company. *Sherman v. Boston*, 486 S.W. 3d 88, 94 (Tex. App.—Houston [14th Dist.] 2016, pet. denied); *see also* TEX. BUS. ORGS. CODE ANN. § 101.106(b) (“A member of a limited liability company ... does not have an interest in any specific property of the company”). Caliente cites no case law to support its argument that it had an ownership interest in the property. Consequently, the Court concludes that Caliente did not have an ownership interest in any of the equipment at issue in this suit.”

## **F. Interpretation and Enforcement of Company Agreement or Certificate of Formation**

### **1. Fiduciary Duties**

*KrisJenn Ranch, LLC v. DMA Properties, Inc. (In re KrisJenn Ranch, LLC)*, \_\_ B.R. \_\_, 2021 WL 1235411 (Bankr. W.D. Tex. 2021).

The court held that there was at least an informal fiduciary relationship between two individuals who were the managers and indirect owners of an LLC such that a loan by one of the individuals to the LLC without obtaining the approval of the other individual as required for a loan and conflict-of-interest transaction under the company agreement breached the fiduciary duty owed by the individual who made the loan. Because of a faulty assumption underlying the damages model, however, the court awarded no damages for the breach of fiduciary duty.

Larry Wright and Daniel Moore formed Black Duck Properties, LLC (“Black Duck”) to engage in the business of flipping saltwater disposal wells. Wright owned 50% of Black Duck through KrisJenn Ranch, LLC (“KrisJenn”), and Moore owned 50% through SCMED Oilfield Consulting, LLC (“SCMED”), an entity owned by Moore. Moore and Wright also served as managers of Black Duck, along with Wright’s son-in-law, Hagan Cohle. Black Duck obtained an assignment of the right to purchase a pipeline right-of-way (ROW), and, after a long and convoluted process to find a buyer or developer, Wright and KrisJenn lent several million dollars to Black Duck to complete the purchase of the ROW. Later, Moore claimed that he was never informed of the loan and that he never authorized the loan as a then-manager of Black Duck. This opinion addressed various claims and counterclaims between and among Wright, Moore, and certain other parties, including a claim by Moore and SCMED against Wright for breach of fiduciary duty based on the allegedly unauthorized loan. Moore argued that KrisJenn’s loan to Black Duck to fund the purchase of the ROW was an unauthorized loan under Black Duck’s company agreement because it was executed without Moore’s consent, and that the loan was for Wright’s own benefit in violation of Wright’s fiduciary duties to Moore and SCMED.

After analyzing the meaning of provisions in agreements entered into by Black Duck in two different transactions obligating Black Duck to pay 20% of the net-profits received from the operation, use, maintenance, or sale of the pipeline, the court concluded that the net-profits interests were net-profits interests in Black Duck that constituted personal property and did not attach and run with the ROW. This threshold issue impacted several other claims in the case, including damages sought by Moore in connection with his breach-of-fiduciary-duty claim.

The court began its analysis of Moore’s breach-of-fiduciary-duty claim by noting that “[t]he Texas Business Organizations Code does not define or specify whether manager or member fiduciary duties exist in the context of limited liability companies.” Moore asserted that Wright, as a manager of Black Duck, owed fiduciary duties to Moore and SCMED, including duties of care, loyalty, disclosure, and a duty to refrain from self-dealing. The court concluded that, at a minimum, Wright owed Moore an informal fiduciary duty, reasoning as follows:

Texas courts recognize formal and informal fiduciary relationships. *Crim Truck & Tractor Co. v. Navistar Int’l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992). In the absence of a formal fiduciary duty, members and managers of an entity may owe informal fiduciary duties to one another. *See Bazan v. Muñoz*, 444 S.W.3d 110, 118 (Tex. App.—San Antonio 2014, no pet.). For example, Texas courts have held that “the nature of the relationships between shareholders in a limited liability company sometimes gives rise to an informal fiduciary relationship between them.” *Id.* Wright does not dispute that he owed fiduciary duties to SCMED and Moore as co-participants in Black Duck, and the Court finds that at least an informal fiduciary relationship

existed between Wright, SCMED, and Moore based on their past dealings and the personal relationship of trust and confidence between Wright and Moore.

The court next stated that whether Wright breached his fiduciary duty depended on whether the loan to Black Duck was authorized under the terms of its company agreement. Section 4.05 of the Company Agreement stated:

If the Company does not have sufficient cash to pay its obligations, any Member(s) that may agree to do so with the Managers' consent may advance all or part of the needed funds to or on behalf of the Company. An advance described in this Section 4.05 constitutes a loan from the Member to the Company ... and is not a Capital Contribution.

In addition, Section 6.10 of the company agreement required transactions between the LLC and an "Interested Person," including KrisJenn, to be authorized "in good faith by the affirmative vote of the disinterested Management, even though the Persons constituting the disinterested Management is less than a quorum." That section further provided that "[t]he contract or transaction must be specifically approved in good faith by the Management." Thus, as a member of Black Duck, KrisJenn had authority under the company agreement to make a loan to Black Duck only with Moore's consent in his capacity as a manager.

Wright argued that Moore's consent was either not necessary to execute the loan to Black Duck, or consent was obtained through an email from Moore in which Moore gave Wright and Cohle full authority to sign on his behalf. The email relied upon by Wright was sent by Moore when he was not available in-person to sign one specific agreement relating to the extension of the ROW purchase closing date. At the time, Moore was in the process of moving his family to North Carolina, so Cohle signed the closing extension agreement on Moore's behalf. Wright and Cohle signed a broadly-worded Consent of Members and Managers of Black Duck in lieu of a meeting that authorized "two of the three managers of [Black Duck] ... to execute certain agreements and documents relating to the matter or matters described on Exhibit A ... without the joinder of FRANK D. (Daniel) MOORE." Moore argued that he never intended his email consent, which was limited in scope to the closing extension agreement, to allow the other managers, Wright and Cohle, to approve the loan to Black Duck Loan on his behalf. Moore also argued that he was not given notice of this "fake board meeting" and was never asked to provide written authorization of proxy to approve the loan to Black Duck.

The court noted that Moore was likely aware that the purchase of the ROW would be accomplished through borrowed funds, but the company agreement treated all advances from its members as loans, and loans to Black Duck and conflict-of-interest transactions required the affirmative vote and consent of Moore. Because Wright did not obtain Moore's consent or specific approval to approve the Black Duck Loan, the loan to Black Duck was not authorized under the terms of the company agreement, and the court found that Moore's email allowing his consent by proxy to approve a closing-date extension did not establish Moore's specific approval of the loan to Black Duck. The court thus concluded that Wright breached his informal fiduciary duty to Moore, but Moore's damage model depended on the assumption that the net profits interests at issue in the case were valid covenants running with the land, and the court's rejection of that proposition precluded Moore's recovery of damages.

Because the Black Duck Loan was not properly authorized, Wright breached his informal fiduciary duty owed to Moore. Wright entered into an ultra vires and conflicted loan transaction without Moore's required consent. While Moore is entitled to assert his legal rights, as he did here, he must prove that he is entitled to an award of damages. Moore seeks actual damages of \$2.28 million for these alleged breaches. The damages model assumes that the Assignment Agreements contain covenants running with the land. Because the Assignment Agreements do not contain valid covenants running with the land, this model for damages is inapposite. Moore did not prove any other calculation for damages resulting from Wright's breach of fiduciary duty. As such, the Court finds that Moore is not entitled to an award of actual damages.

*Global Consulting and Mechanical Services, LLC v. Austin*, No. 5:20cv88-RWS-CMC, 2020 WL 8267591 (E.D. Tex. Dec. 16, 2020), report and recommendation adopted, 2021 WL 603256 (E.D. Tex. Feb. 16, 2021).

The court denied an LLC's request for a preliminary injunction enjoining a former member from violating a covenant not to compete in the company agreement for the pendency of the suit because the LLC did not produce any evidence substantiating the inadequacy of monetary damages and thus did not demonstrate that the LLC would suffer irreparable harm.

Julius, Melanie, and Sebastian Smoak formed Global Consulting and Mechanical Services, LLC ("GCMS") in 2012. GCMS provided consulting and mechanical services for the power turbine industry. GCMS hired William Austin, a twenty-year industry veteran in 2014. Austin performed well as an employee, and the Smoaks admitted Austin as a member of GCMS in January 2017. Austin signed a unanimous written consent of the members by which he agreed to be bound by all covenants, terms, and conditions of GCMS's company agreement.

Paragraph 26 of the company agreement included the following covenant not to compete:

No Member or Manager will engage in any business, venture or transaction, whether directly or indirectly, that might be competitive with the business of the Company or that would be in direct conflict of interest to the Company. Any potential conflicts of interest will be deemed an Involuntary Withdrawal of the offending Member or Manager and may be treated accordingly by the remaining Members. A withdrawing Member or Manager will not carry on a similar business to the business of the Company within any established or contemplated market regions of the Company for a period of at least 2 years after the date of withdrawal.

On December 28, 2019, Austin informed GCMS that he would resign as a GCMS member and employee effective December 31. Austin signed a consulting agreement with Hughes Technical Services, a GCMS customer, about three months later. GCMS believed that Austin solicited consulting services from several of its other clients as well.

GCMS sent Austin a notice letter informing him that he was violating the company agreement, had violated his fiduciary duty to GCMS and its members by using GCMS cash and other resources for Austin's personal use, and was dissociated as a member from the company. GCMS sent HTS a demand that it cease and desist from working with Austin. Austin and HTS continued working together, and GCMS filed suit against Austin for breach of contract, breach of fiduciary duty, tortious interference with a contract, and theft of trade secrets. After filing suit, GCMS moved for a preliminary injunction to enjoin Austin from violating the company agreement's non-compete clause for the pendency of its suit.

To obtain a preliminary injunction, the moving party must establish that it has a substantial likelihood for success on the merits, a substantial threat that it will suffer irreparable harm if the injunction is not issued, that the threat of that harm outweighs any harm the defendant will suffer if the injunction is issued, and that issuing the injunction will not disserve the public interest. Austin argued that GCMS was unlikely to succeed on the merits of its claim because the non-compete clause was unreasonable and unenforceable. Further, Austin argued that even if the non-compete clause was enforceable, GCMS would not suffer irreparable harm as any damages could be redressed with monetary damages.

The court first provided an overview of non-compete covenants under Texas law. Section 15.50 of the Texas Business and Commerce Code provides two threshold requirements that an enforceable non-compete covenant must meet. First, the parties must have an enforceable agreement in existence when they enter the non-compete covenant. The non-compete covenant must be ancillary to, or part of, that otherwise enforceable agreement. Second, the non-compete clause must contain reasonable limitations as to time, scope of proscribed conduct, and geographic area. Should the court find the non-compete covenant unreasonable, it must reform the covenant so as to render it reasonable. In addition, a party seeking to enforce a non-compete covenant through a preliminary injunction must meet all the requirements for a preliminary injunction. Noting that the parties did not address the issue, the court assumed for purposes of the preliminary injunction analysis that GCMS made a prima facie showing that paragraph 26 of the company agreement meets the threshold requirement of being "ancillary to or part of an otherwise enforceable agreement." The court indicated that the non-compete provision at issue was overly broad but did not reach the question of whether the provision was unenforceable or was subject to reformation:

Titled Duty of Loyalty, Paragraph 26, as written, is overbroad in certain respects. The third sentence of [sic] provides that no Member or Manager leaving GCMS will “carry on a similar business to the business of [GCMS] within any established or contemplated market regions of [GCMS] for a period of at least 2 years after the date of the withdrawal.” The Court, however, at this preliminary stage need not reach the question of whether Paragraph 26’s overbreadth makes it unenforceable in its entirety or whether it can and should be enforced as reformed ... because GCMS has failed to meet its high burden to satisfy the other elements of proof necessary for the extraordinary relief of a preliminary injunction.

The court next addressed the requirement that a party requesting a preliminary injunction show irreparable harm. GCMS argued that Austin’s competition posed a threat to GCMS’s industry goodwill. Austin countered that any injuries GCMS suffered from his future employment were remote and speculative and that if GCMS were injured by Austin’s future employment, the court could simply award GCMS monetary damages following a trial. The court held that GCMS failed to carry its burden of demonstrating irreparable harm. The court noted that mere speculation about a possible loss of market share was insufficient evidence of irreparable harm. The court determined that GCMS failed to produce any evidence substantiating the inadequacy of monetary damages. Thus, the court concluded that GCMS would not be entitled to a preliminary injunction even if the court had determined the covenant not to compete was enforceable, reformed or otherwise.

The court also concluded that GCMS failed to establish the other two requirements for a preliminary injunction, i.e., that the threatened injury outweighed any harm that may result from the injunction and that a preliminary injunction would serve the public interest.

***Patterson Midstream Services, LLC v. Five Point Energy, LLC***, No. 01-19-00643-CV, 2020 WL 7213348 (Tex. App.—Houston [1st Dist.] Dec. 8, 2020, no pet. h.) (mem. op.).

The court of appeals held that, under Delaware law, the implied duty of good faith and fair dealing cannot imply a covenant not to usurp company opportunities when the LLC’s operating agreement explicitly disclaims the duty.

Marty Patterson and Patterson Midstream Services, LLC (collectively, “Patterson”), minority members of Redwood Midstream Partners, LLC (“Redwood”), sued the majority member and its related entities, Five Point Capital Midstream Funds, I and II, L.P., their manager, Five Point Energy LLC, David N. Capobianco, and Matthew Morrow (collectively, “Five Point”), alleging breach of Redwood’s operating agreement, or, alternatively, if there is no enforceable contract, fraud, unjust enrichment, quantum meruit, and conversion. Five Point is a private equity firm specializing in the midstream segment of the oil-and-gas industry. Five Point invests through two entities, Five Point Capital Midstream Funds I & II. David Capobianco and Matthew Morrow are Five Point’s managing partners. Marty Patterson has worked for several decades in the energy industry—mostly in the midstream segment—and is the sole owner of Patterson Midstream Services, LLC. In 2013, Five Point and Patterson formed Redwood, a Delaware limited liability company, to operate midstream energy assets.

The operating agreement of Redwood contained two provisions relevant to this dispute: Article 2.11, entitled “Limited Duty of Loyalty,” and Article 4.1, entitled “Limitation of Liability.”

Article 2.11 stated:

Each Member acknowledges that the Five Point Member and its Associates are free to engage or invest in an unlimited number of other activities or businesses, any one or more of which may be related to or competitive with the Business, without having or incurring any obligation under this Agreement to offer any interest in such activities to Company or any Member and neither this Agreement nor any activity undertaken pursuant to this Agreement shall prevent the Five Point Member or its Affiliates from engaging in such activities, or require the Five Point Member to permit Company or any Member or its Affiliates to participate in any such activities, and as a material part of the consideration for the execution of this Agreement by the Five Point Member, each other Member hereby waives, relinquishes, and renounces any such right or claim of participation under this Agreement.

Article 4.1 provided in pertinent part:

To the fullest extent permitted by the Act, no Member, Manager or Officer shall be personally liable to the Company, the other Members, or any other Person for any loss, damages, or claims arising out of or incurred by reason of any act or omission by such Member, Manager, or Officer (including any loss, damages, or claims based on the proposition that such Member, Manager, or Officer owes any fiduciary or other duties to any Person); provided, however, this Section 4.1 shall not limit the liability of a Member, Manager, or Officer for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. Except for the duties expressly set forth in this Agreement, a Member, Manager, or Officer shall not be subject to any duties (including fiduciary duties) with respect to the management of [the] Company.

Between 2014 and 2018, Five Point acquired interests in four businesses. Redwood was not a party to any of these investment opportunities although Patterson claimed that it identified these investment opportunities for Five Point. Patterson brought suit, primarily asserting a claim for breach of contract, specifically breach of the implied duty of good faith and fair dealing under Delaware law. Alternatively—in the event that there was no enforceable contract—Patterson asserted extra-contractual claims for fraud, unjust enrichment, conversion, and quantum meruit. Patterson argued that, while Five Point was “free to invest in their own separate deals apart from Redwood, [ ] they were not to be allowed to steal from [Patterson] their share in the upside on deals Patterson and Patterson LLC sourced for investment[.]” In other words, Patterson alleged that all investment opportunities that it “found, identified, and targeted” belonged to Redwood and that Five Point breached its duty of good faith and fair dealing by usurping those opportunities.

Five Point moved to dismiss Patterson’s claims under Tex. R. Civ. P. 91a, arguing that Patterson’s petition did not provide a legal basis upon which a court could grant relief. After a non-evidentiary hearing, the trial court granted Five Point’s motion to dismiss. Patterson appealed.

Patterson asserted that Redwood’s operating agreement included an implied covenant that Five Point would only invest through Redwood in opportunities identified by Patterson. Five Point responded that no such implied covenant could exist in light of Article 2.11’s limitation on the duty of loyalty.

First, the court recognized that under Delaware law, the implied covenant of good faith and fair dealing is best understood as a gap filler used to analyze unanticipated developments. As a gap filler, the court reasoned that a party could not use the implied duty of good faith and fair dealing to either circumvent the parties’ agreement or create a free-floating duty independent of the operating agreement.

The court determined that the operating agreement unequivocally allowed Five Point to invest in opportunities identified by Patterson without offering Redwood the chance to participate. The court reasoned that, even assuming that the investment opportunities constituted Redwood’s business, they were also an “activity taken pursuant to the Agreement.” Article 2.11 explicitly allowed Five Point to participate in these activities without incurring any contractual duty to either Redwood or Patterson. As a result, there was no “gap” for the duty of good faith and fair dealing to fill.

Additionally, the court stated that Patterson was attempting to use the implied duty of good faith and fair dealing to create a fiduciary duty for Five Point not to usurp Redwood’s investment opportunities. However, section 4.1.2 of the Amended Operating Agreement expressly provided that the contract “does not, create or impose any fiduciary duty on any Member, Manager, or Officer” and that “the duties and obligations of each Member, Manager, or Officer to each other and to [Redwood] are only as expressly set forth in this Agreement.” The court thus concluded that Patterson could not use the implied duty of good faith and fair dealing to recreate a fiduciary duty that was explicitly waived in the contract.

Finally, Patterson urged the court to consider letter agreements predating the operating agreement to determine whether the operating agreement was ambiguous about Five Point’s right to invest in opportunities “identified” by Patterson without offering Redwood the right to participate in the investment. Patterson argued that the court should consider the parties’ prior writings because they were consistent with the parties’ ultimate written contract, and parol evidence can be used to show a prior or contemporaneous agreement that is both collateral to and consistent with a binding agreement, even if the final agreement has a merger clause. The court concluded that the prior letter agreements were not collateral agreements because they addressed the same subject as the operating agreement, and, to the extent that Patterson claimed the letters indicated that the operating agreement was intended to give it the right to participate, through Redwood, in all investments that Patterson identified, the prior agreements



would be inconsistent with the operating agreement. Thus, under both Texas and Delaware law, parol evidence was not admissible to vary the terms of the parties' integrated contract.

After concluding that Patterson's breach-of-contract claim was properly dismissed because the operating agreement permitted the conduct complained of by Patterson in its petition, the court turned to the extra-contractual claims.

Patterson's fraud claim was that it was induced to enter the operating agreement because Five Point fraudulently led it to believe that all investments Patterson sourced would be placed with Redwood in the event that Five Point chose to invest. Because the representations on which Patterson claimed to rely were directly contradicted by the express, unambiguous provisions of the operating agreement—which allowed Five Point to “engage or invest in an unlimited number of other activities or businesses, any one or more of which may be related to or competitive with the Business, without having or incurring any obligation under this Agreement to offer any interest in such activities to [Redwood]”—the court concluded that Patterson could not, as a matter of law, show that its reliance on such representations was justified. Thus, the court held that the trial court properly dismissed Patterson's fraudulent inducement claim.

Patterson also sought imposition of a constructive trust to prevent Five Point from being unjustly enriched and further alleged that “[if] [Patterson is] not protected by specific contract rights, [it] should be awarded an amount equal to such reasonable value based on quantum meruit.” Five Point asserted that no claim for unjust enrichment or quantum meruit will lie when a valid contract between the parties governs the subject matter of the claim, and the court agreed with Five Point.

Finally, the court also agreed with Five Point that Patterson's conversion claim was properly dismissed by the trial court. Patterson sought “to recover damages from [Five Point] for converting to themselves [Patterson's] entitlement to share in distributions from the investment targets that Patterson identified ... and that became investments that [Five Point] carries under the aegis of the Five Point Funds.” Five Point argued that the unspecified distributions that Patterson alleged it was owed did not support a conversion claim. The court stated that money is subject to conversion only when it can be identified as a specific chattel and not if it is an indebtedness that can be discharged by the payment of money. The court agreed with Five Point that Patterson's argument that it was owed a “share in distributions from the investment targets that Patterson identified” was a claim for an indebtedness that could be discharged by the payment of money and not “specific chattel.”

*CyberX Group, LLC v. Pearson*, Civ. A. No. 3:20-CV-2501-B, 2020 WL 5500236 (N.D. Tex. Sept. 11, 2020).

The court denied the plaintiffs' motion for temporary restraining order on the ground that the plaintiffs failed to demonstrate a substantial likelihood of success on the merits of their claims.

Defendant Christopher Pearson established CyberX, LLC (“CyberX”) in 2013 to develop and market software for multi-level-marketing (“MLM”) companies. At least until 2017, Pearson was the sole owner of CyberX. In early 2017, Plaintiff David Lindsey entered into a relationship with Pearson and CyberX wherein Lindsey's healthcare companies, Agentra, LLC and MyHealthPass, LLC, issued monthly payments to CyberX in amounts between \$11,000 and \$30,000. In return, CyberX modified its MLM software to fit the needs of healthcare services and provided the software to Agentra and MyHealthPass.

In January 2018, Pearson emailed Lindsey, expressing his desire to form a separate entity, CXG, with ownership to be split 70/20/10, respectively, between Lindsey, Pearson, and Troy Van Zile—an Agentra employee involved with the software development at CyberX. On March 22, 2018, Pearson and Lindsey signed a handwritten agreement on a single sheet of paper (the “March 22 Agreement”), indicating the ownership division of CXG and seemingly designating Pearson as the sole owner of CyberX. On July 10, 2018, Lindsey, Pearson, and Van Zile executed a more formal and detailed “Company Agreement of CyberX Group LLC” (“Company Agreement”). Section 3.6(B) of the Company Agreement provided that “[e]ach Member shall hold in strict confidence any information that it receives concerning [CXG] that is identified as being confidential (and if that information is provided in writing, that is so marked) and may not disclose it to any Person other than another Member, except for [exceptions listed]. Section 4.12 of the Company Agreement provided that “each Manager, Member and officer of [CXG] at any time and from time to time may engage in and possess interests in other business ventures of any and every type and description, independently or with others, save and except for ones in competition with [CXG], with no obligation to offer to [CXG] or any other Member, Manager, or officer the right to participate therein.”

Pearson served as CXG's president for two years after CXG's formation. During his time as president, Pearson oversaw the development of software, culminating in a product that Plaintiffs refer to as "Healthcare 212." CXG executed two contracts to provide this software to American Workers Insurance Services, Inc. ("AWIS") and Coterie Advisory Group, Inc. ("Coterie").

After the success of Healthcare 212, Lindsey and Pearson planned for development of a second version ("HC 2.0"), which was originally promised to Lindsey by Fall 2019. Pearson did not deliver HC 2.0. According to Plaintiffs, Pearson was not working on HC 2.0, but was instead developing new MLM software for CyberX based on the ideas and designs that had been developed for Healthcare 212. Defendants contend, however, that Pearson did not deliver HC 2.0 because Lindsey failed to fund the project as promised. According to Defendants, CXG was in such financial distress that it had terminated all of its employees by the middle of 2020. The relationship between Lindsey and Pearson soured and they decided to part ways.

Subsequently, Pearson and CyberX, through their attorney, delivered a letter on August 10, 2020 (the "August 10 Letter"), claiming sole ownership of any software developed during the existence of CXG and urging CXG to release AWIS and Coterie from their contracts with CXG. The relevant portion of the August 10 Letter stated: "[CyberX and Pearson] anticipate that AWIS and Coterie will eventually decide to transition to a contract with [CyberX and Pearson] simply because they will eventually need assistance that [CXG and Lindsey] do not have the expertise to provide. We do not want to reach a deal with [AWIS and Coterie] only for a dispute to arise.... [Releasing AWIS and Coterie] will leave AWIS and Coterie free to immediately terminate their contracts with [CXG] during the period if they wish, or to stay with [CXG] if they prefer."

In response, Lindsey and CXG commenced a lawsuit against Pearson and CyberX. They also filed a motion for a TRO on August 25, 2020, seeking, in essence, to prohibit Defendants from (1) disclosing CXG's trade secrets; (2) transferring or licensing CXG's intellectual property; (3) accessing or modifying CXG's software or other intellectual property; (4) soliciting CXG's clients; (5) directly competing with CXG; (6) entering or removing any personal property from CXG's offices; and (7) accessing CXG's bank account.

The court denied the motion for a TRO. It first rejected Plaintiffs' request for a declaratory judgment that "all intellectual property relating to the Healthcare Platform, including all copyrights, trade secrets, trademarks, documents, and works in progress are the sole property of CXG." Plaintiffs argued that CXG's ownership originated from Lindsey's ownership interest in CyberX and its software assets, as well as from CXG's independent ownership of software developed after CXG's formation. The court disagreed:

First, Plaintiffs claim that Lindsey owns the intellectual property developed by CyberX because Pearson transferred a fifty-percent ownership interest in CyberX to Lindsey in exchange for Lindsey's financial support or, alternatively, because Lindsey owns fifty percent of the healthcare software developed since his relationship with CyberX commenced. Plaintiffs' only support for Lindsey's purported ownership are the payments made by Lindsey's company, Agentra, to CyberX, as well as a January 9, 2017, email wherein Pearson states to Lindsey, "I am on board in terms of 50% in CyberX in exchange for a set agreement dependent upon the terms of the contract we make with CyberX & My Health Pass."

In response, Defendants assert that CyberX's relationship with Lindsey was not a partnership, but simply a service agreement wherein CyberX modified its software to fit Agentra's and MyHealthPass's needs, licensed software to the companies, and received monthly payments in return. As evidence of this agreement, Defendants point to similar service contracts between CyberX and its other clients, as well as the monthly invoices issued by CyberX to Agentra and Lindsey. Regarding the January 9, 2017, email, Defendants claim that Pearson's statement was merely made during negotiations for an "agreement that never came to fruition" and deny that any transfer of interest ever occurred. Lastly, Defendants point to the March 22 Agreement that seemingly designates Pearson as the sole owner of CyberX. Absent additional evidence that demonstrates a voluntary transfer of ownership, the Court is satisfied with Defendant's explanation and does not find that Plaintiffs have shown a likelihood of establishing Lindsey's ownership of CyberX or its software.

Second, Plaintiffs claim that CXG owns the intellectual property of the healthcare software developed since CXG's formation. Plaintiffs assert that any software developed by CXG employees, including Pearson, belongs to CXG as "works made for hire" under the Copyright Act

of 1976. Pursuant to the Copyright Act, an employer owns the copyright in “a work prepared by an employee within the scope of his or her employment[.]” 17 U.S.C. §§ 101, 201(b).

The parties dispute the nature of CXG’s business. While Plaintiffs claim that CXG was created as “primarily a technology development company,” Defendants contend that CXG was created as a “middleman or agent for the sale of [CyberX] services to the insurance industry” and that CXG is engaged in marketing, but not developing, software. In support of their claim that CXG is a development company, Plaintiffs point to Pearson’s statement that CXG “create[s] custom software solutions” and an email to a programming team in India, where Pearson states, “[CXG] owns the software[.]” Plaintiffs’ evidence does not demonstrate a substantial likelihood that CXG is a technology development company rather than a marketing company for CyberX. First, Pearson’s statement that CXG “create[s] custom software solutions” is ambiguous and could be interpreted multiple ways. A “software solution” could be actual software development, but could also be a service connecting clients with software providers. Second, Pearson’s email to the India programming team does not provide context for his statement and does not indicate to which “software” it refers. The email’s purpose could simply have been to inform its recipients that the India programming team would not own the software it was helping to develop. If CXG is purely a marketing company, then software development is not within the scope of CXG employment and CXG cannot claim copyright ownership over the software as a work made for hire.

Based on the evidence at hand, Plaintiffs are unlikely to prevail in their request for declaratory judgment. Plaintiffs have not sufficiently shown that any voluntary transfer of ownership ever occurred or that CXG was a software development company rather than a software marketing company. This claim, therefore, may not serve as the basis for a TRO.

The court then turned to Plaintiffs’ contention that they were likely to succeed on their breach of contract claim for violations of sections 3.6 and 4.2 of the Company Agreement. The court disagreed with Plaintiffs’ estimates of their chances of success:

First, Plaintiffs claim that Pearson violated the confidentiality provision, Section 3.6(B) .... Plaintiffs claim that “[b]y asserting dominion over, among other things, CXG’s trade secret assets, it is clear that [Defendants] intend to disclose or license those secrets to third parties[.]” Plaintiffs do not, however, indicate which trade secrets, aside from intellectual property in the software—over which Plaintiffs have not established ownership—are at risk of wrongful disclosure. Moreover, Plaintiffs do not allege that any at-risk trade secrets were identified as being confidential as required by Section 3.6(B). At the hearing, Plaintiffs pointed to a boilerplate “Confidentiality Notice” found at the end of CXG emails, which states that the email message and attachments “may contain confidential and privileged information.” This evidence does little to bolster Plaintiff’s claim that Pearson breached Section 3.6(B), as Plaintiffs have not shown that Pearson disclosed these emails or their attachments to a third party. Accordingly, Plaintiffs have not demonstrated a substantial likelihood of success on their claim for breach of Section 3.6(B).

Second, Plaintiffs claim that Pearson violated Section 4.12, which prohibits members from engaging in other business ventures in competition with CXG. As the sole evidence of Pearson’s breach, Plaintiffs point to the August 10 Letter from Defendants’ attorney, interpreting the letter as “Pearson’s stated intention to co-opt CXG’s current clients[.]” This intent is not apparent from the letter itself. To the contrary, the letter expressly states that Defendants wish to avoid conducting business with AWIS and Coterie in a way that would lead to a dispute with CXG. At the hearing, Defendants explained that this letter was intended to advise CXG to release AWIS and Coterie from their contracts because, from Defendants perspective, CXG could not meet its clients’ needs without Pearson and CyberX. Plaintiffs do not provide any other evidence of Defendants’ intent to solicit CXG’s clients. Accordingly, Plaintiffs have not demonstrated a breach of Section 4.12. Plaintiffs, thus, are unlikely to succeed on their claim for breach of contract.

Finally, Plaintiffs claimed that Pearson breached his fiduciary duty to CXG. The court noted that “[u]nder Texas law, a formal fiduciary relationship exists between a principal and its agent.” It observed that “[w]hen a

fiduciary relationship exists, the employee has a duty to act primarily for the benefit of the employer, not to compete against the employer in matters connected with her employment, and to deal fairly with the employer in all transactions between them.” Plaintiffs alleged that Pearson served as CXG’s president and that, as president, he owed CXG a fiduciary duty that he ultimately breached because “he has not dealt fairly with the company, has competed with the company in its primary business, and has misappropriated company assets.” The court concluded that while Plaintiffs may have demonstrated the existence of a fiduciary duty, they offered little evidence to show that Pearson breached his duty:

Plaintiffs do not allege any unfair dealings other than Pearson’s alleged wrongful competition with CXG and misappropriation of CXG assets. As evidence for his wrongful competition with CXG, Plaintiffs again point to the August 10 Letter. As previously discussed, this letter does not sufficiently demonstrate that Pearson competed with, or intends to compete with, CXG. Additionally, Plaintiffs have not successfully demonstrated that Pearson misappropriated CXG’s assets. The allegedly misappropriated assets are the intellectual property in the software as well as payments made from CXG to CyberX, which Defendants claim were agreed-upon service fees. As discussed, Plaintiffs have not sufficiently demonstrated that CXG owns the software and, therefore, Pearson’s use cannot be considered misappropriation. Further, as discussed, Plaintiffs have not shown that CXG was a development company rather than a marketing company that paid CyberX a fee to sell CyberX’s software. If CXG is a marketing company, then the service payments to CyberX would not have been misappropriated. Plaintiffs, therefore, cannot sufficiently demonstrate that Pearson has misappropriated any of CXG’s assets, competed with CXG, or otherwise breached his fiduciary duty.

In sum, Lindsey and CXG have not established a likelihood of success on the merits of any claim. First, there is insufficient evidence to succeed on Plaintiffs’ claim of ownership in the intellectual property related to the software at issue. Second, Plaintiffs fail to demonstrate that Pearson breached the Company Agreement and thus cannot likely succeed on their breach-of-contract claim. Lastly, Plaintiffs have not demonstrated that they are likely to succeed on their claim for breach of fiduciary duty.

## 2. Financial Rights

*Infinity Emergency Management Group, LLC v. Neighbors Health System, Inc. (In re Neighbors Legacy Holdings, Inc.)*, \_\_ B.R. \_\_, 2021 WL 1042867 (Bankr. S.D. Tex. 2021).

This case involved a complicated structure (which the court characterized as “convoluted”) involving multiple entities, including “series LLCs.” The Trustee of the Debtors’ Unsecured Creditor Trust challenged the standing of Infinity Emergency Management Group, LLC (“Infinity”) to bring derivative claims, asserting that Infinity’s claims sought relief for harm to debtor entities and thus belonged to the Unsecured Creditor Trust. Infinity maintained that its claims sought redress only on behalf of two “series LLCs,” which were non-debtor entities (although the LLC that apparently created the series was a debtor entity). The bankruptcy court concluded that some of Infinity’s claims alleged harm to debtor limited partnerships and that Infinity lacked standing as to those claims. In order to assert the remaining claims, the court concluded that Infinity would need to re-plead to make clear that the alleged harms were suffered by the series LLCs in which Infinity held interests.

The dispute in this case revolved around two of 22 free-standing emergency centers that were operated by debtor Neighbors Legacy Holdings, Inc. and its subsidiaries and affiliates (the “Neighbors Network”). Each emergency center was owned by a separate limited partnership, and each limited partnership had a 1% general partner—Neighbors GP, LLC—and a 99% limited partner—NHS Emergency Centers, LLC (“NHS”). The court stated that “NHS established individual series LLCs to operate (but not to own) each emergency center,” and “each series LLC was owned by two classes of shareholders.” According to the court, “[t]he Class A owners of each series LLC were to be founding members of the Neighbors Network,” and “[t]he Class B owners of each series LLC were physicians that ‘purchased interests in [the] profits and losses [of a] specific series LLC[ ]. ... The management and administration of each emergency center, as well as the entities associated with each center, was carried out by five other Neighbors Network affiliates.’”

The court further described the structure of the two emergency centers involved in this dispute as follows:

Those emergency centers are NEC Eastside Emergency Center, LP and NEC Zaragoza Emergency Center, LP (together, the “Center LPs”). NHS, a Debtor entity, was the sole limited partner of both Center LPs. (ECF Nos. 59-24 at 2, 10; 61-13 at 2, 10). Each Center LP is a Debtor. (ECF No. 80 at 8–9). The series LLCs associated with the Center LPs were Series 114 – Eastside, LLC and Series 115 – Zaragoza, LLC (together, the “Series LLCs”). Neither Series LLC is a Debtor. (ECF No. 80 at 8–9). The Class A shareholder of each Series LLC was Neighbors Investment, which held a 34% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). The Class B shareholder was Infinity, which held a 65% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Investment and Infinity were the sole members of the Series LLCs. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Health provided management and administrative services to the Center LPs, the Series LLCs, and NHS. (ECF Nos. 62-12; 59-29; 59-10; 62-10; 62-24).

In practical terms, the emergency centers were “brick and mortar” stores for the Neighbors Network. The Center LPs were created to own these stores. To that end, the Center LPs provided facilities for Neighbors Network physicians, who provided healthcare services to patients and generated revenue through provision of these services. NHS was created to hold the majority ownership stake in the Center LPs. NHS created the Series LLCs to oversee the day-to-day operations of the Center LPs. While the Series LLCs were created to “operate” the Center LPs, the management and administration of the Center LPs—the “nuts and bolts” of day-to-day operations—was entrusted to Neighbors Health (a Debtor entity). Infinity, a member of the Series LLCs, was supposed to provide physicians to staff the emergency centers in exchange for a cut of the revenue generated by the “brick and mortar” centers. Perhaps inevitably, this convoluted structure produced litigation over which entity or successor could sue for the alleged mismanagement of the Center LPs.

The court next described the process by which Infinity invested in this arrangement and highlighted certain provisions of the series agreements executed by Infinity as well as the NHS operating agreement and the Center LP limited partnership agreements.

The court characterized the “6500 Class B shares in the Series LLCs” as “ownership interests” that “were offered by NHS,” and the court stated that Infinity acquired a “65% interest in both Series LLCs,” each of which was created for the purpose of operating its corresponding free-standing emergency center. Infinity purchased its interests pursuant to two identical “Series Purchase Agreements,” each of which reserved the profits and losses of the relevant emergency center for the corresponding series owners. The purchase agreements required Infinity to provide clinical staffing for the emergency centers, but the clinical staff members were to be employed as independent contractors of a specified Neighbors PLLC rather than as employees of the Series LLCs or any other Neighbors Network affiliate.

The “Series Agreements” executed by Infinity described the basic structure of the Series LLCs and identified the property associated with each Series LLC. Under the series agreements, Infinity acknowledged that the Series LLCs were created to operate the “Series Business[es],” which were the Center LPs. The Series LLCs were to receive “profits, losses, distributions, and other benefits received by NHS” from the Center LPs, and these “profits, losses, [etc.]” were identified as “Series Property.” Infinity was entitled to receive distributions derived from the Series Property, and Neighbors Health—the manager of the Series LLCs—was responsible for making these distributions.

Along with the series agreements, the NHS Operating Agreement defined the Series Property from which Infinity was to receive distributions. The Series LLCs were established by the NHS Operating Agreement, under which NHS was authorized to acquire interests in Texas limited partnerships. NHS was to “allocate or attribute” the “profits, losses, distributions, and allocations” from the limited partnerships to the Series LLCs. Once received or “determined” by NHS, the “profits, losses, distributions, and allocations” from the limited partnerships were considered Series Property.

Under the Center LP Limited Partnership Agreements, the “income, gain, loss, deduction, and credit of the Partnership[s]” were to be allocated 1% to Neighbors GP (the general partner of each Center LP) and 99% to NHS (the limited partner of each Center LP). Additionally, partnership revenues, which included all gross receipts of the partnership received by the partnership, were to be distributed to Neighbors GP and NHS in accordance with

their respective allocations. The Center LPs were the “Series Business[es]” from which NHS was supposed to receive the “profits, losses, distributions, and other benefits,” which were to be distributed to the Series LLCs.

Four years after Infinity purchased its interests in the Series LLCs, certain entities in the Neighbors Network filed for Chapter 11 relief. The Center LPs and the general and limited partners of the Center LPs, including NHS, were debtors. Neither Neighbors Investment (the Class A interest owner of the Series LLCs) nor the Series LLCs were debtors. [Interestingly, the court did not address whether the series should be included as debtors by virtue of NHS’s status as a debtor (since the series that were created by NHS would not actually be separate entities from NHS under Texas law).]

At issue in this case was whether Infinity could pursue derivative claims filed against Neighbors Health and Neighbors Health’s directors and officers or whether the claims belonged to the Unsecured Creditor Trust. Infinity asserted its claims on behalf of the Series LLCs based on alleged breaches of fiduciary duty, abuses of control, gross mismanagement, and waste of corporate assets by Neighbors Health and its officers and directors. The wrongs of which Infinity complained stemmed from the directors’ and officers’ alleged failure to “properly oversee the operations and finances of” the Series LLCs. Infinity based the derivative claims on the defendants’ actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; (3) limited partner shares of the Center LPs to be wrongly collateralized; (4) fees billed by the Center LPs to be held in Center LP accounts and never “pushed back” to the Series LLCs; (5) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; and (6) Series LLC funds to be transferred to other “unprofitable series entities.” Infinity asserted that these actions resulted in losses of revenue and profit to the Series LLCs, but the Creditor Trustee argued that the Center LPs, rather than the Series LLCs, suffered the harm alleged. The court stated that the core of the issue was which entity owned the profits that were diminished by the defendants’ alleged mismanagement. Infinity claimed that the non-debtor Series LLCs owned the business operations of the emergency centers and that it was thus the Series LLCs’ profits that were impaired by the mismanagement, but the Creditor Trustee contended that the Center LPs associated with the emergency centers owned the centers’ operations and suffered the loss of profits, thus vesting claims for redress in the debtor Center LPs.

The court discussed at length the “web of agreements” defining what the Series LLCs owned. Although Infinity contended that the agreements clearly established that the Series LLCs owned the emergency centers’ business operations, and, by implication, the profits from those business operations, the court agreed with the Creditor Trustee that the Series LLCs only had an interest in distributions from Center LP profits. According to the court, the agreements made clear that certain property identified in Infinity’s complaint was, at the time it was damaged, owned by the Center LPs. Because this alleged damage occurred while the property was owned by the Center LPs, the Trustee was vested with the exclusive right to seek redress for this damage. Specifically, Infinity did not have standing to seek redress for the defendants’ actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; and (3) fees billed by the Center LPs to be held in Center LP accounts and never “pushed back” to the Series LLCs.

The court concluded that it was unclear whether Infinity had a viable derivative claim based on the three remaining alleged harms, i.e., that the defendants caused: (1) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; (2) Series LLC funds to be transferred to other “unprofitable series entities;” and (3) limited partner shares of the Center LPs to be wrongly collateralized. As to the first two of these harms, Infinity’s complaint did not make clear whether the Series LLCs owned the physician fees and the funds that were allegedly wrongfully transferred. As to the claim that Center LP shares were wrongfully collateralized, Infinity’s failure to specify whether the defendants were acting as managers of the Series LLCs or of NHS was significant in that the series agreement contained a provision by which the members appeared to give NHS the right to encumber the Series Property, including Center LP shares acquired by NHS and allocated to the Series LLCs. Nevertheless, the court stated that Infinity might have a contractual claim based on the defendants’ “wrongful collateralization” based on the management agreement between the Series LLC and Neighbors Health, which restricted Neighbors Health’s ability to borrow money or execute promissory notes on the Series LLCs’ behalf. Because Infinity’s complaint did not make clear its standing to pursue these claims, the court stated that Infinity must re-plead its allegations as to these claims.

### 3. Authorization, Approval, or Consent Requirements

*KrisJenn Ranch, LLC v. DMA Properties, Inc. (In re KrisJenn Ranch, LLC)*, \_\_ B.R. \_\_, 2021 WL 1235411 (Bankr. W.D. Tex. 2021).

The court held that there was at least an informal fiduciary relationship between two individuals who were the managers and indirect owners of an LLC such that a loan by one of the individuals to the LLC without obtaining the approval of the other individual as required for a loan and conflict-of-interest transaction under the company agreement breached the fiduciary duty owed by the individual who made the loan. Because of a faulty assumption underlying the damages model, however, the court awarded no damages for the breach of fiduciary duty.

Larry Wright and Daniel Moore formed Black Duck Properties, LLC (“Black Duck”) to engage in the business of flipping saltwater disposal wells. Wright owned 50% of Black Duck through KrisJenn Ranch, LLC (“KrisJenn”), and Moore owned 50% through SCMED Oilfield Consulting, LLC (“SCMED”), an entity owned by Moore. Moore and Wright also served as managers of Black Duck, along with Wright’s son-in-law, Hagan Cohle. Black Duck obtained an assignment of the right to purchase a pipeline right-of-way (ROW), and, after a long and convoluted process to find a buyer or developer, Wright and KrisJenn lent several million dollars to Black Duck to complete the purchase of the ROW. Later, Moore claimed that he was never informed of the loan and that he never authorized the loan as a then-manager of Black Duck. This opinion addressed various claims and counterclaims between and among Wright, Moore, and certain other parties, including a claim by Moore and SCMED against Wright for breach of fiduciary duty based on the allegedly unauthorized loan. Moore argued that KrisJenn’s loan to Black Duck to fund the purchase of the ROW was an unauthorized loan under Black Duck’s company agreement because it was executed without Moore’s consent, and that the loan was for Wright’s own benefit in violation of Wright’s fiduciary duties to Moore and SCMED.

After analyzing the meaning of provisions in agreements entered into by Black Duck in two different transactions obligating Black Duck to pay 20% of the net-profits received from the operation, use, maintenance, or sale of the pipeline, the court concluded that the net-profits interests were net-profits interests in Black Duck that constituted personal property and did not attach and run with the ROW. This threshold issue impacted several other claims in the case, including damages sought by Moore in connection with his breach-of-fiduciary-duty claim.

The court began its analysis of Moore’s breach-of-fiduciary-duty claim by noting that “[t]he Texas Business Organizations Code does not define or specify whether manager or member fiduciary duties exist in the context of limited liability companies.” Moore asserted that Wright, as a manager of Black Duck, owed fiduciary duties to Moore and SCMED, including duties of care, loyalty, disclosure, and a duty to refrain from self-dealing. The court concluded that, at a minimum, Wright owed Moore an informal fiduciary duty, reasoning as follows:

Texas courts recognize formal and informal fiduciary relationships. *Crim Truck & Tractor Co. v. Navistar Int’l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992). In the absence of a formal fiduciary duty, members and managers of an entity may owe informal fiduciary duties to one another. *See Bazan v. Muñoz*, 444 S.W.3d 110, 118 (Tex. App.—San Antonio 2014, no pet.). For example, Texas courts have held that “the nature of the relationships between shareholders in a limited liability company sometimes gives rise to an informal fiduciary relationship between them.” *Id.* Wright does not dispute that he owed fiduciary duties to SCMED and Moore as co-participants in Black Duck, and the Court finds that at least an informal fiduciary relationship existed between Wright, SCMED, and Moore based on their past dealings and the personal relationship of trust and confidence between Wright and Moore.

The court next stated that whether Wright breached his fiduciary duty depended on whether the loan to Black Duck was authorized under the terms of its company agreement. Section 4.05 of the Company Agreement stated:

If the Company does not have sufficient cash to pay its obligations, any Member(s) that may agree to do so with the Managers’ consent may advance all or part of the needed funds to or on behalf of the Company. An advance described in this Section 4.05 constitutes a loan from the Member to the Company ... and is not a Capital Contribution.

In addition, Section 6.10 of the company agreement required transactions between the LLC and an “Interested Person,” including KrisJenn, to be authorized “in good faith by the affirmative vote of the disinterested Management, even though the Persons constituting the disinterested Management is less than a quorum.” That section further provided that “[t]he contract or transaction must be specifically approved in good faith by the Management.” Thus, as a member of Black Duck, KrisJenn had authority under the company agreement to make a loan to Black Duck only with Moore’s consent in his capacity as a manager.

Wright argued that Moore’s consent was either not necessary to execute the loan to Black Duck, or consent was obtained through an email from Moore in which Moore gave Wright and Cohle full authority to sign on his behalf. The email relied upon by Wright was sent by Moore when he was not available in-person to sign one specific agreement relating to the extension of the ROW purchase closing date. At the time, Moore was in the process of moving his family to North Carolina, so Cohle signed the closing extension agreement on Moore’s behalf. Wright and Cohle signed a broadly-worded Consent of Members and Managers of Black Duck in lieu of a meeting that authorized “two of the three managers of [Black Duck] ... to execute certain agreements and documents relating to the matter or matters described on Exhibit A ... without the joinder of FRANK D. (Daniel) MOORE.” Moore argued that he never intended his email consent, which was limited in scope to the closing extension agreement, to allow the other managers, Wright and Cohle, to approve the loan to Black Duck Loan on his behalf. Moore also argued that he was not given notice of this “fake board meeting” and was never asked to provide written authorization of proxy to approve the loan to Black Duck.

The court noted that Moore was likely aware that the purchase of the ROW would be accomplished through borrowed funds, but the company agreement treated all advances from its members as loans, and loans to Black Duck and conflict-of-interest transactions required the affirmative vote and consent of Moore. Because Wright did not obtain Moore’s consent or specific approval to approve the Black Duck Loan, the loan to Black Duck was not authorized under the terms of the company agreement, and the court found that Moore’s email allowing his consent by proxy to approve a closing-date extension did not establish Moore’s specific approval of the loan to Black Duck. The court thus concluded that Wright breached his informal fiduciary duty to Moore, but Moore’s damage model depended on the assumption that the net profits interests at issue in the case were valid covenants running with the land, and the court’s rejection of that proposition precluded Moore’s recovery of damages.

Because the Black Duck Loan was not properly authorized, Wright breached his informal fiduciary duty owed to Moore. Wright entered into an ultra vires and conflicted loan transaction without Moore’s required consent. While Moore is entitled to assert his legal rights, as he did here, he must prove that he is entitled to an award of damages. Moore seeks actual damages of \$2.28 million for these alleged breaches. The damages model assumes that the Assignment Agreements contain covenants running with the land. Because the Assignment Agreements do not contain valid covenants running with the land, this model for damages is inapposite. Moore did not prove any other calculation for damages resulting from Wright’s breach of fiduciary duty. As such, the Court finds that Moore is not entitled to an award of actual damages.

#### **4. Assignment of Membership Interest**

*Villareal v. Saenz*, 5-20-CV-00571-OLG-RBF, 2021 WL 1986831 (W.D. Tex. May 18, 2021).

The court held that a broad release executed by two members of an LLC and the LLC in connection with one member’s buyout of the other member’s membership interest barred claims by the LLC and purchasing member against the selling member for breach of fiduciary duty and other causes of action that were based on conduct by the selling member before execution of the release. The court declined to dismiss claims premised on conduct of the selling member after execution of the release, noting that the interplay between the Texas LLC statute and the operating agreement was unclear as to whether the selling member continued to be a member and, as such, continued to owe fiduciary duties after the assignment of the membership interest.

In January, 2019, Jonathan Villarreal and John Saenz formed ZroBlack, LLC (“ZroBlack”), a Texas limited liability company, the purpose of which was to provide applications and services regarding cell phone data capture and erasure for both commercial and governmental use. Villarreal and Saenz each owned 50% of the LLC. Villarreal was responsible for performing the in-house coding, hardware engineering, and servicing of the



technology, and Saenz was responsible for client engagement and promoting the company. Villarreal assigned his intellectual property interest in software he developed to ZroBlack.

A few months after ZroBlack was formed, it entered into a Professional Services Agreement (PSA) with a foreign customer under which the foreign customer paid \$1.5 million up front and agreed to make future payments based on an earn-out arrangement. Villarreal and ZroBlack alleged that Saenz then withdrew \$740,000 and transferred the money to his personal account, while Villarreal transferred \$740,000 to a newly formed distribution account “according to the terms of the LLC agreement.” According to Villarreal and ZroBlack, the distributions to both Villarreal and Saenz constituted their salary through the end of 2019 and the \$740,000 Saenz withdrew was thus not yet earned.

Soon after Villarreal and Saenz began their consulting work under the PSA, they began to disagree about Saenz’s performance as ZroBlack’s CEO. Ultimately, they decided to part ways, and a lawyer prepared a document entitled “Release” that Saenz and Villarreal executed on behalf of themselves and ZroBlack on August 9, 2019. In the Release, the parties agreed that Saenz would “assign[ ] [ ] his entire interest in ZroBlack LLC to Villarreal.” At the same time they executed the Release, the parties executed a document entitled “Unanimous Written Consent In Lieu of Meeting of The Members of ZroBlack LLC,” which “memorialize[d]” the assignment of Saenz’s “entire interest.” The Release provided that Villarreal and Saenz would split future earn-out payments from the foreign customer, and they fully released each other “from all claims and demands, known or unknown” (see provision quoted below). The Release did not mention: (1) the \$740,000; (2) any company property, such as a laptop that had been acquired by Saenz in connection with his duties as CEO; or (3) ZroBlack’s proprietary and trade secret information, domain name, webpage, or server.

Beginning on August 15, 2019, Villarreal requested on several occasions that Saenz release ZroBlack’s domain name and return the laptop, which allegedly contained ZroBlack’s proprietary trade secrets, including the code related to ZroBlack’s phone-security project. Saenz allegedly refused to do so, and Villarreal received an email on August 15, 2019, from GoDaddy informing him that Saenz had, the day before, revoked Villarreal’s access to the domain name. In September of 2019, Villarreal learned Saenz had allegedly deleted thousands of emails and documents on ZroBlack’s email server and had taken down its webpage. According to Villarreal and ZroBlack, Saenz “blackmailed ZroBlack over the domain name, webpage, and email server, offering to sell it back to ZroBlack for \$7,000.” Without access to the ZroBlack domain, Villarreal and ZroBlack contended that they were unable to update ZroBlack’s credentials with various entities, agencies, and websites, which in turn prevented ZroBlack from competing for government contracts.

In 2020, Villarreal and ZroBlack sued Saenz, requesting ex parte preliminary and permanent injunctive relief. The plaintiffs alleged the following claims against Saenz: (1) violations of the federal Defend Trade Secrets Act (DTSA) and Texas Uniform Trade Secrets Act (TUTSA); (2) violations of the federal Computer Fraud and Abuse Act (CFAA); (3) violations of the federal Anti-cybersquatting Consumer Protection Act (ACPA); (4) breach of contract; (5) breach of fiduciary duty; (6) tortious interference with prospective business relations; (7) conversion; (8) violation of the Texas Theft Liability Act; and (9) fraud. The plaintiffs also sought a declaration pursuant to 28 U.S.C. § 2201 that the ZroBlack Operating Agreement and Release are void and unenforceable due to fraud and mutual mistake, and the plaintiffs brought legal malpractice and breach-of-fiduciary-duty claims against the law firm and lawyer (collectively, the “law firm”) that drafted the Release and advised Villarreal and ZroBlack on it. Saenz and the law firm filed a motion to dismiss. As further described below, in this opinion, the magistrate recommended dismissal of the plaintiffs’ claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent premised on conduct allegedly committed while Saenz served as ZroBlack’s CEO—conversion, fraud, breach of contract, tortious interference, violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz’s refusal to return ZroBlack’s laptop—and request for declaratory relief. The magistrate recommended that the plaintiffs’ claims for breach of fiduciary duty and for violations of the CFAA and ACPA—insofar as premised on Saenz’s alleged conduct after the parties executed the Release—should remain, at least at this juncture.

The court first addressed the impact of the Release on the plaintiffs’ claims against Saenz. Paragraph 7 of the Release provided, in relevant part:

Each party hereby fully releases the other Parties from all claims and demands, known or unknown. Each Party understands that, as to claims that are known to that Party when the release is signed, any statutory provisions that would otherwise apply to limit this general release are hereby waived.

Each Party also understands that this release extends to claims and demands that are not known at the time this release is signed.

The court state that “[a] ‘broadly worded general release[ ]’ that is unlimited to a specific cause of action or occurrence—such as the one at issue here—is typically valid and enforceable under Texas law,” and “a release of ‘any and all’ claims applies to ‘all possible causes of action.’” The court understood the Release to be a “complete bar” against claims existing at the time of its execution. Thus, it barred most, but not all, of the plaintiffs’ claims because most of the facts on which the plaintiffs premised their claims against Saenz existed at the time the Release was executed. According to the court, that some or all of the plaintiffs’ claims might not have accrued for statute-of-limitations purposes was distinguishable from whether the claims existed at the time. In any event, the court pointed out that the parties released not only all known and unknown claims but also all known or unknown demands. At the time of the Release, the plaintiffs could have demanded return of the laptop, return of the \$740,000, a declaration that the ZroBlack Operating Agreement was void for fraud, and a transfer of the ZroBlack domain. On the other hand, accepting the allegations in the complaint as true, the Release did not preclude claims premised on Saenz’s later revocation of Villarreal’s access to the domain and deletion of documents on the server because these events allegedly occurred after the parties executed the Release. Furthermore, any claims or demands surrounding these occurrences would not have existed at the time. Additionally, as conceded by Saenz, the Release could not bar the plaintiffs’ claims for breach of the Release.

The court next rejected the plaintiffs’ contentions that the Release should be set aside due to mutual mistake, fraud, or considerations of public policy. The plaintiffs alleged no facts to plausibly suggest mutual mistake and did not adequately explain or allege how Saenz’s alleged fraudulent inducement of the ZroBlack Operating Agreement several months before execution of the Release could bear on the validity of the Release, which the plaintiffs did not argue was induced by fraud. Nor were there any plausible allegations that the terms of the Release were themselves the product of fraud or misrepresentation by the law firm. Thus, the plaintiffs’ claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent predicated on Saenz’s conduct as ZroBlack’s CEO—conversion, fraud, breach of the company agreement, and violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz’s refusal to return the laptop—and for declaratory relief were barred by the Release.

The court next turned to the merits of the plaintiffs’ claims that were not barred by the terms of the Release. With respect to the plaintiff’s claim for breach of contract based on the terms of the Release and Unanimous Consent, the court found no plausible basis had been pled for breach of contract. Pursuant to the Release and Unanimous Consent, Saenz “assign[ed] [ ] his entire interest in ZroBlack LLC” to Villarreal pursuant to Article VII of the ZroBlack Operating Agreement. The documents did not define the term “interest” and did not indicate an intent to otherwise obligate Saenz to return any alleged company funds, property, or trade secrets, including the \$740,000 and laptop. Nevertheless, the plaintiffs asserted that these items of property would necessarily be included within Saenz’s assignment and that Saenz thus breached the agreements by refusing to return them. The court stated that there was only one reasonable interpretation of Saenz’s “entire interest in ZroBlack LLC,” as that phrase was used in the documents, and that interpretation was that Saenz assigned his membership interest in the company itself. The court stated that “[t]his interest is defined under Texas law to exclude any supposed personal ‘interest’ he had in company property.” The court made clear that it was not suggesting that Saenz’s mere status as a member of ZroBlack meant that he owned any kind of “interest” in any specific property of the company that he would have the power to assign when acting in an individual capacity to execute the Release, citing Tex. Bus. Orgs. Code § 101.106(b) (“A member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company”). According to the court, “That Villarreal believed—or believes now in hindsight—that Saenz’s ‘interest’ in ZroBlack LLC included an assignable personal ‘interest’ in the company’s property isn’t helpful to Villarreal’s position. The plain language in both agreements is at odds with any such subjective belief.” Thus, the court concluded that the breach-of-contract claim should be dismissed.

The court found that the plaintiffs’ claims that Saenz violated his fiduciary duties by maintaining dominion and control over ZroBlack’s domain and email server to the company’s detriment after the parties executed the Release should survive dismissal at this juncture based on the possibility that Saenz, as a member who assigned his membership interest, might nevertheless still be a member who owed fiduciary duties to ZroBlack. The court explained as follows:

Citing case law on partnerships, Saenz contends that his fiduciary duties to ZroBlack ceased once he assigned his interest in the LLC to Villarreal. *See* Dkt. No. 41 at 21. But under Texas law, “[a] member of a limited liability company may not withdraw or be expelled from the company.” Tex. Bus. Org. Code § 101.107. Further, “an assignor member does not cease to be a member merely by assigning the member’s interest.” Miller & Ragazzo, 13 Tex. Prac., Texas Methods of Practice § 59:2 (3d ed. 2021) (citing *id.* § 101.111(a)). At the same time, the Operating Agreement refers to an assignor as an “exiting member” without defining that term or discussing its implications. *See* Dkt. No. 33-3 at 9. Ultimately, Saenz hasn’t addressed the interplay between Texas law on LLCs and the language in the Operating Agreement. Accordingly, on the present briefing, the Court can’t conclude as a matter of law that Saenz didn’t owe ZroBlack any fiduciary duties after he assigned his interest in the company to Villarreal.

After concluding that the plaintiffs’ claims for post-Release violations of CFAA and ACPA should not be dismissed at this juncture, the court addressed the plaintiffs’ claim against the law firm who drafted the Release and concluded that requiring the plaintiffs to litigate those claims in state court would not raise fairness or comity issues and that there was no justification for the exercise of supplemental jurisdiction over those claims.

## 5. Forum Selection

*Rieder v. Woods*, 603 S.W.3d 86 (Tex. 2020).

The Supreme Court concluded that a series LLC’s agreement and a Nevada LLC’s operating agreement were not a single, unified instrument; consequently, a forum selection clause in the series agreement could not be viewed as part of the operating agreement. The court also concluded that the forum selection clause could not be enforced by or against nonsignatories under the transaction-participant enforcement theory.

Cadbury Solutions LLC was a Nevada LLC with its principal place of business in Wisconsin. Its only members were plaintiff Kenny Woods and defendants Anthony Rieder and Ed Rapee III, none of whom were Texas residents. Plaintiff-intervenor CQuentia Series LLC was a Texas entity with Alan Meeker, a Texas resident, serving as the manager and CEO of CQuentia.

Cadbury was formed in connection with consummating a business relationship with CQuentia. The parties disputed whether Cadbury was created for the sole purpose of doing business with CQuentia, as the Cadbury operating agreement (the “Cadbury Agreement”) broadly stated that the company’s purpose was “to exercise all powers which may be legally exercised by limited liability companies under the [Nevada LLC Act].” The agreement did not reference CQuentia, Meeker, or any business dealings among them. Nor did it contain a forum selection clause. The agreement did, however, include a choice of law provision requiring construction and application of the contract under Nevada law.

On the same day that Cadbury was formed, the company executed a series agreement with CQuentia (the Series Agreement). The court stated that the agreement created a series LLC under Texas law with Cadbury and CQuentia as its initial members (the “Series Agreement”). (In footnotes, the court noted that an LLC may, by agreement, “establish ... one or more designated series of members, managers, membership interests, or assets that: (1) has separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses with specified property or obligations; or (2) has a separate business purpose or investment objective.” TEX. BUS. ORGS. CODE § 101.601(a); *see also id.* §§ 101.601–.662 (authorizing and regulating series limited liability companies).) Woods signed the Series Agreement on Cadbury’s behalf, and Meeker signed for CQuentia. Unlike the Cadbury Agreement, the Series Agreement was specific in declaring its purpose as the sale and distribution of medical-related services. In addition, unlike the Cadbury Agreement, the Series Agreement required application of Texas law and contained the following forum-selection clause: GOVERNING LAW.... ANY CLAIMS OR CONTROVERSIES UNDER OR RELATED TO THIS AGREEMENT SHALL BE EXCLUSIVELY DETERMINED IN THE STATE AND/OR FEDERAL COURTS LOCATED IN TARRANT COUNTY, TEXAS, TO WHOSE JURISDICTION EACH PARTY IRREVOCABLY CONSENTS. None of the individual members of the two companies signed the Series Agreement in their individual capacities; neither Rieder nor Rapee signed the agreement in their official capacities; and the agreement did not refer to the Cadbury Agreement by name or any other designation.

The relationship between Cadbury and CQuentia (as well as the relationship between the Cadbury members) quickly disintegrated. Woods sued Rieder, Rapee, and Cadbury in Tarrant County as specified in the Series Agreement. Cadbury later sued Woods and Meeker in Wisconsin. CQuentia and Meeker ultimately intervened in the Texas suit.

In the Texas suit, Cadbury, Rieder, and Rapee filed a consolidated special appearance challenging personal jurisdiction and, alternatively, a motion to dismiss for forum non conveniens, arguing jurisdiction was proper and more convenient in Wisconsin. After a contentious hearing at which the plaintiffs assailed the special appearance on numerous grounds, the trial court found personal jurisdiction lacking as to Woods's claims against Cadbury, Rieder, and Rapee, but denied the special appearance as to CQuentia's and Meeker's claims. In doing so, the trial court found that CQuentia's and Meeker's (but not Woods's) claims against the defendants were encompassed by the Series Agreement's forum selection clause, so litigation of those claims was mandatory in Tarrant County. The court of appeals affirmed in part, reversed in part, and held that the forum selection clause bound all involved parties. Ultimately, the Supreme Court granted the defendants' petition for review to determine whether the forum selection clause could be enforced by signatory CQuentia and nonsignatories Woods and Meeker.

The Supreme Court began its analysis by discussing the basic operation of forum selection clauses and their nature as "creatures of contract." The court phrased the issues that it confronted as two-fold: "(1) whether nonsignatories Woods and Meeker can enforce the forum-selection clause against nonsignatories Rieder and Rapee and signatory Cadbury, and (2) whether signatory CQuentia can enforce the forum-selection clause against nonsignatories Rieder and Rapee." To address those issues, the court observed that "this case presents an unusual variation that requires us to first determine whether the Cadbury Agreement and the Series Agreement may be construed as one transaction, so that the forum-selection clause applies as if it were also part of the Cadbury Agreement." As the court observed:

Where appropriate, "a court may determine, as a matter of law," that multiple separate contracts, documents, and agreements "were part of a single, unified instrument." In determining whether multiple agreements are part and parcel of a unified instrument, a court may consider whether each written agreement and instrument was "a necessary part of the same transaction." But when construing multiple documents together, courts must do so with caution, bearing in mind that tethering documents to each other is "simply a device for ascertaining and giving effect to the intention of the parties and cannot be applied arbitrarily and without regard to the realities of the situation."

The Court of Appeals had concluded that the Cadbury Agreement and the Series Agreement were executed for a "unitary purpose" and should therefore be construed together. The Supreme Court disagreed. First, the court noted that the terms and obligations of the agreements were separate and independent. With respect to the Cadbury Agreement, the court observed that its plain language could not reasonably be construed as supporting the conclusion that it was executed for the sole purpose of entering into the Series Agreement with CQuentia. Instead, the Cadbury Agreement evidenced Woods, Rieder, and Rapee's intent to form a broad-functioning LLC, while simultaneously laying out their responsibilities and obligations with respect to Cadbury and each other. Similarly, based on the Series Agreement's plain language, the court concluded that the parties to that agreement, Cadbury and CQuentia, manifested an intent to create a series LLC—one that existed separate and apart from both Cadbury and CQuentia—that was formed for the express purpose of engaging in the sale and distribution of medical-related services.

Second, the court analyzed the merger clauses in both agreements. According to the court, Woods, Rieder, and Rapee's inclusion of a merger clause in the Cadbury Agreement bound the three to that agreement and made that agreement's terms the final, binding, and superseding obligations that each agreed to undertake with respect to Cadbury. The merger clause in the Series Agreement operated in a similar manner, making its terms final and superseding any and all prior agreements by and between Cadbury and CQuentia. Because the two agreements clearly imposed distinct obligations with respect to separate subject matters and were subject to different governing laws, the court concluded that the merger clauses in both agreements supported the separateness of the two instruments.

Third, the court observed that the parties' concerted efforts to limit their liability exposure through separately formed LLCs manifested an intent that Cadbury, CQuentia, and their members would remain distinct

from one another in the eyes of the law. According to the court, these liability-limiting measures would have been unnecessary if the parties had intended the two business-formation documents to be construed as a single transaction: “After analyzing the circumstances surrounding the execution of both agreements, we conclude that by creating two separate legal entities—Cadbury and the Cadbury/CQuentia Series LLC—the context further establishes the agreements were executed for separate and distinct purposes. For example, Woods, Rieder, and Rapee chose to form Cadbury, a limited liability company, before entering the Series Agreement with CQuentia. If Cadbury’s members had intended to bind themselves to the Series Agreement as individuals, they could have done so without forming Cadbury. They did not do so. Moreover, neither Woods nor Meeker signed the Series Agreement as individuals; rather, both signed only in representative capacities.”

Finally, the court rejected the argument that Woods could enforce the forum selection clause against Rieder and Rapee via the Cadbury Agreement’s board exculpation clause. The Cadbury Agreement included an exculpation clause that limited the liability of board members and officers to certain categories of claims. The court of appeals had held that Woods’ claims fell within those actionable categories. Based on the erroneous conclusion that the Cadbury Agreement and the Series Agreement could be read together, the court of appeals then determined that Woods’s claims fell within the scope of the forum-selection clause. The Supreme Court disagreed: “The court of appeals’ holding that the forum-selection clause can be enforced rests on a faulty premise and fails because the two agreements cannot be construed as one instrument. The board exculpation clause is part of the Cadbury Agreement, which is separate from and beyond the reach of the Series Agreement’s forum-selection clause. Woods therefore cannot enforce the forum-selection clause against Rieder and Rapee via that [board exculpation] clause.”

The Supreme Court then turned its attention to whether the forum selection clause could be enforced against Cadbury, Rieder, and Rapee as “transaction participants”—i.e., parties who are “closely related to the contractual relationship.” The court noted its prior precedent where it observed that “courts have held that ‘transaction participants’ may enforce a valid forum-selection clause even if they are not actual signatories to the contract.” According to the court, the rationale favoring a nonsignatory’s enforcement of a forum-selection clause against a signatory is rooted in foreseeability. That is, when a signatory has already agreed to submit contract-related disputes to a particular forum, enforcement of the forum selection provision “comports with the ‘legitimate expectations of the parties, [as] manifested in their freely negotiated agreement.’” The court ultimately concluded that it did not need to decide “whether or under what circumstances the transaction-participant theory might apply, because enforcement by and against the nonsignatory parties was not reasonably foreseeable.” As the court observed:

In [*Pinto Technology Ventures, L.P. v. Sheldon*, 526 S.W.3d 428 (Tex. 2017)], we explained that, “[b]ecause forum-selection clauses are creatures of contract, the circumstances in which nonsignatories can be bound ... are rare.” The extent to which nonsignatories may be subject to a forum-selection clause is thus determined by reference to “common principles of contract and agency law and the parties’ chosen language[.]” To that end, Cadbury’s and CQuentia’s business forms are designed to shield its members from individual liability for the company’s obligations. Cadbury’s members did not agree to be bound to the Series Agreement in their individual capacities, either by signature or by contract language. Nor did they agree to litigate internal disputes between Cadbury and its members in a Texas forum or even under Texas law. There is simply no basis from which to conclude that Wisconsin residents, in their individual capacities, would foresee being haled into a Texas forum, under a forum-selection clause in an agreement they did not sign, to resolve a dispute over the viability of a Nevada limited liability company and the validity of its operating agreement, both of which are governed by Nevada law.

Similarly, Meeker signed the Series Agreement only in a representative capacity; he did not make himself subject to the Series Agreement as an individual. Given the legal separateness between a limited liability company’s member and the business entity itself, neither Cadbury nor its members could have reasonably foreseen that Meeker would later seek to invoke the contract’s benefits in his individual capacity when he was not willing to execute the contract in that capacity.

Here, the only two parties and signatories to the Series Agreement—Cadbury and CQuentia—have conceded that any contract-related claims between them must be heard in their agreed forum, Tarrant County, Texas. But with respect to the claims involving nonsignatory plaintiffs and defendants, we hold the transaction-participant enforcement theory is inapplicable for want of foreseeability.

In the courts below, Woods, Meeker, and CQuentia raised additional arguments to support personal jurisdiction over Cadbury, Rieder, and Rapee. The court of appeals did not address these alternative arguments. The Supreme Court concluded that judicial economy was best served by reversing and remanding to the court of appeals for consideration of the unaddressed points.

In conclusion, the Supreme Court succinctly summarized its analysis:

Forum-selection clauses are creatures of contract, the terms of which are fundamental to our analysis. In certain circumstances, courts may construe multiple documents as if they form a single, unified instrument. But this is not one of those cases. After thoroughly analyzing the agreements at issue, we hold the court of appeals erred in construing the Cadbury Agreement and the Series Agreement as a single, unified instrument and by applying the transaction-participant enforcement theory.

The mere fact that the Cadbury Agreement and the Series Agreement bore some relationship to one another and were executed on the same day is not controlling. The two agreements were executed by different parties, deal with separate situations, impose distinct obligations, and are governed by different law. Furthermore, neither agreement is essential to the other, references the other, nor manifests an intent to fulfill any of the obligations in the other. Perhaps most importantly, we are unable to glean from either agreement's express terms that they were executed as a part of the same business transaction. To the contrary, by including a merger clause in each agreement, the parties manifested an intent that the agreements would operate independently. Finally, Woods, Rieder, and Rapee's decision to form Cadbury in an effort to shield themselves from personal liability is further telling of their intent, as is the conduct of Meeker (CQuentia) and Woods (Cadbury) in signing the Series Agreement as representatives, not individuals. These liability-limiting measures would have been unnecessary had the parties intended the two agreements to constitute a single transaction. To hold otherwise would undermine the parties' intent as expressed in their agreements. For these reasons, we reverse the court of appeals' judgment and remand to that court to consider the unaddressed issues.

#### **G. Assignment or Transfer of Membership Interest**

*Villareal v. Saenz*, 5-20-CV-00571-OLG-RBF, 2021 WL 1986831 (W.D. Tex. May 18, 2021).

The court held that a broad release executed by two members of an LLC and the LLC in connection with one member's buyout of the other member's membership interest barred claims by the LLC and purchasing member against the selling member for breach of fiduciary duty and other causes of action that were based on conduct by the selling member before execution of the release. The court declined to dismiss claims premised on conduct of the selling member after execution of the release, noting that the interplay between the Texas LLC statute and the operating agreement was unclear as to whether the selling member continued to be a member and, as such, continued to owe fiduciary duties after the assignment of the membership interest.

In January, 2019, Jonathan Villarreal and John Saenz formed ZroBlack, LLC ("ZroBlack"), a Texas limited liability company, the purpose of which was to provide applications and services regarding cell phone data capture and erasure for both commercial and governmental use. Villarreal and Saenz each owned 50% of the LLC. Villarreal was responsible for performing the in-house coding, hardware engineering, and servicing of the technology, and Saenz was responsible for client engagement and promoting the company. Villarreal assigned his intellectual property interest in software he developed to ZroBlack.

A few months after ZroBlack was formed, it entered into a Professional Services Agreement (PSA) with a foreign customer under which the foreign customer paid \$1.5 million up front and agreed to make future payments based on an earn-out arrangement. Villarreal and ZroBlack alleged that Saenz then withdrew \$740,000 and transferred the money to his personal account, while Villarreal transferred \$740,000 to a newly formed distribution account "according to the terms of the LLC agreement." According to Villarreal and ZroBlack, the distributions to both Villarreal and Saenz constituted their salary through the end of 2019 and the \$740,000 Saenz withdrew was thus not yet earned.

Soon after Villarreal and Saenz began their consulting work under the PSA, they began to disagree about Saenz's performance as ZroBlack's CEO. Ultimately, they decided to part ways, and a lawyer prepared a document

entitled “Release” that Saenz and Villarreal executed on behalf of themselves and ZroBlack on August 9, 2019. In the Release, the parties agreed that Saenz would “assign[ ] [ ] his entire interest in ZroBlack LLC to Villarreal.” At the same time they executed the Release, the parties executed a document entitled “Unanimous Written Consent In Lieu of Meeting of The Members of ZroBlack LLC,” which “memorialize[d]” the assignment of Saenz’s “entire interest.” The Release provided that Villarreal and Saenz would split future earn-out payments from the foreign customer, and they fully released each other “from all claims and demands, known or unknown” (see provision quoted below). The Release did not mention: (1) the \$740,000; (2) any company property, such as a laptop that had been acquired by Saenz in connection with his duties as CEO; or (3) ZroBlack’s proprietary and trade secret information, domain name, webpage, or server.

Beginning on August 15, 2019, Villarreal requested on several occasions that Saenz release ZroBlack’s domain name and return the laptop, which allegedly contained ZroBlack’s proprietary trade secrets, including the code related to ZroBlack’s phone-security project. Saenz allegedly refused to do so, and Villarreal received an email on August 15, 2019, from GoDaddy informing him that Saenz had, the day before, revoked Villarreal’s access to the domain name. In September of 2019, Villarreal learned Saenz had allegedly deleted thousands of emails and documents on ZroBlack’s email server and had taken down its webpage. According to Villarreal and ZroBlack, Saenz “blackmailed ZroBlack over the domain name, webpage, and email server, offering to sell it back to ZroBlack for \$7,000.” Without access to the ZroBlack domain, Villarreal and ZroBlack contended that they were unable to update ZroBlack’s credentials with various entities, agencies, and websites, which in turn prevented ZroBlack from competing for government contracts.

In 2020, Villarreal and ZroBlack sued Saenz, requesting ex parte preliminary and permanent injunctive relief. The plaintiffs alleged the following claims against Saenz: (1) violations of the federal Defend Trade Secrets Act (DTSA) and Texas Uniform Trade Secrets Act (TUTSA); (2) violations of the federal Computer Fraud and Abuse Act (CFAA); (3) violations of the federal Anti-cybersquatting Consumer Protection Act (ACPA); (4) breach of contract; (5) breach of fiduciary duty; (6) tortious interference with prospective business relations; (7) conversion; (8) violation of the Texas Theft Liability Act; and (9) fraud. The plaintiffs also sought a declaration pursuant to 28 U.S.C. § 2201 that the ZroBlack Operating Agreement and Release are void and unenforceable due to fraud and mutual mistake, and the plaintiffs brought legal malpractice and breach-of-fiduciary-duty claims against the law firm and lawyer (collectively, the “law firm”) that drafted the Release and advised Villarreal and ZroBlack on it. Saenz and the law firm filed a motion to dismiss. As further described below, in this opinion, the magistrate recommended dismissal of the plaintiffs’ claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent premised on conduct allegedly committed while Saenz served as ZroBlack’s CEO—conversion, fraud, breach of contract, tortious interference, violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz’s refusal to return ZroBlack’s laptop—and request for declaratory relief. The magistrate recommended that the plaintiffs’ claims for breach of fiduciary duty and for violations of the CFAA and ACPA—insofar as premised on Saenz’s alleged conduct after the parties executed the Release—should remain, at least at this juncture.

The court first addressed the impact of the Release on the plaintiffs’ claims against Saenz. Paragraph 7 of the Release provided, in relevant part:

Each party hereby fully releases the other Parties from all claims and demands, known or unknown. Each Party understands that, as to claims that are known to that Party when the release is signed, any statutory provisions that would otherwise apply to limit this general release are hereby waived. Each Party also understands that this release extends to claims and demands that are not known at the time this release is signed.

The court state that “[a] ‘broadly worded general release[ ]’ that is unlimited to a specific cause of action or occurrence—such as the one at issue here—is typically valid and enforceable under Texas law,” and “a release of ‘any and all’ claims applies to ‘all possible causes of action.’” The court understood the Release to be a “complete bar” against claims existing at the time of its execution. Thus, it barred most, but not all, of the plaintiffs’ claims because most of the facts on which the plaintiffs premised their claims against Saenz existed at the time the Release was executed. According to the court, that some or all of the plaintiffs’ claims might not have accrued for statute-of-limitations purposes was distinguishable from whether the claims existed at the time. In any event, the court pointed out that the parties released not only all known and unknown claims but also all known or unknown

demands. At the time of the Release, the plaintiffs could have demanded return of the laptop, return of the \$740,000, a declaration that the ZroBlack Operating Agreement was void for fraud, and a transfer of the ZroBlack domain. On the other hand, accepting the allegations in the complaint as true, the Release did not preclude claims premised on Saenz's later revocation of Villarreal's access to the domain and deletion of documents on the server because these events allegedly occurred after the parties executed the Release. Furthermore, any claims or demands surrounding these occurrences would not have existed at the time. Additionally, as conceded by Saenz, the Release could not bar the plaintiffs' claims for breach of the Release.

The court next rejected the plaintiffs' contentions that the Release should be set aside due to mutual mistake, fraud, or considerations of public policy. The plaintiffs alleged no facts to plausibly suggest mutual mistake and did not adequately explain or allege how Saenz's alleged fraudulent inducement of the ZroBlack Operating Agreement several months before execution of the Release could bear on the validity of the Release, which the plaintiffs did not argue was induced by fraud. Nor were there any plausible allegations that the terms of the Release were themselves the product of fraud or misrepresentation by the law firm. Thus, the plaintiffs' claims against Saenz for violations of the DTSA and TUTSA, breach of fiduciary duty—to the extent predicated on Saenz's conduct as ZroBlack's CEO—conversion, fraud, breach of the company agreement, and violations of the Texas Theft Liability Act, CFAA, ACPA—to the extent the CFAA and ACPA claims were premised on Saenz's refusal to return the laptop—and for declaratory relief were barred by the Release.

The court next turned to the merits of the plaintiffs' claims that were not barred by the terms of the Release. With respect to the plaintiff's claim for breach of contract based on the terms of the Release and Unanimous Consent, the court found no plausible basis had been pled for breach of contract. Pursuant to the Release and Unanimous Consent, Saenz "assign[ed] [ ] his entire interest in ZroBlack LLC" to Villarreal pursuant to Article VII of the ZroBlack Operating Agreement. The documents did not define the term "interest" and did not indicate an intent to otherwise obligate Saenz to return any alleged company funds, property, or trade secrets, including the \$740,000 and laptop. Nevertheless, the plaintiffs asserted that these items of property would necessarily be included within Saenz's assignment and that Saenz thus breached the agreements by refusing to return them. The court stated that there was only one reasonable interpretation of Saenz's "entire interest in ZroBlack LLC," as that phrase was used in the documents, and that interpretation was that Saenz assigned his membership interest in the company itself. The court stated that "[t]his interest is defined under Texas law to exclude any supposed personal 'interest' he had in company property." The court made clear that it was not suggesting that Saenz's mere status as a member of ZroBlack meant that he owned any kind of "interest" in any specific property of the company that he would have the power to assign when acting in an individual capacity to execute the Release, citing Tex. Bus. Orgs. Code § 101.106(b) ("A member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company"). According to the court, "That Villarreal believed—or believes now in hindsight—that Saenz's 'interest' in ZroBlack LLC included an assignable personal 'interest' in the company's property isn't helpful to Villarreal's position. The plain language in both agreements is at odds with any such subjective belief." Thus, the court concluded that the breach-of-contract claim should be dismissed.

The court found that the plaintiffs' claims that Saenz violated his fiduciary duties by maintaining dominion and control over ZroBlack's domain and email server to the company's detriment after the parties executed the Release should survive dismissal at this juncture based on the possibility that Saenz, as a member who assigned his membership interest, might nevertheless still be a member who owed fiduciary duties to ZroBlack. The court explained as follows:

Citing case law on partnerships, Saenz contends that his fiduciary duties to ZroBlack ceased once he assigned his interest in the LLC to Villarreal. *See* Dkt. No. 41 at 21. But under Texas law, "[a] member of a limited liability company may not withdraw or be expelled from the company." Tex. Bus. Org. Code § 101.107. Further, "an assignor member does not cease to be a member merely by assigning the member's interest." *Miller & Ragazzo*, 13 Tex. Prac., Texas Methods of Practice § 59:2 (3d ed. 2021) (citing *id.* § 101.111(a)). At the same time, the Operating Agreement refers to an assignor as an "exiting member" without defining that term or discussing its implications. *See* Dkt. No. 33-3 at 9. Ultimately, Saenz hasn't addressed the interplay between Texas law on LLCs and the language in the Operating Agreement. Accordingly, on the present briefing, the Court can't



conclude as a matter of law that Saenz didn't owe ZroBlack any fiduciary duties after he assigned his interest in the company to Villarreal.

After concluding that the plaintiffs' claims for post-Release violations of CFAA and ACPA should not be dismissed at this juncture, the court addressed the plaintiffs' claim against the law firm who drafted the Release and concluded that requiring the plaintiffs to litigate those claims in state court would not raise fairness or comity issues and that there was no justification for the exercise of supplemental jurisdiction over those claims.

#### **H. Access to Books and Records**

*Pacific World Energy LTD v. PIE Investments LLC*, No. 09-19-00155-CV, 2020 WL 5240457 (Tex. App.—Beaumont Sept. 3, 2020, pet. filed) (mem. op.).

The court of appeals affirmed the trial court's orders dismissing Pacific's petition for writ of mandamus, granting summary judgment in favor of appellee PIE Investments LLC ("PIE"), and denying Pacific's request for attorney's fees, largely on the grounds that PIE delayed but did not "refuse" to produce books and records.

Pacific filed a petition for mandamus to compel PIE "to permit an examination and copying of PIE's books and records[.]" (The court observed that "[a] method for the enforcement of the right of inspection or examination of the books and records of a corporation is by mandamus.") According to Pacific, its counsel requested PIE's corporate books and records from PIE's counsel and [Philippe] Mulacek [the director of PIE and majority owner], but PIE only produced two Company Unit Certificates, which showed ownership by Mulacek and Pacific, and "a copy of a partial assignment and assumption of a membership interest dated September 24, 2014."

After PIE failed to produce the requested records, Pacific's counsel sent a written demand letter to PIE which requested (1) PIE's organization and governance documents; (2) any voting agreement, voting trust, proxy or other instrument to which any member of PIE is a party and which directly or indirectly relates to the voting of membership interests in PIE; (3) any instruments evidencing any sale, conveyance, assignment, gift, donation, or other transfer by any member of PIE from its inception to November 16, 2017; (4) the unit ledger identifying all present unit-holders and the unit ownership interests of each in PIE as of November 16, 2017; (5) complete financial statements and accounts from PIE's inception to November 16, 2017; (6) evidence of timely filing of all required Texas and federal tax returns, as well as information reports required to be filed with the Texas State Comptroller's Office; and (7) all written resolutions, consents, "or other similar written approvals or actions" of PIE's members or directors, from PIE's inception until November 16, 2017. According to Pacific, PIE's counsel emailed that PIE would reply in due course, but when PIE had not responded by December 5, 2017, Pacific's counsel "followed up with counsel for PIE" and PIE's counsel "promised to provide all of the requested document[s] on or before January 15, 2018[.]" Pacific pleaded that PIE's counsel provided PIE's "unaudited financials since inception and franchise tax filings[.]" but never provided other documents.

Pacific pleaded that the purposes for its inspection request were to obtain an understanding of (1) PIE's full ownership history, (2) the full extent of PIE's assets and liabilities from September 2014 to date, including contributions by members and any oil and gas interests held or divested by PIE, and (3) the full history of PIE's management and operations since Pacific became a member. Pacific alleged that PIE's failure to produce the requested documents violated section 101.502 of the Texas Business Organizations Code (TBOC), and Pacific asserted that it had the right to recover its costs and expenses under section 101.503.

In its response to Pacific's petition for mandamus, PIE asserted that Pacific's request to inspect PIE's records was made in bad faith, intended solely for harassment, and was not made for a proper purpose. PIE maintained that the trial court should award PIE attorney's fees "because PIE's denial of access is proper and because [Pacific] is not acting in good faith and does not have a proper purpose for its inspection." PIE argued that, in the alternative, the trial court should deny Pacific's request for attorney's fees because PIE had a good faith basis for "resisting" Pacific's request.

PIE subsequently filed a hybrid motion for summary judgment, in which it asserted that it agreed to produce the records and that Pacific cannot recover its attorney's fees and expenses because PIE's refusal to produce records is an essential element of Pacific's claim. According to PIE, the requested documents were provided on December 2, 2018. In response, Pacific asserted that under section 101.501 of the TBOC, PIE had five days to make its corporate records available for inspection, and PIE failed to comply with that statutory deadline. Additionally, Pacific argued that "PIE's defense that it did not refuse to provide records is not a basis for dismissal of the case."

According to Pacific, PIE's defense of lack of refusal is relevant only to the award of attorney's fees and "has nothing to do with PIE's obligation to provide records under the statute." Pacific argued that "PIE's position must be that by resisting production, demanding a jury trial on improper purpose, and requiring the court and parties to prepare for such a trial up to the day of trial, PIE did not refuse to provide records[.]" Pacific asserted that there was no good faith basis for such an argument.

The trial court ultimately signed an order granting PIE's hybrid motion for summary judgment, dismissing the petition for writ of mandamus, and denying Pacific's request for attorney's fees. The court of appeals affirmed:

Section 3.153 of the TBOC provides that each owner or member of a filing entity may examine the filing entity's books and records "to the extent provided by the governing documents of the entity and the title of this code governing the filing entity." Tex. Bus. Orgs. Code Ann. § 3.153. Under section 3.152(b) of the TBOC, a court may require a filing entity to open its books and records for inspection or copying upon a showing that, among other things, (1) a demand to inspect the entity's books and records was made and (2) the entity refused the good faith demand to inspect its books and records. *Id.* § 3.152(b). Section 101.501 of the TBOC requires a limited liability company to keep certain records at its principal office in the United States, or to make available to a person at its principal office in the United States, certain categories of documents "not later than the fifth day after the date the person submits a written request to examine the books and records of the company under Section 3.152(a) or 101.502[.]" *Id.* § 101.501(a). Section 101.502 of the TBOC provides that a member of a limited liability company may, "on written request and for a proper purpose ... examine and copy at any reasonable time and at the member's or assignee's expense" records that the TBOC requires the limited liability company to keep. *Id.* § 101.502. Pursuant to section 101.503 of the TBOC, which is entitled "Penalty for Refusal to Permit Examination of Certain Records[.]" a limited liability company that refuses to allow a member to examine and copy records "on written request that complies with Section 101.502(a) ... is liable to the member ... for any cost or expense, including attorney's fees, incurred in enforcing the member's ... rights. *Id.* § 101.503(a). Additionally, section 101.503 provides that it is a defense that the person or entity suing "was not acting in good faith or for a proper purpose in making the ... request for examination." *Id.* § 101.503(b)(2). ...

The parties agree that PIE eventually provided all the requested documents, thus leaving the issue of whether the trial court erred by denying Pacific the right to recover attorney's fees as the issue to be decided in this appeal. Under section 101.503, a limited liability company that "refuses" to comply with a records request that was made in good faith and for a proper purpose is liable for the requesting party's attorney's fees. Tex. Bus. Orgs. Code Ann. § 101.503. The *Westerburg* court explained that the party asking the trial court to order production of records has the burden of persuasion. *See [Westerburg v. W. Royalty Corp., No. 07-15-00082-CV, 2015 WL 8781425, at \*5 (Tex. App.—Amarillo Dec. 11, 2015, pet. denied) (mem. op.)]* To recover attorney's fees, section 101.503 explicitly requires that the requesting party demonstrate that the limited liability company refused to comply with the request. *See* Tex. Bus. Orgs. Code Ann. § 101.503(a). As was the case in *Westerburg*, section 101.503 does not define the term "refuse." We therefore afford the term "its common, ordinary meaning, as stated in a dictionary." If a word has more than one common meaning, we will apply the meaning that is most consistent with its statutory context. "Refuse" means "[t]o deny, decline, reject[.]" and it is distinguishable from the term "fail" because " 'refuse involves an act of the will, while 'fail' may be an act of inevitable necessity.' " *Id.* (quoting BLACK'S LAW DICTIONARY 1282 (6th ed. 1990)). Another commonly accepted meaning of "refuse" is " 'to show or express unwillingness to do or comply with.' " *Id.* (quoting MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 1047 (11th ed. 2003)). "Fail may be defined as falling short." *Id.*

In this case, as in *Westerburg*, the undisputed evidence demonstrates that PIE consistently agreed to produce documents, initially produced some responsive documents, and ultimately produced all responsive documents. Considering the entire record, we conclude that the trial court's implicit conclusion that PIE did not refuse to provide the requested documents is supported by sufficient evidence. ... Pacific cited section 101.503 itself, but otherwise cited no authority in

support of its contention that PIE's refusal to provide records for a year after the mandamus was filed constitutes a refusal as a matter of law under section 101.503 of the TBOC. The text of section 101.503 does not support such a contention, and, as discussed above, *Westerburg* holds to the contrary.

For all these reasons, we conclude that the trial judge did not abuse her discretion by denying Pacific's request for attorney's fees and dismissing the petition for writ of mandamus.

***Head v. Ascendant Petroleum Holding, LLC***, \_\_ S.W.3d \_\_, 2020 WL 4379195 (Tex. App.—Eastland 2020, no pet.).

The court of appeals affirmed the trial court's grant of a plea to the jurisdiction. Because plaintiff's membership interest had been repossessed, he lacked standing to assert a direct claim for inspection of books and records.

In 2011, Tom L. Stover, the Oil and Gas Properties Manager for Ascendant, offered John Head the opportunity to acquire one membership unit in Ascendant. Head accepted Stover's offer, and the parties executed three documents: a secured promissory note in the amount of \$50,000, a security agreement, and the Ascendant Petroleum Holding, LLC Limited Liability Company Agreement ("Company Agreement"). The Company Agreement specifically provided that it was to be governed by the law of the State of Delaware. Conversely, the note and the security agreement provided that they would be governed by Texas law.

Under the terms of the secured promissory note and the security agreement, Ascendant accepted Head's membership unit in Ascendant as collateral for the payment of the promissory note and Head's performance of the security agreement and the Company Agreement. One of the conditions of the promissory note was that the balance of the note would immediately become due and payable upon Head's insolvency.

On July 19, 2017, a Colorado court rendered a judgment for \$912,720.58 plus postjudgment interest of \$105.99 a day in favor of Stover against Head individually and against his law firm, Head and Associates, PC. These amounts remain unpaid.

Appearing pro se, Head filed suit against Ascendant, the manager of Ascendant (CAW Resources, LLC), Bobby Pugh (manager of CAW Resources), and three subsidiaries of Ascendant (collectively the "Appellees"). He asserted a number of claims, including breach of fiduciary duty against CAW Resources and Pugh and a demand for an inspection of the books and records of Ascendant and its subsidiaries.

After Head filed suit, Ascendant's attorney sent a letter to Head on March 7, 2018 notifying him that he was in breach of the security agreement and the promissory note's solvency requirements because Head had failed to pay what he owed under the Colorado judgment and that he was presumed insolvent. The letter demanded that Head provide Ascendant "with reasonable and sufficient evidence of [Head's] solvency" within ten days. The letter further provided that Ascendant would take possession of Head's membership unit in Ascendant if Head did not provide evidence of his solvency.

Head did not provide the requested evidence of his solvency. Ascendant's attorney then sent Head another letter on April 3, 2018 notifying him that Ascendant had taken possession of Head's membership unit and that Head was no longer a member of Ascendant.

After taking possession of Head's membership interest, Appellees filed a plea to the jurisdiction asking the trial court to dismiss Head's claims because Head no longer had standing due to the loss of his membership interest in Ascendant. After a hearing, the trial court granted Appellees' plea to the jurisdiction and dismissed Head's claims in their entirety. Head appealed, arguing, among other things, that the trial court improperly granted Appellees' plea to the jurisdiction because Head was still a member of Ascendant.

The court of appeals began by noting that Ascendant was a Delaware LLC; therefore, Delaware law controlled the interpretation of the Company Agreement. The Company Agreement itself also provided that it was to be interpreted under Delaware law. The court observed that in filing a plea to the jurisdiction challenging Head's standing to maintain his lawsuit, Appellees had challenged the trial court's subject matter jurisdiction. Because subject matter jurisdiction is a question of law, the court conducted a de novo review of the trial court's granting of the plea.

Since standing is determined on a claim-by-claim basis, the court was required to determine whether Head's claims were direct or derivative. The court cited the Delaware opinion of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and expressed the standard as follows:

... the test we use to determine whether a limited liability company member’s claim is direct or derivative turns solely on the following questions: (1) who suffered the alleged harm (the limited liability company or the suit member, individually) and (2) who would receive the benefit of any recovery or other remedy (the limited liability company or the members, individually)? As explained by the court in *Kelly v. Blum* [No. 4516-VCP, 2010 WL 629850 (Del. Ch. Feb. 24, 2010)]:

Specifically, the Court evaluates whether the nature of the alleged injury is such that it falls directly on the LLC as a whole and only secondarily on an individual member as a function of and in proportion to his pro rata investment in the LLC, in which case the claim would be derivative, or whether the injury inflicts direct harm on the rights of the member as an individual.

Applying that test, the court of appeals concluded that Head’s breach of fiduciary duty claims were “all based on alleged injuries to the limited liability company as a whole” and were premised “on the general allegation that mismanagement of Ascendant and its subsidiaries [had] occurred.” Head could not prove his alleged injuries without proving injury to Ascendant. Accordingly, the claims were derivative. In contrast, the court determined that Head’s demand for an inspection of the books and records was a direct claim.

With respect to the inspection claim, the court of appeals concluded that, after the repossession of his membership interest, Head lacked standing to assert the claim:

We must next determine whether Head had standing to bring his direct claim to compel an inspection of Appellees’ books and records. With respect to Ascendant’s books, the Delaware Code provides that a member of a limited liability company has the right, subject to reasonable standards established by the limited liability company agreement, a manager, or members, to make a reasonable demand to inspect the records of the company for “any purpose reasonably related to the member’s interest as a member of the limited liability company.” 6 DEL. CODE ANN. § 18-305. Section 18-305’s corporate analogue, 8 Delaware Code Section 220, guides the scope of Section 18-305. *See* 8 DEL. CODE ANN. § 220. Section 220 “ ‘plain[ly] and unambiguous[ly]’ limits inspection rights to current stockholders and directors.” *Prokupek v. Consumer Capital Partners LLC*, C.A. No. 9918-VCN, 2014 WL 7452205, at \*6 (Del. Ch. Dec. 30, 2014) (alterations in original) (quoting *King v. DAG SPE Managing Member, Inc.*, C.A. No. 7770-VCP, 2013 WL 6870348, at \*6 (Del. Ch. Dec. 23, 2013) (mem. op.)). Thus, Head no longer had standing to inspect Ascendant’s books after he no longer held an ownership interest in Ascendant. *See id.* at \*7 (By its plain language, Delaware Code Section 18-305(a) of the LLC Act “confers inspection rights only on current members of an LLC.”).

Head also did not have standing to inspect the books of CAW Resources or the three subsidiaries. Head did not have an ownership interest in any of these entities. His only basis for requesting an inspection of the records of these other entities was his ownership of an interest in Ascendant—an ownership interest that no longer exists. Accordingly, the trial court did not err in granting Appellees’ plea to the jurisdiction on Head’s direct claim.

## **I. Dissolution/Winding Up**

*In re Two Wheels Properties, LLC*, 625 B.R. 869 (Bankr. S.D. Tex. 2020).

The bankruptcy court held that a limited liability company whose charter was forfeited pursuant to the Texas Tax Code (for failure to report or pay franchise taxes) was required under Texas law to wind up and thus did not have standing to file a Chapter 11 bankruptcy petition to continue its business and affairs.

The charter of Two Wheels Properties, LLC (the “LLC” or “Debtor”), was forfeited by the Texas Secretary of the State on February 2, 2018, and the LLC filed its petition under Chapter 11 of the Bankruptcy Code on November 2, 2020. At its initial status conference with the Debtor, the court *sua sponte* questioned the Debtor’s standing to file a Chapter 11 proceeding given forfeiture of its Texas corporate charter. In this opinion, the court concluded that the LLC was not eligible to be a debtor under Chapter 11.

The LLC relied on two cases in which the courts opined whether debtors may seek bankruptcy relief in the name of the forfeited corporation. In one case, the court held that a forfeited corporation under the Texas Tax Code was eligible for bankruptcy relief within three years of dissolution because Texas law provides that dissolved corporations continue their existence for three years following dissolution for limited purposes of liquidation and distribution of assets. *In re ABZ Ins. Servs.*, 245 B.R. 255, 261–62 (Bankr. N.D. Tex. 2000). In the other case, the court held that a corporation that was forfeited under the Texas Tax Code more than ten years earlier could not file for bankruptcy under Chapter 7 because its existence as a dissolved corporation for purposes of winding down its operations continued for only three years following its dissolution. *In re Am. Heartland Sagebrush Secs. Invs., Inc.*, 334 B.R. 848, 852–53 (Bankr. N.D. Tex. 2005). Thus, the LLC argued that it was properly a debtor in this case because three years had not lapsed since its forfeiture.

The court turned to the question of whether the LLC, which it characterized as “a corporate entity dissolved pre-petition by forfeiture of its corporate charter,” was a “person” who may be a debtor under Chapter 11. The court stated that the resolution of the question hinged on state law, and the court pointed out that the effect of a forfeiture under Tex. Tax Code §171.251 is that (1) the corporation is denied the right to sue or defend in a Texas court; and (2) each director or officer of the corporation is liable for a debt of the corporation. The LLC, however, relied on Section 11.356 of the Texas Business Organizations Code, which provides:

(a) Notwithstanding the termination of a domestic filing entity under this chapter, *the terminated filing entity continues in existence until the third anniversary of the effective date of the entity's termination only for purposes of:*

- (1) prosecuting or defending in the terminated filing entity's name an action or proceeding brought by or against the terminated entity;
- (2) permitting the survival of an existing claim by or against the terminated filing entity;
- (3) *holding title to and liquidating property that remained with the terminated filing entity at the time of termination or property that is collected by the terminated filing entity after termination;*
- (4) *applying or distributing property, or its proceeds*, as provided by § 11.053; and
- (5) settling affairs not completed before termination.

Under this provision, the LLC argued that it was permitted it to “continue in existence until the third anniversary of the effective date for limited tasks such as liquidating, applying or distributing property.”

The court pointed out, however, that *In re ABZ Insurance Services*, the only case favorably cited by the LLC, considered an entity’s ability to file a Chapter 7 bankruptcy petition. The court stated that the distinction between Chapter 7 and Chapter 11 is important because of the provisions of Sections 11.053, 11.356, and 11.201 of the Texas Business Organizations Code. Although forfeited entities survive for limited purposes after termination, an entity’s limited survival continues for the entity to wind up, for which there exists a statutory procedure.

The court went on to conclude that an entity that is forfeited under the Tax Code for failure to report or pay its franchise taxes may not be reinstated and may only wind up and apply its property to its liabilities and obligations. The court reached this conclusion based on the inability of an entity to reinstate its corporate charter under Sections 11.201 (“[a] terminated entity may not be reinstated under [Section 11.201] if the termination occurred as a result of ... forfeiture under the Tax Code”) and 11.356(b) (“[a] terminated filing entity may not continue its existence for the purpose of continuing the business or affairs for which the terminated filing entity was formed unless the terminated filing entity is reinstated under Subchapter E”) of the Texas Business Organizations Code. [The court did not address Section 11.254 of the Texas Business Organizations Code, which acknowledges the ability of an entity that has been forfeited under the Texas Tax Code to reinstate under the Texas Tax Code.]

In conclusion, the court stated that an entity that forfeits its corporate charter is permitted to prosecute a Chapter 7 bankruptcy case within three years of its forfeiture because it is liquidating its assets to satisfy its liabilities and obligations. The court held that the LLC in this case could not properly be a debtor under Chapter 11 to continue its business or affairs through the pendency of the case and post-confirmation of any plan of reorganization. Thus, the court dismissed the case.

*Enshikar v. Zaid*, No. 14-18-00933-CV, 2020 WL 6203348 (Tex. App.—Houston [1st Dist.] Oct. 22, 2020, no pet.) (mem. op.).

“ . . . Enshikar makes various arguments that Zaid and Jumaa are individually or vicariously liable for the 2015 judgment because at the time of Enshikar’s workplace accident Advance Tire was no longer an LLC but had transformed into a different entity, either a partnership run by Zaid and Jumaa or a sole proprietorship run by Jumaa. Each of Enshikar’s issues is premised on his contention that Advance Tire had ceased its existence as an LLC at the time of his injury and no longer shielded Zaid and Jumaa personally from liability. We begin with an analysis of Advance Tire’s status as an LLC at the time of Enshikar’s accident.

Under the Business Organizations Code, a filing entity such as an LLC does not cease existing until, after required windup of the entity is complete, the entity files a certificate of termination. Tex. Bus. Orgs. Code Ann. §§ 11.101, .102; *see id.* § 1.002(22) (LLC is filing entity). This requirement may not be waived. *See* Tex. Bus. Orgs. Code Ann. § 101.054(a)(6).

Enshikar does not contest that Advance Tire was formed as an LLC and does not challenge the trial court’s findings of fact that his accident occurred on January 23, 2012 and that Advance Tire filed a certificate of termination on March 23, 2012. Because the certificate of termination was filed two months after the accident, on the date of the accident Advance Tire existed as an LLC, not a partnership or sole proprietorship that might allow for personal liability of Zaid or Jumaa. *See* Tex. Bus. Orgs. Code Ann. § 11.102. . . .

Enshikar also raises various arguments positing that the LLC terminated before the filing of the certificate of termination due to violations of the company agreement and untimely winding up of the business. We conclude the cited non-waivable provisions from the Business Organizations Code dictating when an LLC terminates its existence controls over Enshikar’s theories as to why we should consider the entity to have terminated earlier. Enshikar also argues that Business Organizations Code section 11.051(3) compels a different result. *See* Tex. Bus. Orgs. Code Ann. § 11.051(3). This section, however, concerns when winding up of an entity is triggered, and does not dictate when the entity terminates its existence. *See id.*

Even if we were to agree with Enshikar, it is unclear how it would help him collect the judgment. In his negligence lawsuit, he sued Advance Tire and served its corporate representative. He did not bring suit against a partnership or sole proprietorship doing business as ‘Advance Tire and Wheels, LLC,’ nor did he sue Zaid or Jumaa individually or as a partner or sole proprietor. It is difficult to determine how Enshikar would collect the judgment from Zaid or Jumaa on the basis of individual or vicarious liability when neither they nor the entities they purportedly operated were sued in the negligence action.”

*Katz v. Intel Pharma, LLC*, Civ. A. No. H-18-1347, 2020 WL 3871493 (S.D. Tex. July 9, 2020).

The district court denied a summary judgment motion on breach of fiduciary duty by concluding that agency-law principles supported the proposition that a managing member of an LLC owed a fiduciary duty to the LLC. The court also concluded that, even if the LLC had its certificate revoked, a derivative action could still be maintained.

Terry Katz alleged that he owned a 25% interest in Landon Suggs’ nutritional supplement company, Intel Pharma, LLC (“Intel”), based on an oral contract with Suggs. Katz eventually brought a derivative claim on behalf of Intel asserting that Suggs had breached his fiduciary duties to Intel by transferring its assets to other entities. In response, Suggs alleged that Katz was not a member because there was no oral contract. In an earlier opinion and order, the court denied Suggs’ motion for partial summary judgment on this argument, as it found that the record showed a fact question on whether a valid oral contract existed. In this opinion, Suggs moved for summary judgment on the breach of fiduciary duty claim by arguing (1) that he owed Katz no fiduciary duty, and (2) that because Intel no longer existed, Katz had no standing to bring a derivative claim on its behalf.

Suggs argued that, under Texas law, a controlling member in an LLC does not owe a fiduciary duty to a minority member. The court pointed out that Katz had not alleged that a fiduciary duty was owed to him. Instead, Katz’s claim was derivative and based on a breach of fiduciary duty owed to Intel. Suggs did not dispute that he served as Intel’s managing member, but the court was troubled because “[t]he parties have not provided, and the court has not found, a case expressly stating that under Texas law, an LLC’s managing member owes the company fiduciary duties as a matter of law.” The court observed that “[t]he Texas Business Organization Code is silent as to an LLC member’s fiduciary duties, except to state that ‘[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.’” Tex. Bus. Org. Code § 101.401.

Based on agency-law principles, however, the court found support for the proposition that Suggs did owe fiduciary duties to Intel:

.... The cases support finding that Suggs owed Intel Pharma fiduciary duties based on agency-law principles. *See, e.g., Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002) (under Texas law, “agency is also a special relationship that gives rise to a fiduciary duty”); *In re Hardee*, No. 11-60242, 2013 WL 1084494, at \*3–4 (Bankr. E.D. Tex. Mar. 14, 2013) (the LLC’s managing member had the power to transact on the LLC’s behalf, making him the LLC’s agent and causing the member to owe a fiduciary duty to the company).

Intel Pharma’s operating agreement also supports finding that Suggs, as its managing member, acted as the company’s agent. The agreement provides that “[t]he Members, within the authority granted by the Act and the terms of this Agreement shall have the complete power and authority to manage and operate the Company and make all decisions affecting its business and [affairs].” (Docket Entry No. 69-1 at 23). The agreement does not “expand or restrict” fiduciary duties that Suggs owed to Intel Pharma.

Suggs also argued that Intel no longer existed and that, correspondingly, Katz’s alleged membership interest no longer existed. The court noted that, under Texas law, “an LLC member must have and maintain [membership] status in order to have standing to prosecute derivative claims on the entity’s behalf.” According to the court, however, Suggs did not explain why Intel ceased to exist. Assuming that it was because the Secretary of State revoked Intel’s certificate, the court still found that a derivative action could be maintained:

The record does not provide details of why Intel Pharma no longer exists. Katz’s Second Amended Complaint alleges that in January 2017, the Texas Secretary of State revoked Intel Pharma’s certificate of formation. (Docket Entry No. 59 at 8). Assuming that to be true, and that it caused a dissolution, Katz could still bring a derivative claim on the company’s behalf. Under the Texas Business Organizations Code, a domestic business entity continues in existence for three years after termination or dissolution, for limited purposes. TEX. BUS. ORG. CODE ANN. § 11.356 (West 2006). One purpose is for “prosecuting or defending in the terminated filing entity’s name an action or proceeding brought by or against the terminated entity.” *Id.* § 11.356(a)(1). If the Texas Secretary of State revoked Intel Pharma’s certificate and caused a dissolution, the company would continue to exist for three years for the purpose of having a derivative claim filed on its behalf. *See Gill v. Grewal*, No. 4:14-cv-2502, 2020 WL 3171360, at \*7 (S.D. Tex. June 15, 2020) (an LLC continued to exist for three years after dissolution for the purpose of a derivative suit). Katz sued in April 2018, less than three years from when the State allegedly revoked Intel Pharma’s certificate of formation. (Docket Entry No. 1).

Suggs argues that this case is similar to *In re Lonestar Logo & Signs, LLC*. But in *Lonestar*, the record showed that the plaintiff was no longer a member of the LLC when suit was filed, because the company had redeemed the plaintiff’s interest, denying the plaintiff standing to bring a derivative claim. 552 S.W.3d at 346, 352. It was the plaintiff’s lack of current membership, rather than the LLC ceasing to conduct business, that precluded standing. *Id.* at 347–52. Here, the record shows a factual dispute material to determining whether Katz was a member of Intel Pharma. (Docket Entry No. 58 at 17).

Suggs has not shown that the undisputed record evidence warrants granting summary judgment on the claim that Suggs breached his fiduciary duty. The record fails to show that, as a matter of law, Suggs did not owe a fiduciary duty to Intel Pharma, LLC, or that Katz lacks standing to bring a derivative claim.

## J. Merger, Conversion, Sale of Assets

*Trustmark National Bank v. Encore Lawn and Landscape of Greater Houston, LLC (In re Huff)*, 625 B.R. 654 (Bankr. S.D. Tex. 2021).

The bankruptcy court granted summary judgment against an LLC's lender to the extent the lender's claim was based on the assertion that the LLC had merged with another LLC.

Trustmark National Bank ("Trustmark") made a loan to Encore Pools, LLC/Encore Lawn and Landscape of Greater Houston, LLC (collectively, "Encore"), and Trustmark ultimately sought to subject the assets of another LLC (2C Commercial Services, LLC or "2C") to Trustmark's lien on the basis that Encore and 2C had merged subsequent to the loan transaction. Although Trustmark presented evidence that at least one of the owners of Encore represented to Trustmark that Encore and 2C merged, reports provided to Trustmark showed 2C receivables as Encore future receivables, and the two owners of Encore each filed assumed name certificates stating that they owned 2C, there was no documentation showing a merger, and the court granted partial summary judgment against Trustmark as to that issue. As the court explained:

Under Texas law, for a merger involving a "domestic entity" to become effective, a party must file a certificate of merger with the Texas Secretary of State. *See* Tex. Bus. Org. Code §§ 10.151(a)(1)(A); 10.153(a). "Domestic entity" includes limited liability companies like Encore and 2C. *Id.* § 1.002(18) ("domestic entity" means an "organization formed under or the internal affairs of which are governed" by the Texas Business Organizations Code), § 1.002(62) (an "organization" includes limited liability companies). A merger becomes effective at the time provided by the plan of merger or, if a Subchapter D filing is required, when the Texas Secretary of State or county clerk, as appropriate, accepts the filing. *Id.* § 10.007. Once a merger is effective, the surviving company assumes the liabilities of the merged company and the merged company ceases to legally exist. *Id.* §§ 10.008(a)(1), (3). Here, that would mean that one of the Encore companies, as the surviving company, assumed 2C's liabilities and business operations, and 2C ceased existing.

The parties have been litigating this case for about four years and discovery closed. Trustmark produced no evidence that Encore and 2C legally merged under Texas law in 2015 or at any other time. For example, there is no plan of merger, no filing about a merger with the Texas Secretary of State or any other government agency. And Trustmark could not identify which Encore entity was the supposed surviving company. Counsel for Trustmark also stated at the summary judgment hearing that there was no documented merger agreement.

Additionally, although there was evidence of a lease between Encore and 2C, the court stated that there was no documented evidence of a legal documented sale of 2C assets to Encore or a legal documented sale of the ownership interest of 2C's owner, Huff, to Encore. In the absence of any documentation such as a sale agreement, plan of exchange to acquire membership interests in 2C, or receipts or final records evidencing a sale of any 2C asset, the court also granted partial summary judgment as to those issues.

The court denied summary judgment, however, as to "whether there was a transfer, assignment, conveyance, or combination of Huff's interest in 2C, including any assets or receivables, to Encore." The court noted that 2C and Huff did not seek summary judgment on Trustmark's claim that assets of Encore had been fraudulently transferred to 2C, and the court stated that ruling on summary judgment as to no "transfer" would effectively be ruling on the fraudulent transfer claim itself. The court expressly made no finding about the legality, meaning, or relevance of an assignment, conveyance, or combination of interest between 2C and Encore.

*Ramachandran v. Jain*, No. 3:18-CV-00811-X, 2020 WL 7353714 (N.D. Tex. Dec 15, 2020).

The court held that, under Delaware law, a conversion from a limited liability company to a corporation does not constitute a sale of substantially all the company's assets.

AROG Pharmaceuticals, Inc. ("AROG"), a startup biotechnology company developing an anticancer drug, hired Abhijit Ramachandran in 2010 to coordinate FDA approval tests for the drug. AROG maintains a long-term incentive unit plan pursuant to which employees are issued units as an award for meeting certain performance goals. The units are worth a percentage of the company's worth should the company be sold. Unit holders are only eligible



for a payout if—subject to a few minor exceptions—they are continuously employed by AROG from the date AROG issues the units until the consummation of a sale of the company. Any employees who do not meet the eligibility requirements forfeit their right to payment. Over the course of his employment, Ramachandran was awarded 250,000 units.

In 2017, AROG and Ramachandran’s relationship soured, and ultimately AROG fired Ramachandran. Ramachandran sued his former employer on several grounds. Among the arguments made by Ramachandran was the argument that a payout under the long-term incentive unit plan was triggered on the basis that a “Sale of the Company” occurred during his employment when AROG converted from an LLC to a corporation. Under the Plan, a “Sale of the Company” occurs in the event of:

- (i) a change in ownership of the Company through a transaction or series of transactions, such that any Person other than a Member (as defined in the Limited Liability Company Agreement) is or becomes the beneficial owner (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended), directly or indirectly, of Capital Securities of the Company representing 50% or more of Capital Securities of the combined voting power of the Company’s then outstanding securities; provided that, for such purposes, any initial public offering of or acquisition by the Company shall be disregarded;
- (ii) the sale or other disposition of all or substantially all of the Company’s assets (determined on a consolidated basis) including by way of transfer of Capital Securities of, or merger or consolidation of or other similar event with respect to, its Affiliates or Subsidiaries, as applicable.

The parties agreed that proportional ownership in AROG never changed; therefore, subsection (i) did not apply. Because AROG’s conversion into a corporation involved an “exchange” of membership interests in the LLC for common stock in the new corporation, Ramachandran argued that the conversion amounted to a “transfer of Capital Securities of, or merger or consolidation of or other similar event.” Even assuming this to be true, the court stated that subsection (ii) was not satisfied when any transfer of securities occurs; the provision is only triggered when a “*sale ... of all or substantially all of the Company’s assets*” occurs “*by way of transfer of Capital Securities of, or merger or consolidation of or other similar event.*” Ramachandran provided no authority suggesting that a business transaction effecting a proportional exchange of interests of its owners for the purpose of facilitating a change in business form is a sale of assets under Delaware law. Because no sale occurred during Ramachandran’s employment, he was not entitled to payment.

## **K. Forfeiture and Involuntary Termination**

*In re Two Wheels Properties, LLC*, 625 B.R. 869 (Bankr. S.D. Tex. 2020).

The bankruptcy court held that a limited liability company whose charter was forfeited pursuant to the Texas Tax Code (for failure to report or pay franchise taxes) was required under Texas law to wind up and thus did not have standing to file a Chapter 11 bankruptcy petition to continue its business and affairs.

The charter of Two Wheels Properties, LLC (the “LLC” or “Debtor”), was forfeited by the Texas Secretary of the State on February 2, 2018, and the LLC filed its petition under Chapter 11 of the Bankruptcy Code on November 2, 2020. At its initial status conference with the Debtor, the court *sua sponte* questioned the Debtor’s standing to file a Chapter 11 proceeding given forfeiture of its Texas corporate charter. In this opinion, the court concluded that the LLC was not eligible to be a debtor under Chapter 11.

The LLC relied on two cases in which the courts opined whether debtors may seek bankruptcy relief in the name of the forfeited corporation. In one case, the court held that a forfeited corporation under the Texas Tax Code was eligible for bankruptcy relief within three years of dissolution because Texas law provides that dissolved corporations continue their existence for three years following dissolution for limited purposes of liquidation and distribution of assets. *In re ABZ Ins. Servs.*, 245 B.R. 255, 261–62 (Bankr. N.D. Tex. 2000). In the other case, the court held that a corporation that was forfeited under the Texas Tax Code more than ten years earlier could not file for bankruptcy under Chapter 7 because its existence as a dissolved corporation for purposes of winding down its operations continued for only three years following its dissolution. *In re Am. Heartland Sagebrush Secs. Invs., Inc.*, 334 B.R. 848, 852–53 (Bankr. N.D. Tex. 2005). Thus, the LLC argued that it was properly a debtor in this case because three years had not lapsed since its forfeiture.

The court turned to the question of whether the LLC, which it characterized as “a corporate entity dissolved pre-petition by forfeiture of its corporate charter,” was a “person” who may be a debtor under Chapter 11. The court stated that the resolution of the question hinged on state law, and the court pointed out that the effect of a forfeiture under Tex. Tax Code §171.251 is that (1) the corporation is denied the right to sue or defend in a Texas court; and (2) each director or officer of the corporation is liable for a debt of the corporation. The LLC, however, relied on Section 11.356 of the Texas Business Organizations Code, which provides:

(a) Notwithstanding the termination of a domestic filing entity under this chapter, *the terminated filing entity continues in existence until the third anniversary of the effective date of the entity's termination only for purposes of:*

- (1) prosecuting or defending in the terminated filing entity's name an action or proceeding brought by or against the terminated entity;
- (2) permitting the survival of an existing claim by or against the terminated filing entity;
- (3) *holding title to and liquidating property that remained with the terminated filing entity at the time of termination or property that is collected by the terminated filing entity after termination;*
- (4) *applying or distributing property, or its proceeds,* as provided by § 11.053; and
- (5) settling affairs not completed before termination.

Under this provision, the LLC argued that it was permitted it to “continue in existence until the third anniversary of the effective date for limited tasks such as liquidating, applying or distributing property.”

The court pointed out, however, that *In re ABZ Insurance Services*, the only case favorably cited by the LLC, considered an entity’s ability to file a Chapter 7 bankruptcy petition. The court stated that the distinction between Chapter 7 and Chapter 11 is important because of the provisions of Sections 11.053, 11.356, and 11.201 of the Texas Business Organizations Code. Although forfeited entities survive for limited purposes after termination, an entity’s limited survival continues for the entity to wind up, for which there exists a statutory procedure.

The court went on to conclude that an entity that is forfeited under the Tax Code for failure to report or pay its franchise taxes may not be reinstated and may only wind up and apply its property to its liabilities and obligations. The court reached this conclusion based on the inability of an entity to reinstate its corporate charter under Sections 11.201 (“[a] terminated entity may not be reinstated under [Section 11.201] if the termination occurred as a result of ... forfeiture under the Tax Code”) and 11.356(b) (“[a] terminated filing entity may not continue its existence for the purpose of continuing the business or affairs for which the terminated filing entity was formed unless the terminated filing entity is reinstated under Subchapter E”) of the Texas Business Organizations Code. [The court did not address Section 11.254 of the Texas Business Organizations Code, which acknowledges the ability of an entity that has been forfeited under the Texas Tax Code to reinstate under the Texas Tax Code.]

In conclusion, the court stated that an entity that forfeits its corporate charter is permitted to prosecute a Chapter 7 bankruptcy case within three years of its forfeiture because it is liquidating its assets to satisfy its liabilities and obligations. The court held that the LLC in this case could not properly be a debtor under Chapter 11 to continue its business or affairs through the pendency of the case and post-confirmation of any plan of reorganization. Thus, the court dismissed the case.

***Bradley J. Fish, Inc. v. Lesar Electric & Design LLC***, No. 01-19-00064-CV, 2020 WL 4589758 (Tex. App. —Houston [1st Dist.] Aug. 27, 2020, no pet.) (mem. op.).

Appellant, Bradley J. Fish, Inc., doing business as Sullair of Houston (“Sullair”), challenged the trial court’s rendition of summary judgment in favor of appellee, Lesar Electric & Design LLC (“Lesar”), in Lesar’s suit against Sullair for breach of contract. The court of appeals affirmed the grant of summary judgment and concluded in part that Lesar had paid its delinquent franchise taxes and had not forfeited its right to do business in Texas.

Lesar, a licensed electrical contractor, alleged that it entered into two contracts with Sullair to perform electrical work. Sullair paid Lesar twenty-five percent of the balance due under each contract as a down payment and agreed to pay the remaining seventy-five percent owed when the work was complete. Lesar performed and completed the work under the contracts, but Sullair did not pay the remaining \$68,289 owed. Lesar sued for breach of contract.

Sullair denied that it had a contract with Lesar. Instead, Sullair alleged that it signed contracts with Phillip Rodriguez and Aaron Burns, employees of Lesar, who represented themselves as being partners providing services under the trade name “Lesar Electric & Design.” Sullair also alleged that neither Lesar nor Rodriguez and Burns had filed “the Texas Assumed Name Certificate as required by Texas law,” that Lesar was not “in good standing with the Texas Comptroller of Public Accounts,” and that Lesar had “forfeited its right to do business in the State of Texas, including the right to file litigation in Texas courts.”

Lesar moved for summary judgment and attached copies of its contracts. Lesar also attached as an exhibit to its summary judgment motion a copy of an Assumed Name Certificate, filed with the Harris County Clerk, authorizing use of the name “Lesar Electric & Design” for the period from April 11, 2016 to April 1, 2026. In addition, Lesar included a copy of an Application for Reinstatement and Request to Set Aside Revocation or Forfeiture filed with the Texas Secretary of State on May 18, 2018, accompanied by a May 17, 2018 tax clearance letter showing Lesar “ha[d] met all franchise tax requirements and [was] eligible for reinstatement.”

The trial court granted summary judgment for Lesar. On appeal, Sullair cited *Smith v. CDI Rental Equipment, Ltd.*, 310 S.W.3d 559, 564 (Tex. App.—Texarkana 2010, no pet.), for the proposition that a “company is prohibited from maintaining an action in a Texas court arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed.” The court of appeals observed, however, that Lesar had filed with its summary judgment motion an Assumed Name Certificate showing that Lesar was certified to do business as “Lesar Electric & Design.” According to the court, “[t]he valid assumed name certificate ... conclusively shows that Lesar had standing to sue in its corporate name.”

Sullair also argued that summary judgment was improperly granted because Lesar had forfeited its right to do business in Texas due to its failure to pay franchise taxes. The court of appeals disagreed:

Under Texas law, a corporation that has forfeited its corporate privileges is denied the right to sue in state court unless its corporate privileges are revived. *See* TEX. TAX CODE ANN. § 171.252(1). But “[t]he purpose of [section 171.252] is to enforce collection of state franchise taxes, not to prohibit a corporate cause of action.” *Flameout Design & Fabrication, Inc. v. Pennzoil Caspian Corp.*, 994 S.W.2d 830, 839 (Tex. App.—Houston [1st Dist.] 1999, no pet.). A corporation’s payment of delinquent taxes and reinstatement of status will relate back and revive whatever rights the corporation had when the suit was previously filed. *Bluebonnet Farms, Inc. v. Gibraltar Sav. Ass’n*, 618 S.W.2d 81, 85 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref’d n.r.e.).

Here, Lesar provided evidence showing that it had paid its tax debt and had applied to have its corporate privileges reinstated while its suit was pending in the trial court, showing that it had legal capacity to sue Sullair. We conclude that Lesar’s payment of its tax debt renders moot Sullair’s argument that “Lesar ... forfeited its right to do business in Texas under [Texas] Tax Code section 171.252.” We hold that the trial court did not err in granting Lesar summary judgment.

*See also Katz v. Intel Pharma, LLC*, Civ. A. No. H-18-1347, 2020 WL 3871493 (S.D. Tex. July 9, 2020), summarized above under “Dissolution/Winding Up.”

## **L. Veil Piercing**

***DGG Group, LLC v. Lockhart Fine Foods, LLC***, Case No. 1:20-CV-00330-RP, 2021 WL 308946 (W.D. Tex. Jan. 29, 2021).

The court held that a Delaware LLC that formed another LLC to acquire the assets of a business was the alter ego of the acquisition LLC for purposes of personal jurisdiction where the Delaware LLC, one month after the acquisition, entered into a management agreement with the acquisition LLC under which the Delaware LLC managed the business in exchange for all the net profits of the business, and the acquisition LLC transferred all its working capital assets to the Delaware LLC.

DGG Group, LLC (“DGG”) was a Texas limited liability company that manufactured cookies and cookie dough. Sinbad Foods, LLC (“Sinbad”), a Delaware limited liability company that maintained its principal place of business in California, decided to acquire DGG’s business. To effectuate the acquisition, Sinbad formed Lockhart Fine Foods, LLC (“Lockhart”), a Delaware LLC, to purchase DGG’s assets. After the sale, DGG claimed that

Lockhart defaulted on its required payments under the asset purchase agreement and violated the agreement by delivering poorly maintained equipment, refusing to provide transition services, and failing to provide negotiated discounts. DGG also alleged that Lockhart, after it failed to make required payments to DGG, fraudulently transferred its assets to Sinbad by pledging its assets to secure a \$243,000 bank loan to Sinbad. DGG sued both Lockhart and Sinbad, and Sinbad challenged the court's jurisdiction over Sinbad.

DGG argued that Lockhart's contacts with Texas should be imputed to Sinbad as its alter ego or agent for the purpose of establishing specific jurisdiction. The court pointed out that the Fifth Circuit has held "that it is compatible with due process for a court to exercise personal jurisdiction over an individual or a corporation that would not ordinarily be subject to personal jurisdiction in that court when the individual or corporation is an alter ego or successor of a corporation that would be subject to personal jurisdiction in that court." The court explained that in such a case the jurisdictional contacts of one are the jurisdictional contacts of the other. To apply the alter-ego doctrine in this manner, the Fifth Circuit generally demands "proof of control by [one corporation] over the internal business operations and affairs of another corporation to make the other its agent or alter ego, and hence fuse the two together for jurisdictional purposes." The court listed the following nonexhaustive factors in determining whether a plaintiff asserting personal jurisdiction has overcome the presumption of corporate separateness: (1) the amount of stock owned by the parent of the subsidiary; (2) whether the entities have separate headquarters, directors and officers; (3) whether corporate formalities are observed; (4) whether the entities maintain separate accounting systems; and (5) whether the parent exercises complete control over the subsidiary's general policies or daily activities.

The court concluded that there was sufficient proof that Sinbad controlled Lockhart to such a degree that they should be treated as alter egos for purposes of jurisdiction. It was undisputed that Lockhart "was formed to take advantage of a new business opportunity—purchasing [DGG's] cookie-making operation and business model for Sinbad (an existing manufacturer)." A month after the sale closed, Lockhart entered into a management agreement with Sinbad under which Sinbad would manage all aspects of Lockhart's cookie business in exchange for all of the net profits, payable as "management fees." The same individual signed the management agreement as CEO of both Sinbad and Lockhart. Lockhart also transferred to Sinbad all its rights and ownership in the working capital assets acquired pursuant to the asset purchase agreement. Based on such proof, the court concluded that Lockhart's contacts, which consisted of manufacturing and other business activities in the Texas market and purposefully directed tortious activities toward Texas, were properly imputed to Sinbad. Additionally, the court concluded that DGG's causes of action arose out of the forum-related contacts, and the exercise of personal jurisdiction was fair and reasonable. Thus, the magistrate judge recommended that the district court deny Sinbad's motion to dismiss.

*Spicer v. Maxus Healthcare Partners, LLC*, 616 S.W.3d 59 (Tex. App.—Fort Worth 2020, no pet. h.).

Addressing a split in the courts of appeals, the court in this case concluded that Section 21.223 of the Business Organizations Code did not require a showing that an LLC member used the LLC to commit fraud for her personal benefit where the claimant was not relying on veil piercing to hold the member liable but was attempting to hold the member directly liable for fraudulent misrepresentations made in connection with an asset purchase agreement entered into by the LLC.

This dispute arose out of the sale of Texas RHH, LLC ("Texas RHH"), a home healthcare business owned by Misty Brady. Maxus Healthcare Partners, LLC ("Maxus"), the purchaser Texas RHH's assets, obtained a multi-million dollar judgment against Texas RHH for breach of contract and against Brady for fraud.

Among the arguments made on appeal was Brady's argument that the trial court erred by entering judgment against Brady for fraud in her individual capacity when Maxus neither pleaded nor proved that Brady had acted primarily for her personal benefit. Brady relied on Section 21.223 of the Texas Business Organizations Code, arguing that, as the owner of Texas RHH, LLC, Brady could not be liable for misrepresentations made on Texas RHH's behalf unless Maxus pleaded and proved that she had used Texas RHH to commit fraud for her direct personal benefit. Maxus argued that Section 21.223 did not apply because (1) Maxus did not seek to hold Brady liable under any veil-piercing theory but instead sought to hold her liable for her own fraudulent conduct, and (2) Maxus was not seeking to hold Brady liable for Texas RHH's "contractual obligation" or for "any matter relating to or arising from the obligation" but instead for her own fraud. Maxus relied on *Alexander v. Kent*, 480 S.W.3d 676 (Tex. App.—Fort Worth 2015, no pet.), to support its Section 21.223 argument. The court addressed this argument as follows:

Section 21.223, which applies to LLCs via Section 101.002(a), reflects legislative limits on recovery from an individual based on a company's obligations. *See* Tex. Bus. Orgs. Code Ann. §§ 21.223(a)(2), (b), 101.002(a); *Chan v. Sharpe*, No. 02-14-00286-CV, 2015 WL 5722833, at \*4 (Tex. App.—Fort Worth Aug. 26, 2015, pet. denied) (mem. op.) (“To pierce the corporate veil, and thus disregard the corporate form, a plaintiff must show that the shareholder used the corporation to ‘perpetrate an actual fraud ... primarily for the direct personal benefit’ of the shareholder.”) (quoting Tex. Bus. Orgs. Code Ann. § 21.223(b)); *see also Ritchie v. Rupe*, 443 S.W.3d 856, 869 (Tex. 2014) (stating that “[f]raudulent or illegal actions by a corporation’s directors may result in disregard of the corporate form” (citing Tex. Bus. Orgs. Code Ann. § 21.223(b))); *PHC-Minden, L.P. v. Kimberly-Clark Corp.*, 235 S.W.3d 163, 175 (Tex. 2007) (noting that fraud is vital to piercing the corporate veil under Section 21.223).

Under Section 21.223, a company's owner cannot be held liable to the company or to the company's obligees with respect to “any contractual obligation of the [company] or any matter relating to or arising from the obligation on the basis that the [owner] is or was the alter ego of the [company] or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory” unless the obligee shows that the owner “caused the [company] to be used for the purpose of perpetrating and did perpetrate actual fraud on the obligee primarily for the direct personal benefit” of the owner. Tex. Bus. Orgs. Code Ann. § 21.223(a)(2), (b). If Section 21.223 applies, then it “preempts any other liability imposed for that obligation under common law or otherwise” unless the owner expressly agreed to be personally liable to the obligee for the obligation or “is otherwise liable to the obligee for the obligation under this code or other applicable statute.” *Id.* §§ 21.224–.225; *Willis v. Donnelly*, 199 S.W.3d 262, 272–73 (Tex. 2006) (holding that ratification is a “similar theory” of derivative liability covered by Section 21.223).

A split has arisen in the courts of appeals regarding whether Section 21.223 preempts an individual's direct tort liability in addition to his or her vicarious liability under a piercing-the-veil or related theory. *See Bates Energy Oil & Gas v. Complete Oilfield Servs.*, 361 F. Supp. 3d 633, 664–72 (W.D. Tex. 2019). As the federal district court noted in *Bates*, “Texas has long had two methods for holding individual corporate agents or officers personally liable when they are acting within the course and scope of their employment or role as corporate agents—piercing the corporate veil or direct individual liability” and “recent cases [involving Section 21.223] have muddled [the] distinction” between these two methods. *Id.* at 664, 667. The court concluded that Section 21.223's language applied only to claims holding an owner vicariously liable for a contract-related corporate obligation in both contract and tort and to claims seeking to hold an owner liable for a corporate obligation on the basis of other “classic veil piercing” scenarios under Texas common law. *Id.* at 672–73.

Appellants refer us to *TecLogistics, Inc. v. Dresser-Rand Group*, a cross-appeal of a judgment on a jury verdict on breach of contract and fraud in which our sister court considered Section 21.223's application. 527 S.W.3d 589, 599–600, 603 (Tex. App.—Houston [14th Dist.] 2017, no pet.). *TecLogistics*'s president had created false invoices to bill Dresser Rand. *Id.* at 592–93, 596, 597–98. At trial, Dresser Rand submitted a proposed jury question regarding the president's individual liability for common law fraud, and the court considered whether the proposed question was raised by the pleadings and evidence. *Id.* at 595.

The court held, among other things, that the trial court did not abuse its discretion by refusing the proposed question, reasoning that Section 21.223 had entirely replaced the common law and that neither statutory exception applied. *Id.* at 591, 598–99. The court noted that because *TecLogistics*'s president was the only person involved in creating and tendering the false invoices to Dresser Rand, she was the human agent through which *TecLogistics* had committed actual fraud. *Id.* Thus, because the court concluded that Section 21.223(a)(2)'s requirements were met, *TecLogistics*'s president was shielded when Dresser Rand (1) had failed to allege in its pleadings that she had acted primarily for her direct personal benefit, (2) had presented no such evidence of her acting for her direct personal benefit at trial, and (3) had proposed no jury question that would have permitted such a finding. *Id.* at 598–99, 603.

Maxus relies on *Alexander* to support its argument that Brady is directly and individually liable for fraud. In *Alexander*, we stated that the general rule in Texas “has always been” that a “corporation’s employee is personally liable for tortious acts which he directs or participates in during his employment” and that a corporate agent can be held individually liable for fraudulent statements or knowing misrepresentations even when made in the capacity of a corporate representative. 480 S.W.3d at 697–98.

In *Alexander*, Kent (the plaintiff and later appellee) hired K.B. Alexander Co. (KBA), a construction company of which Alexander was president and sole stockholder. *Id.* at 680. Kent sued KBA for breach of contract and Alexander individually for fraud based on false payment applications misrepresenting that subcontractors had been paid. *Id.* at 680, 682–83. Kent nonsuited KBA after it declared bankruptcy and proceeded on his fraud claim against Alexander. *Id.*

Although Alexander argued that he could not be held individually liable because he was not a party to the Kent–KBA contract and had signed the contract and pay applications only in his capacity as KBA’s president, we concluded that because the action involved holding Alexander liable for his own fraudulent statements, there was no need to pierce the corporate veil under a vicarious liability theory. *See id.* at 697–98; *cf. Chan*, 2015 WL 5722833, at \*5 (holding that when each of the appellant’s claims sought to impose personal liability on his fellow shareholders for obligations owed by their company Wan Fu Foods, Inc., Section 21.223(b) imposed a burden on the appellant to prove actual fraud).

Maxus sued Brady for fraud based on her acts and omissions throughout the due diligence and negotiation process that led to Maxus’s overpayment for Texas RHH’s assets. Because Maxus’s fraud claim is based on Brady’s direct liability for fraudulent acts, we decline Appellants’ invitation to follow our sister court’s interpretation of Section 21.223. *See Alexander*, 480 S.W.3d at 697–98. We overrule this portion of Appellants’ first issue.

***White v. Cyr (Matter of Cyr)***, 838 F. App’x 54 (5th Cir. 2020).

The court affirmed the district court’s dismissal of a claim to hold the individual owner of an LLC liable based on alter ego where the plaintiff did not adequately allege any of the relevant factors identified by the court. The court affirmed the district court’s dismissal of vicarious and agency liability claims against the individual owner where the plaintiff did not allege any grounds to characterize the LLC’s CEO as the agent of the owner.

Dr. White agreed to provide pain management services to patients of Orthopaedic & Spine Institute L.L.C. (“OSI”). OSI agreed to pay Dr. White 50% of gross revenue collected from patients and third-party payers. When OSI failed to pay Dr. White, he sued OSI and OSI’s owner, Dr. Cyr. After Dr. Cyr filed for relief under Chapter 7 of the Bankruptcy Code, Dr. White filed a claim in bankruptcy court, requesting that Dr. Cyr’s debts to him be determined to be non-dischargeable under Section 523(a) of the Bankruptcy Code.

In 2014, Dr. White met with Dr. Cyr and Linda D’Spain, OSI’s CEO, about affiliating with OSI. Dr. Cyr and D’Spain made several representations to Dr. White that OSI was profitable and would be able to pay him his negotiated compensation packages, that OSI had an existing management system with computerized billing, that OSI had practices and relationships with third-party payers that allowed for timely payment, that OSI’s reimbursement rates were consistent with those in the community, and that OSI would timely apply for Dr. White’s credentials so that he could receive prompt payment. The district court dismissed Dr. White’s claim that Dr. Cyr committed fraud that gave rise to a nondischargeable debt under § 523(a)(2)(A) of the Bankruptcy Code because Dr. Cyr’s alleged oral misrepresentation of his financial condition was required to be in writing to render Dr. Cyr’s debt nondischargeable. The district court also dismissed Dr. White’s agency and vicarious liability claims because it concluded that Dr. White did not plausibly allege that D’Spain was Dr. Cyr’s agent. Dr. White argued that he pled enough facts to demonstrate that D’Spain was Dr. Cyr’s agent. If D’Spain was Dr. Cyr’s agent and committed fraud that can be attributed to Dr. Cyr, the resulting debt would also not be dischargeable under § 523(a)(2)(A) of the Bankruptcy Code.

To prevail on his claim that Dr. Cyr’s misrepresentation regarding the profitability of his clinic gave rise to a nondischargeable debt, Dr. White was required by § 523(a)(2)(A) to allege sufficient facts to demonstrate that this representation was “obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.” The court characterized the alleged misrepresentation as a statement respecting OSI’s financial condition, which was also in turn a statement respecting Dr. Cyr’s

financial condition based on the rationale that a statement about a single asset of a debtor can be a statement respecting the debtor's financial condition. If a statement is a "statement respecting the debtor's financial condition," the statement does not prevent discharge unless it meets the requirements of § 523(a)(2)(B)(i)-(iv), including the requirement that the statement be in writing. The court concluded that, even assuming the falsity of the representation, it was a statement respecting the debtor's financial condition that was not in writing and thus was not nondischargeable under § 523(a)(2)(B).

Dr. White argued that the district court erred in dismissing his claim to pierce OSI's "corporate" veil under an alter-ego theory. The court quoted corporate case law for the proposition that a court may pierce the corporate veil to hold the shareholders liable when the corporation is the alter ego of its owners or shareholders, i.e., when there is "such a unity between corporation and individual ... that the separateness of the corporation has ceased and holding only the corporation liable would result in an injustice." Relevant factors identified by the court included: (1) the payment of alleged corporate debts with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his or her personal use; (4) inadequate capitalization; (5) whether the corporation has been used for personal purposes; and (6) other failure to keep corporate and personal assets separate. Although the court stated that it was not necessary to allege any of these factors, the court found it telling that Dr. White did not sufficiently allege any of them. Dr. White alleged numerous facts about the nature of Dr. Cyr's relationship with OSI—his ownership, his ability to negotiate contracts, his treatment of patients, etc.—but failed to allege any impermissible unity between the two other than the bare allegation that Dr. Cyr used OSI's funds for personal purposes. Thus, the court concluded that Dr. White failed to allege any facts supporting plausible relief based on alter ego.

Dr. White also argued that D'Spain was Dr. Cyr's agent and that, as such, D'Spain's alleged fraud could be attributed to Dr. Cyr, resulting in a debt would not be dischargeable under § 523(a)(2)(A). The court stated that, under Texas law, agency relationships are created by express or implied agreements by the parties, or the relationship may be based on apparent authority where the principal permits the agent to hold herself out as having authority and a reasonable person concludes that the agent has such authority. According to the court, Dr. White's theory of agency rested on D'Spain's purported apparent authority to act on Dr. Cyr's behalf, but Dr. White failed to allege any facts to suggest that she had such authority. Dr. White's only factual assertions about D'Spain related to her presence in his initial meeting with Dr. Cyr and her correspondence with Dr. White about his payments and credentials. Even assuming all of these allegations to be true, Dr. White merely detailed his interactions with D'Spain as OSI's CEO. None of these facts suggested that she was Dr. Cyr's agent. Absent an agency relationship, Dr. White did not plead any other grounds on which Dr. Cyr could be vicariously liable for D'Spain's actions. Thus, the court affirmed the district court's dismissal of Dr. White's agency and vicarious liability claims.

*Hawxhurst v. Austin's Boat Tours*, No. 08-19-00257-CV, 2020 WL 5094673 (Tex. App.—El Paso Aug. 28, 2020, no pet.) (mem. op.).

The court of appeals affirmed the trial court's granting of summary judgment to the extent that it dismissed claims brought against the two individual defendants on an alter-ego theory of liability.

Gerald Hawxhurst alleged that in July 2015, he was boating on Lake Travis when he observed a life jacket floating in the water. He maneuvered his yacht towards the life jacket so that his passenger could pull it from the lake. As he approached the life jacket, his propeller became entangled in a dock line that was tied to the life jacket and anchored to the bottom of the lake by a heavy object. The motor became disabled, and while Hawxhurst's passenger attempted to remove the line from the motor, the yacht drifted into the rocky shore, damaging the hull and resulting in repair costs of \$409. According to Hawxhurst, the life jacket bore the name of Austin's Boat Tours, a company that organizes boat tours and parties on Lake Travis.

Hawxhurst contacted Austin's Boat Tours. He alleged that the person with whom he spoke by phone identified himself as the company's owner, acknowledged that a company representative had placed the "make-shift buoy" in the lake and had left it there, and promised to pay for repairs to the yacht. Hawxhurst further contended that he spoke to and exchanged emails with the company's lawyer, memorializing its agreement to pay for the repairs. Hawxhurst had the boat repaired and forwarded the invoice to the company, which refused to pay.

Hawxhurst filed suit against Austin's Boat Tours, Austin Edwards, and Angel Edwards. After the defendants identified Aria Transport LLC as the owner and operator of Austin's Boat Tours, Hawxhurst joined that entity as an additional defendant. Hawxhurst's petition sought to hold Austin Edwards and Angel Edwards individually liable for the alleged obligations of Aria Transport. He alleged that each defendant was the alter ego

of the other defendants. He further alleged that to the extent any of the defendants was an entity formed for the purposes of limiting the personal exposure of any other defendant, “such corporate or other status was and is fraudulent,” has been improperly maintained to defraud him as a creditor, and should be disregarded for the purposes of liability and damages. According to Hawxhurst, the Edwardses directly managed, controlled, and dominated the operations of Austin’s Boat Tours and Aria Transport such that a “unity of ownership” existed between the Edwardses on the one hand and between Austin’s Boat Tours and Aria Transport on the other. Hawxhurst also argued that Aria Transport was undercapitalized and that maintaining the separate legal existence of Austin’s Boat Tours and Aria Transport would promote injustice and fraud, making it equitable to treat them as the alter egos of the Edwardses.

All defendants (collectively, the “ABT Parties”) then filed a motion for summary judgment on all claims, which was granted by the trial court. With respect to the piercing claim, the court of appeals concluded that Hawxhurst had not satisfied the evidentiary burden required to maintain claims against Austin Edwards and Angel Edwards in their individual capacities:

Use of the limited liability company form ordinarily functions to insulates members and managers from personal liability for the LLC’s obligations. [See TEX.BUS.ORG.S.CODE ANN. § 101.114 (“Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.”). Cf. *SSP Partners v. Gladstrong Investments (USA) Corp.*, 275 S.W.3d 444, 451 (Tex. 2008) (“We have held that the limitation on liability afforded by the corporate structure can be ignored only ‘when the corporate form has been used as part of a basically unfair device to achieve an inequitable result’ ”) (quoting *Castleberry v. Branscum*, 721 S.W.2d 270, 271 (Tex. 1986)).] As applied in this case, alter-ego liability requires a particular relationship between the LLC and an individual member in order to disregard the entity form—the LLC must be organized and operated as a mere tool or business conduit of the individual. Stated differently, alter-ego liability can be imposed only when there is such unity between company and individual that the separateness of the LLC has ceased and holding only the company liable would result in injustice.

In their motion for summary judgment, the ABT Parties argued that Hawxhurst had no evidence to support the claim that the Edwardses should be held individually liable for the obligations of Aria Transport. In particular, they alleged that Hawxhurst has no evidence that the company was the alter ego of Austin or Angel Edwards, that its form was used to perpetrate a fraud on him, or that the company’s form was used to evade its legal obligations or cause an injustice to him. To the extent these elements were legally necessary to establish the Edwardses’ alter-ego liability, it became Hawxhurst’s burden to present more than a scintilla of evidence—enough to enable reasonable and fair-minded people to differ in their conclusions—to raise a genuine issue of material fact on each challenged element.

For purposes of this case, which involves both a negligence claim and a contract claim, we will focus on Hawxhurst’s evidence relating to the relationship between the LLC and its owners, i.e. whether it has been organized and operated as a mere tool or business conduit of the individual owners. A determination of whether this level of unity exists “is shown from the total dealings” of the entity. The relevant indicators include: the degree to which corporate formalities have been followed and company and individual property have been kept separately; the amount of financial interest, ownership, and control ... maintained over the company; and the use of the company for personal purposes. [Unless a member expressly assumes liability, he may not be held liable for the LLC’s *contractual obligations* on the basis that the member is or was the alter ego of the LLC unless the member is shown to have caused the company to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the member. See TEX.BUS.ORG.S.CODE ANN. §§ 21.223-.225, 101.002; *Saltworks Ventures, Inc. v. Residences at Spoke, LLC*, No. 03-16-00711-CV, 2018 WL 2248274, at \*10 (Tex. App.—Austin May 17, 2018, no pet.).]

Setting aside proffered evidence that was excluded by the trial court in evidentiary rulings that have not been challenged on appeal, Hawxhurst’s evidence to support his alter-ego allegations



was limited. He relied upon discovery responses and complained about the late disclosure that Aria Transport existed and was the owner and operator of Austin’s Boat Tours. He pointed out that the ABT Parties identified Austin Edwards as the sole member and manager of Aria Transport, while public reports identify Angel Edwards as a director of Aria Transport and the evidence identified her as one of the “owners” of the company. He also complained about the ABT Parties attaching evidence to their motion that he contends should have been produced earlier in response to discovery requests.

Nothing presented or argued by Hawxhurst satisfied his burden in response to a no-evidence motion of presenting more than a scintilla of evidence that the “total dealings” of Aria Transport reflect that its corporate formalities have not been followed or that corporate and individual property have not been kept separately; that the Edwardses exert inappropriate control over the company; or that the company was abused for personal purposes. [While we analyze this issue under the no-evidence standard, we note that the ABT Parties also presented traditional summary-judgment grounds. They argued that Aria Transport was formed nearly two years before the incident that resulted in this litigation, proving that it was not formed for the purpose of perpetuating a fraud on Hawxhurst. They also presented evidence that Aria Transport had observed business formalities by maintaining distinct records and bank accounts, and by paying separate taxes. They presented evidence that the company had sufficient assets to pay any judgment.] Accordingly, we affirm the grant of summary judgment dismissing all claims against Austin and Angel Edwards in their individual capacities.

#### **M. Series**

***Infinity Emergency Management Group, LLC v. Neighbors Health System, Inc. (In re Neighbors Legacy Holdings, Inc.)***, \_\_ B.R. \_\_, 2021 WL 1042867 (Bankr. S.D. Tex. 2021).

This case involved a complicated structure (which the court characterized as “convoluted”) involving multiple entities, including “series LLCs.” The Trustee of the Debtors’ Unsecured Creditor Trust challenged the standing of Infinity Emergency Management Group, LLC (“Infinity”) to bring derivative claims, asserting that Infinity’s claims sought relief for harm to debtor entities and thus belonged to the Unsecured Creditor Trust. Infinity maintained that its claims sought redress only on behalf of two “series LLCs,” which were non-debtor entities (although the LLC that apparently created the series was a debtor entity). The bankruptcy court concluded that some of Infinity’s claims alleged harm to debtor limited partnerships and that Infinity lacked standing as to those claims. In order to assert the remaining claims, the court concluded that Infinity would need to re-plead to make clear that the alleged harms were suffered by the series LLCs in which Infinity held interests.

The dispute in this case revolved around two of 22 free-standing emergency centers that were operated by debtor Neighbors Legacy Holdings, Inc. and its subsidiaries and affiliates (the “Neighbors Network”). Each emergency center was owned by a separate limited partnership, and each limited partnership had a 1% general partner—Neighbors GP, LLC—and a 99% limited partner—NHS Emergency Centers, LLC (“NHS”). The court stated that “NHS established individual series LLCs to operate (but not to own) each emergency center,” and “each series LLC was owned by two classes of shareholders.” According to the court, “[t]he Class A owners of each series LLC were to be founding members of the Neighbors Network,” and “[t]he Class B owners of each series LLC were physicians that ‘purchased interests in [the] profits and losses [of a] specific series LLC[ ]. ... The management and administration of each emergency center, as well as the entities associated with each center, was carried out by five other Neighbors Network affiliates.’”

The court further described the structure of the two emergency centers involved in this dispute as follows:

Those emergency centers are NEC Eastside Emergency Center, LP and NEC Zaragoza Emergency Center, LP (together, the “Center LPs”). NHS, a Debtor entity, was the sole limited partner of both Center LPs. (ECF Nos. 59-24 at 2, 10; 61-13 at 2, 10). Each Center LP is a Debtor. (ECF No. 80 at 8–9). The series LLCs associated with the Center LPs were Series 114 – Eastside, LLC and Series 115 – Zaragoza, LLC (together, the “Series LLCs”). Neither Series LLC is a Debtor. (ECF No. 80 at 8–9). The Class A shareholder of each Series LLC was Neighbors Investment, which held a 34% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). The Class B

shareholder was Infinity, which held a 65% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Investment and Infinity were the sole members of the Series LLCs. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Health provided management and administrative services to the Center LPs, the Series LLCs, and NHS. (ECF Nos. 62-12; 59-29; 59-10; 62-10; 62-24).

In practical terms, the emergency centers were “brick and mortar” stores for the Neighbors Network. The Center LPs were created to own these stores. To that end, the Center LPs provided facilities for Neighbors Network physicians, who provided healthcare services to patients and generated revenue through provision of these services. NHS was created to hold the majority ownership stake in the Center LPs. NHS created the Series LLCs to oversee the day-to-day operations of the Center LPs. While the Series LLCs were created to “operate” the Center LPs, the management and administration of the Center LPs—the “nuts and bolts” of day-to-day operations—was entrusted to Neighbors Health (a Debtor entity). Infinity, a member of the Series LLCs, was supposed to provide physicians to staff the emergency centers in exchange for a cut of the revenue generated by the “brick and mortar” centers. Perhaps inevitably, this convoluted structure produced litigation over which entity or successor could sue for the alleged mismanagement of the Center LPs.

The court next described the process by which Infinity invested in this arrangement and highlighted certain provisions of the series agreements executed by Infinity as well as the NHS operating agreement and the Center LP limited partnership agreements.

The court characterized the “6500 Class B shares in the Series LLCs” as “ownership interests” that “were offered by NHS,” and the court stated that Infinity acquired a “65% interest in both Series LLCs,” each of which was created for the purpose of operating its corresponding free-standing emergency center. Infinity purchased its interests pursuant to two identical “Series Purchase Agreements,” each of which reserved the profits and losses of the relevant emergency center for the corresponding series owners. The purchase agreements required Infinity to provide clinical staffing for the emergency centers, but the clinical staff members were to be employed as independent contractors of a specified Neighbors PLLC rather than as employees of the Series LLCs or any other Neighbors Network affiliate.

The “Series Agreements” executed by Infinity described the basic structure of the Series LLCs and identified the property associated with each Series LLC. Under the series agreements, Infinity acknowledged that the Series LLCs were created to operate the “Series Business[es],” which were the Center LPs. The Series LLCs were to receive “profits, losses, distributions, and other benefits received by NHS” from the Center LPs, and these “profits, losses, [etc.]” were identified as “Series Property.” Infinity was entitled to receive distributions derived from the Series Property, and Neighbors Health—the manager of the Series LLCs—was responsible for making these distributions.

Along with the series agreements, the NHS Operating Agreement defined the Series Property from which Infinity was to receive distributions. The Series LLCs were established by the NHS Operating Agreement, under which NHS was authorized to acquire interests in Texas limited partnerships. NHS was to “allocate or attribute” the “profits, losses, distributions, and allocations” from the limited partnerships to the Series LLCs. Once received or “determined” by NHS, the “profits, losses, distributions, and allocations” from the limited partnerships were considered Series Property.

Under the Center LP Limited Partnership Agreements, the “income, gain, loss, deduction, and credit of the Partnership[s]” were to be allocated 1% to Neighbors GP (the general partner of each Center LP) and 99% to NHS (the limited partner of each Center LP). Additionally, partnership revenues, which included all gross receipts of the partnership received by the partnership, were to be distributed to Neighbors GP and NHS in accordance with their respective allocations. The Center LPs were the “Series Business[es]” from which NHS was supposed to receive the “profits, losses, distributions, and other benefits,” which were to be distributed to the Series LLCs.

Four years after Infinity purchased its interests in the Series LLCs, certain entities in the Neighbors Network filed for Chapter 11 relief. The Center LPs and the general and limited partners of the Center LPs, including NHS, were debtors. Neither Neighbors Investment (the Class A interest owner of the Series LLCs) nor the Series LLCs were debtors. [Interestingly, the court did not address whether the series should be included as

debtors by virtue of NHS's status as a debtor (since the series that were created by NHS would not actually be separate entities from NHS under Texas law).]

At issue in this case was whether Infinity could pursue derivative claims filed against Neighbors Health and Neighbors Health's directors and officers or whether the claims belonged to the Unsecured Creditor Trust. Infinity asserted its claims on behalf of the Series LLCs based on alleged breaches of fiduciary duty, abuses of control, gross mismanagement, and waste of corporate assets by Neighbors Health and its officers and directors. The wrongs of which Infinity complained stemmed from the directors' and officers' alleged failure to "properly oversee the operations and finances of" the Series LLCs. Infinity based the derivative claims on the defendants' actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; (3) limited partner shares of the Center LPs to be wrongly collateralized; (4) fees billed by the Center LPs to be held in Center LP accounts and never "pushed back" to the Series LLCs; (5) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; and (6) Series LLC funds to be transferred to other "unprofitable series entities." Infinity asserted that these actions resulted in losses of revenue and profit to the Series LLCs, but the Creditor Trustee argued that the Center LPs, rather than the Series LLCs, suffered the harm alleged. The court stated that the core of the issue was which entity owned the profits that were diminished by the defendants' alleged mismanagement. Infinity claimed that the non-debtor Series LLCs owned the business operations of the emergency centers and that it was thus the Series LLCs' profits that were impaired by the mismanagement, but the Creditor Trustee contended that the Center LPs associated with the emergency centers owned the centers' operations and suffered the loss of profits, thus vesting claims for redress in the debtor Center LPs.

The court discussed at length the "web of agreements" defining what the Series LLCs owned. Although Infinity contended that the agreements clearly established that the Series LLCs owned the emergency centers' business operations, and, by implication, the profits from those business operations, the court agreed with the Creditor Trustee that the Series LLCs only had an interest in distributions from Center LP profits. According to the court, the agreements made clear that certain property identified in Infinity's complaint was, at the time it was damaged, owned by the Center LPs. Because this alleged damage occurred while the property was owned by the Center LPs, the Trustee was vested with the exclusive right to seek redress for this damage. Specifically, Infinity did not have standing to seek redress for the defendants' actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; and (3) fees billed by the Center LPs to be held in Center LP accounts and never "pushed back" to the Series LLCs.

The court concluded that it was unclear whether Infinity had a viable derivative claim based on the three remaining alleged harms, i.e., that the defendants caused: (1) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; (2) Series LLC funds to be transferred to other "unprofitable series entities;" and (3) limited partner shares of the Center LPs to be wrongly collateralized. As to the first two of these harms, Infinity's complaint did not make clear whether the Series LLCs owned the physician fees and the funds that were allegedly wrongfully transferred. As to the claim that Center LP shares were wrongfully collateralized, Infinity's failure to specify whether the defendants were acting as managers of the Series LLCs or of NHS was significant in that the series agreement contained a provision by which the members appeared to give NHS the right to encumber the Series Property, including Center LP shares acquired by NHS and allocated to the Series LLCs. Nevertheless, the court stated that Infinity might have a contractual claim based on the defendants' "wrongful collateralization" based on the management agreement between the Series LLC and Neighbors Health, which restricted Neighbors Health's ability to borrow money or execute promissory notes on the Series LLCs' behalf. Because Infinity's complaint did not make clear its standing to pursue these claims, the court stated that Infinity must re-plead its allegations as to these claims.

Finally, the court addressed Infinity's assertion that it could invoke Section 101.463 of the Texas Business Organizations Code, which provides special rules for closely held LLCs. The court discussed these provision in this context and ultimately concluded that the issues raised (whether the fact that the defendants were no longer governing persons and officers affected Infinity's ability to rely on these provisions and whether Infinity should recover directly) were not yet ripe:

Generally, to assert a derivative claim, a limited liability company's member must comply with sections 101.452 through 101.460. *See* TEX. BUS. ORGS. CODE ANN. § 101.463(b). However, under section 101.463, "[s]ections 101.452-101.460 do not apply to a claim or a derivative proceeding

by a member of a *closely held* limited liability company against a governing person, member, or officer of the limited liability company. *Id.* § 101.463(b) (emphasis added). If a member’s derivative claim is asserted “against a person *who is not* a governing person, member, or officer,” sections 101.452 through 101.460 still apply. *Id.* § 101.463(b) (emphasis added).

Section 101.463 also allows courts to treat derivative claims asserted by members of closely held limited liability companies as direct claims “if justice requires.” *Id.* § 101.463(c). To further enable members to vindicate their derivative claims, any recovery from such a proceeding “may be paid directly to the plaintiff or [company] if necessary to protect the interests of creditors or other members.” *Id.* This authorization does not, however, “transform the derivative action into a direct action.” *Gill v. Grewal*, 4:14-CV-2502, 2020 WL 3171360, at \*4 (S.D. Tex. June 15, 2020); *Black Elk Energy*, 2016 WL 4055044, at \*2. Moreover, the Court retains the authority to direct any recovery to the entity that suffered the injury rather than to the derivative plaintiff. *Swank*, 258 S.W.3d at 665 (holding that, under the corporate analog to section 101.463(c), “the trial court has *discretion* to award damages in a derivative proceeding directly to the shareholder.” (emphasis added)).

At bottom, section 101.463 “offers procedural benefits to members of limited liability companies, allowing them to pursue derivative actions for their own benefit.” *Black Elk Energy*, 2016 WL 4055044, at \*2; *see also In re LoneStar Logo & Signs, LLC*, 552 S.W.3d 342, 349–50 (Tex. App.—Austin 2018, no pet.) (quoting *Sneed v. Webre*, 465 S.W.3d 169, 181 (Tex. 2015)) (Section 101.463 authorizes “a shareholder of a closely held corporation [to] bring a derivative proceeding ... free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply ...” (internal quotation marks omitted, brackets in original)). In enacting these procedural benefits, the Texas Legislature removed the ability of independent directors “to decide whether continuing the derivative proceeding is in the best interest of the corporation.” *See Sneed*, 465 S.W.3d at 185–87 (examining the predecessor statute to the statute authorizing shareholder derivative proceedings against closely held corporations); *See LoneStar Logo*, 552 S.W.3d at 349–50 (relying on the Texas Supreme Court’s opinion in *Sneed* to interpret section 101.463). Section 101.463 enables members of closely held limited liability companies to bring derivative litigation without the impediments that burden other derivative suits.

However, plaintiff-members must qualify for access to this fast-tracked derivative relief under section 101.463. Specifically, the derivative action must be asserted against “a governing person, member, or officer.” TEX. BUS. ORGS. CODE ANN. § 101.463(b). Only then are the procedural benefits of section 101.463 unlocked.

Infinity’s standing to assert its purported derivative claim turns on the applicability of section 101.463(b). That is, whether Infinity was required to comply with sections 101.452 through 101.460 in asserting a derivative claim against Defendants on behalf of the Series LLCs. *See id.* § 101.463(b). Central to Infinity’s asserted standing under section 101.463(b) is the Defendants’ status in relation to the Series LLCs.

At the time Infinity initiated this proceeding in state court, it was an action against “governing person[s], member[s], or officer[s].” (*See* ECF No. 1-23 at 1–4). Since then, however, the Neighbors D&Os resigned their positions as officers and directors of all Neighbors entities. (*See* Case No. 18-33836, ECF Nos. 772 at 34; 862 at 1). The Liquidating Trustee took over management of Neighbors Health and NHS. (*See* Case No. 18-33836, ECF No. 772 at 8, 11, 34). And Neighbors Health rejected all unassumed executory contracts, which may have included the Management Agreement between Neighbors Health and the Series LLCs. (Case No. 18-33836, ECF No. 772 at 36). As it stands, Infinity’s derivative claim is no longer asserted against “governing person[s], member[s], or officer[s].” (ECF No. 80 at 1–4).

However, based on Infinity’s pleadings, it remains unclear whether the Series LLCs suffered injuries for which Infinity could seek derivative relief. Whether Defendants’ changes in status divested Infinity of its ability to rely on section 101.463 is a question that is not yet ripe.

It would also be premature to reach Infinity’s request under section 101.463 that, should Infinity recover on its derivative claim, any recovery be paid directly to Infinity under section 101.463(c)(2). First, Infinity has yet to plead a viable derivative claim, accompanied by the

requisite showing standing. Second, it is not clear whether justice will require Infinity to be paid directly should it recover on its derivative claim. *See* TEX. BUS. ORGS. CODE ANN. § 101.463(c). The appropriate relief, if any, will be determined at a future date. It is sufficient that Infinity is aware that its efforts may not result in any direct recovery.

*Rieder v. Woods*, 603 S.W.3d 86 (Tex. 2020) (citing Tex. Bus. Orgs. Code § 101.601(a) and noting that an LLC “may by agreement ‘establish ... one or more designated series of members, managers, membership interests, or assets that: (1) has separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses with respect to specified property or obligations; or (2) has a separate business purpose or investment objective’”; referencing Tex. Bus. Orgs. Code §§ 101.601–.662 as “authorizing and regulating series limited liability companies”).

#### **N. Creditor’s Remedies: Charging Order; Enforcement of Security Interest**

*In re M.W.M.*, No. 05-19-00757-CV, 2020 WL 6054337 (Tex. App.—Dallas Oct. 14, 2020, no pet.) (mem. op.).

The court of appeals affirmed the trial court’s granting of a charging order on various grounds, including that it did not reach entities in which Father had no ownership interest and it did not result in a garnishment of Father’s wages.

Following Father and Mother’s 2010 divorce, Mother obtained two judgments against Father relating to his obligations under the divorce decree, but Father made no payment on those judgments. Upon Mother’s application, the trial court signed an order that “charged” Father’s interest in certain entities with Mother’s judgments and ordered those entities not to pay Father any money or “expend any money for [his] personal benefit” until the judgments were paid.

The “Application for Charging Order” asserted that Father “ha[d] a position of authority in each of the following business organizations”: Driskill Energy Partners, LP; Michael W. Mitchell Family LP; Mitchell Energy Partners, LLC; Mitchell Energy Advisors, LLC; and M2 Investment Properties, LLC (collectively, the Mitchell Entities). Father filed a response stating that he held an ownership interest in Michael W. Mitchell Family LP, but “does not have any interest in any of” the other four entities listed in the application (collectively, the four disputed entities). He contended that there is “no basis to impose a charging order” on any of the four disputed entities.

After a hearing, the trial court signed the complained-of order, which was titled “Charging Order” and described the Mitchell Entities as “business organizations owned, operated, or controlled by [Father].” The order provided that (1) “the interest of [Father] in any and all of the Mitchell Entities is hereby subjected to a charging order in favor of and for the benefit of [Mother]”; (2) “[a]ny money due or to become due to [Father] by reason of his interest in the partnership shall be paid directly to [Mother]”; and (3) “none of the Mitchell Entities shall (a) pay any money to [Father], (b) pay any personal living expenses of [Father], or (c) expend any money for [Father’s] personal benefit, so long as any portion of this Court’s [judgments] remains unpaid.”

The four disputed entities filed a “Motion to Modify Charging Order,” asserting that “[b]ecause the Business Organizations Code does not entitle a judgment creditor to a charging order over entities for which the judgment debtor merely works, whether in a position of authority or not, the Non-Owned Entities respectfully request that the Court modify the Charging Order so that it only affects Michael W. Mitchell Family, LP—the only entity in which [Father] holds a membership interest.” The motion to modify cited Texas Business Organizations Code sections 101.112 (charging orders regarding limited liability companies) and 153.256 (charging orders regarding limited partnerships). In a declaration attached to the motion, Father stated that “[a]lthough I may hold manager or director positions in [the four disputed entities], I do not hold direct partnership, membership, or shareholder interests in any of those entities.” After a hearing, the trial court denied the motion to modify.

On appeal, Father argued that the trial court “erred when it subjected [the four disputed entities] to a charging order.” Father asserted (1) there is no evidence that Father holds an ownership interest in the four disputed entities; (2) the order “is void and must be vacated” because it “exceeded the court’s statutory authority” under the Texas Business Organizations Code; and (3) the order “interferes with [Father’s] interest in his current wages and, therefore, violates the Texas Constitution.” The court of appeals rejected all of these challenges:

We begin with appellants' complaint regarding lack of evidence that Father holds an "ownership interest" in the four disputed entities. According to appellants, "[t]he threshold requirement for a charging order is that the debtor must have an ownership interest in the entity on which the charging order is imposed," and "[a]bsent such an ownership interest," it was "improper" for the trial court to "impose a charging order." But the complained-of order's qualifying language charges only "the interest of [Father] in any and all of the Mitchell Entities." Pursuant to the order's qualifying provision, if Father owns no interest in a particular entity, the trial court's order charges nothing as to that entity. Nothing in the charging statutes specifically prohibits such application. *See* TEX. BUS. ORGS. CODE §§ 101.112, 153.256. Because the order does not purport to charge an interest in entities in which Father has no ownership interest, we conclude the complained-of lack of evidence of ownership interest in the four disputed entities is immaterial.

In their second subpart, appellants contend the complained-of order "exceeded the court's statutory authority" and is "void" because "[a]lthough the Business Organizations Code gives judgment creditors a lien on any distributions made to a debtor on account of the debtor's ownership interest in an entity, the trial court's order in this case far oversteps that limitation." This voidness argument was not asserted in the trial court.

Even assuming without deciding this complaint can be raised on appeal, the business organizations code was not the trial court's sole means to enforce its judgments. Appellants state in their opening appellate brief that the trial court's order "not only places a lien on any distributions that [Father] would be entitled to receive (assuming that he had an ownership interest in the Non-Owned Entities)," but also "acts as an injunction" in that it "purports to preclude the entities from paying [Father]" as a non-owner. Injunctive relief is an available means to enforce a judgment. Though Mother's application did not use the word "injunction," her requested relief included enjoining payments to Father or payment of his living expenses by the Mitchell Entities, and the trial court granted that requested relief. To the extent appellants argue the trial court lacked "authority" to do so, we disagree.

We also reject appellants' contention in their third subpart that the trial court's order violates the Texas Constitution's garnishment provision. That provision states, "No current wages for personal service shall ever be subject to garnishment, except for the enforcement of court-ordered: (1) child support payments; or (2) spousal maintenance." TEX. CONST. art. 16, § 28. According to appellants, the "practical effect" of the complained-of order "is to preclude [Father] from receiving any compensation from any of the Non-Owned Entities, in any form whatsoever," and "[t]his implicates the exact concern the Texas Constitution addresses."

Appellants rely on *McLendon v. Mandel*, No. 05-96-00160-CV, 1996 WL 403974 (Tex. App.—Dallas July 9, 1996, no writ) (not designated for publication). In that case, several creditors of debtor Gordon B. McLendon, Jr. sought "an injunction against [debtor] from taking any further money or property" from three specified entities in which he held interests. The trial court signed an order enjoining the debtor "from receiving or taking any money or property" from those entities "by loans, bonuses, wages, distributions or in any other form or manner until further order of the Court."

The debtor appealed, asserting in part that "to the extent [the injunction] prevents him from receiving current wages," "that portion of the injunction constitutes an unconstitutional garnishment of his wages." This Court disagreed, stating "the injunction does not violate article XVI, section 28 of the Texas Constitution" because "[t]he injunction does not place McLendon's current wages in the hands of a third party or take them from a third party." [This Court then considered and agreed with Mr. McLendon's argument that the injunction constituted a "seizure" of his wages precluded under Texas Property Code section 42.001(b). To the extent appellants' reliance on *McLendon* is based on that portion of the ruling, they did not assert any property code violation in the trial court or in their opening appellate brief. They cite property code section 42.001(b) for the first time in their appellate reply brief and thus present no property code violation for our review.]

Here, as in *McLendon*, nothing in the trial court's order places any wages of Father in "the hands of a third party" or "take[s] them from a third party." Thus, we disagree with appellants' position that the complained-of order violates the Texas Constitution's garnishment provision and affirm the trial court's order.

***Thomas as Trustee of Performance Products, Inc. v. Hughes***, SA-16-CV-00951-DAE, 2020 WL 5015441 (W.D. Tex. Aug. 24, 2020).

The magistrate judge recommended the granting of Plaintiffs' motion for a charging order against a membership interest in an LLC.

Johnny Thomas, as trustee of Performance Products, Inc., and Carolyn Percy, in her capacities as Trustee of the Percy Marital Trust and Executor of the Estate of James Percy (collectively "Plaintiffs"), won a judgment against Lou Ann Hughes in the amount of \$3,911,252.80. The judgment remained unpaid, and Plaintiffs asked the court to enter a charging order against Hughes's membership interest in M. G. & Sons, LLC. The court cited § 101.112 of the Texas Business Organizations Code, which provides the following:

(a) On application by a judgment creditor of a member of a limited liability company or of any other owner of a membership interest in a limited liability company, a court having jurisdiction may charge the membership interest of the judgment debtor to satisfy the judgment.

(b) If a court charges a membership interest with payment of a judgment as provided by Subsection (a), the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect of the membership interest.

(c) A charging order constitutes a lien on the judgment debtor's membership interest. The charging order lien may not be foreclosed on under this code or any other law.

The court further noted that a charging order is the "exclusive remedy by which a judgment creditor of a member or of any other owner of a membership interest may satisfy a judgment out of the judgment debtor's membership interest." *Id.* § 101.112(d). A judgment creditor "does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company." *Id.* § 101.112(f).

The evidence indicated that Hughes was the sole member of the LLC. Plaintiffs argued that as a judgment debtor, Hughes's membership interest in the LLC was subject to a charging order, which constituted a lien on Hughes's membership interest. Plaintiffs contended that they had the right to receive any distribution to which Hughes would otherwise be entitled with respect to her membership interest. In addition, Plaintiffs asked the court to order that Hughes and M. G. & Sons be required to obtain leave of court before transferring any asset of M. G. & Sons to any third party, transferring any funds to any third party except for transactions in the ordinary course of business, or transferring Hughes's interest in M. G. & Sons to any third party.

Defendants' (Hughes, Advanced Probiotics, LLC, and Performance Probiotics, LLC) acknowledged that Plaintiffs had received a judgment that had not been superseded or otherwise stayed pending appeal and that Texas law allowed for a charging order. Defendants argued, however, that Plaintiffs' motion went beyond what § 101.112 allowed in two respects. First, Hughes took issue with the language used by Plaintiffs in their motion that the charging order "direct[ ] that M. G. & Sons, LLC pay to Plaintiffs all funds and assets whatsoever, which by virtue of Hughes's membership interest would have been distributed to Hughes." Hughes argued that this language did not track § 101.112(b) and that a proper charging order would simply state that M. G. & Sons is directed to pay the judgment creditors "any distribution to which the judgment debtor would otherwise be entitled in respect of the membership interest." Second, Hughes opposed Plaintiffs' request for language in the charging order requiring Hughes to obtain leave of court before transferring real property, funds, or her interest in M. G. & Sons to a third party. Hughes argued that this language would violate § 101.112(f) because it is an attempt to "exercise legal or equitable remedies with respect to the property of the limited liability company."

Plaintiffs responded by maintaining that the language in their proposed charging order was not overbroad in light of the jury's finding that Hughes engaged in fraudulent transfers to frustrate Percy's attempts to collect his judgment. Plaintiffs argued that they had well-founded concerns that Hughes may again attempt to circumvent the charging order by transferring something other than "distributions" to herself from M. G. & Sons and then claiming the transfer was not subject to the charging order. As to the argument that the charging order application requested improper legal or equitable remedies over the property, Plaintiffs responded that the proposed

requirement that Hughes seek leave of court before transferring assets of or interests in M. G. & Sons simply provided security against any attempts at future fraudulent transfers.

The magistrate judge agreed with Plaintiffs' position:

The undersigned agrees with Plaintiffs that their proposed charging order language is not overbroad. The language "directing" M. G. & Sons, LLC to pay to "Plaintiffs all funds and assets whatsoever, which by virtue of Hughes's membership interest would have been distributed to Hughes" that is challenged by Defendants appears in Plaintiffs' motion and not the proposed charging order. The proposed charging order states the following:

Plaintiffs have the right to receive any distribution to which Hughes would otherwise be entitled in respect of her membership interest in M. G. & Sons, LLC. Any membership distributions, profits, cash, assets, or other monies due or that shall become due to Hughes by virtue of her membership in M. G. & Sons, LLC shall be paid by Hughes, M. G. & Sons, LLC, and/or any third party to the Plaintiffs through their counsel of record.

Section 101.112(b) entitles the judgment creditor to the "right to receive any distribution to which the judgment debtor would otherwise be entitled in respect of that membership interest." Plaintiffs direct the Court to the charging order language used in *Pajoooh v. Royal W. Investments LLC, Series E*, 518 S.W.3d 557 (Tex. App.—Houston [1st Dist.] 2017, no pet.), which ordered U.S. Capital Investments to pay to Royal West Investment LLC, Series E "all funds and assets whatsoever, which by virtue of the membership interest ... would have been distributed" to Pajoooh. Given Hughes's history evading the payment of monetary judgments and the jury finding that Hughes engaged in fraudulent transfers of assets, the specificity included in Plaintiffs' proposed charging order language is not overbroad. Defendants fail to direct the Court to any authority prohibiting the inclusion of the words "profits, cash, assets, or other monies" to clarify the scope of possible "distributions" by virtue of Hughes's membership interest in M. G. & Sons, LLC.

Regarding the proposed language requiring Hughes to seek leave of court before transferring real property, assets, or her membership interest, the undersigned also finds this language does not run afoul of the parameters of Section 101.112. Again, the Texas Business Organizations Code prohibits Plaintiffs from obtaining possession of or otherwise exercising legal or equitable remedies with respect to the property of the M. G. & Sons, LLC. Tex. Bus. Orgs. Code § 101.112(f). Plaintiffs do not seek to obtain possession of the real property located at 727 Isom Road, San Antonio, Texas. As Plaintiffs point out in their reply, "[t]he charging order was developed to prevent disruption of a partnership's business by a judgment creditor seeking to force an execution sale of a partner's interest to satisfy a nonpartnership debt." Accordingly, a charging order entitles a judgment creditor to receive a partner's share of profits directly from a partnership "when and if those profits are distributed," but does not entitle a creditor to participate in the partnership or compel distribution of profits. Nothing in Plaintiffs' proposed charging order disrupts M. G. & Sons' business, forces the sale of Hughes's interest, or compels distribution of profits. The requirement that Hughes seek leave of court prior to transferring assets of or her interest in M. G. & Sons is not prohibited by Section 101.112(f) and is justified in light of Hughes's history of fraudulent transfers to avoid payment of a judgment.

***Head v. Ascendant Petroleum Holding, LLC***, \_\_ S.W.3d \_\_, 2020 WL 4379195 (Tex. App.—Eastland 2020, no pet.).

The court of appeals affirmed the trial court's grant of a plea to the jurisdiction. Because plaintiff's membership interest had been repossessed, he lacked standing to assert derivative and direct claims.

In 2011, Tom L. Stover, the Oil and Gas Properties Manager for Ascendant, offered John Head the opportunity to acquire one membership unit in Ascendant. Head accepted Stover's offer, and the parties executed three documents: a secured promissory note in the amount of \$50,000, a security agreement, and the Ascendant Petroleum Holding, LLC Limited Liability Company Agreement ("Company Agreement"). The Company



Agreement specifically provided that it was to be governed by the law of the State of Delaware. Conversely, the note and the security agreement provided that they would be governed by Texas law.

Under the terms of the secured promissory note and the security agreement, Ascendant accepted Head's membership unit in Ascendant as collateral for the payment of the promissory note and Head's performance of the security agreement and the Company Agreement. One of the conditions of the promissory note was that the balance of the note would immediately become due and payable upon Head's insolvency.

On July 19, 2017, a Colorado court rendered a judgment for \$912,720.58 plus postjudgment interest of \$105.99 a day in favor of Stover against Head individually and against his law firm, Head and Associates, PC. These amounts remain unpaid.

Appearing pro se, Head filed suit against Ascendant, the manager of Ascendant (CAW Resources, LLC), Bobby Pugh (manager of CAW Resources), and three subsidiaries of Ascendant (collectively the "Appellees"). He asserted a number of claims, including breach of fiduciary duty against CAW Resources and Pugh and a demand for an inspection of the books and records of Ascendant and its subsidiaries.

After Head filed suit, Ascendant's attorney sent a letter to Head on March 7, 2018 notifying him that he was in breach of the security agreement and the promissory note's solvency requirements because Head had failed to pay what he owed under the Colorado judgment and that he was presumed insolvent. The letter demanded that Head provide Ascendant "with reasonable and sufficient evidence of [Head's] solvency" within ten days. The letter further provided that Ascendant would take possession of Head's membership unit in Ascendant if Head did not provide evidence of his solvency.

Head did not provide the requested evidence of his solvency. Ascendant's attorney then sent Head another letter on April 3, 2018 notifying him that Ascendant had taken possession of Head's membership unit and that Head was no longer a member of Ascendant.

After taking possession of Head's membership interest, Appellees filed a plea to the jurisdiction asking the trial court to dismiss Head's claims because Head no longer had standing due to the loss of his membership interest in Ascendant. After a hearing, the trial court granted Appellees' plea to the jurisdiction and dismissed Head's claims in their entirety. Head appealed, arguing, among other things, that the trial court improperly granted Appellees' plea to the jurisdiction because Head was still a member of Ascendant.

The court of appeals began by noting that Ascendant was a Delaware LLC; therefore, Delaware law controlled the interpretation of the Company Agreement. The Company Agreement itself also provided that it was to be interpreted under Delaware law. The court observed that in filing a plea to the jurisdiction challenging Head's standing to maintain his lawsuit, Appellees had challenged the trial court's subject matter jurisdiction. Because subject matter jurisdiction is a question of law, the court conducted a de novo review of the trial court's granting of the plea.

Since standing is determined on a claim-by-claim basis, the court was required to determine whether Head's claims were direct or derivative. The court cited the Delaware opinion of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and expressed the standard as follows:

... the test we use to determine whether a limited liability company member's claim is direct or derivative turns solely on the following questions: (1) who suffered the alleged harm (the limited liability company or the suit member, individually) and (2) who would receive the benefit of any recovery or other remedy (the limited liability company or the members, individually)? As explained by the court in *Kelly v. Blum* [No. 4516-VCP, 2010 WL 629850 (Del. Ch. Feb. 24, 2010)]:

Specifically, the Court evaluates whether the nature of the alleged injury is such that it falls directly on the LLC as a whole and only secondarily on an individual member as a function of and in proportion to his pro rata investment in the LLC, in which case the claim would be derivative, or whether the injury inflicts direct harm on the rights of the member as an individual.

Applying that test, the court of appeals concluded that Head's breach of fiduciary duty claims were "all based on alleged injuries to the limited liability company as a whole" and were premised "on the general allegation that mismanagement of Ascendant and its subsidiaries [had] occurred." Head could not prove his alleged injuries

without proving injury to Ascendant. Accordingly, the claims were derivative. In contrast, the court determined that Head's demand for an inspection of the books and records was a direct claim.

Because the derivative claims required the plaintiff to be a member, the court concluded that the trial court properly dismissed the claims for lack of standing:

The Delaware LLC Act creates a statutory right to bring a derivative action. *CML V, LLC v. Bax*, 6 A.3d 238, 241 (Del. Ch. 2010), *aff'd*, 28 A.3d 1037 (Del. 2011) (citing 6 Del. C. §§ 18–1001 & 18–1002). Additionally, “[Delaware] case law governing corporate derivative suits is equally applicable to suits on behalf of an LLC.” *VGS, Inc. v. Castiel*, No. C.A. 17995, 2003 WL 723285, at \*11 (Del. Ch. Mar. 10, 2003) (mem. op.) (noting that the Delaware LLC Act's provisions for a derivative action originated “from the well-developed body of Delaware law governing derivative suits by stockholders of a corporation”).

Delaware follows the continuous ownership requirement for derivative suits, requiring that a derivative plaintiff must not only be a stockholder at the time of the alleged wrong and at the time of the commencement of suit but must also maintain his shareholder status throughout the litigation. The rationale behind this rule is that “shareholders sue in a representative capacity only,” and “a plaintiff's derivative claim is regarded as a property right belonging to the corporation instead of the shareholder.” *Ala. By-Prods. Corp. v. Cede & Co. ex rel. Shearson Lehman Bros., Inc.*, 657 A.2d 254, 265 (Del. 1995).

Standing then, for the derivative action plaintiff, is not so much a matter of the plaintiff having a personal stake in the outcome of the controversy as a matter of the plaintiff having an interest in the corporation which justifies the plaintiff's bringing suit on its behalf. When the interest is extinguished, so is the plaintiff's justification for maintaining a derivative action.

Head acknowledges that he must continue to have an ownership interest in Ascendant in order to continue to have standing to prosecute his claims. In their plea to the jurisdiction, Appellees argued that Head was no longer a member of Ascendant because Ascendant repossessed Head's membership unit on April 3, 2018. ...

Appellees assert that the evidence they submitted with their plea to the jurisdiction negated the existence of a jurisdictional fact—that Head remained a member of Ascendant. Appellees further assert that the burden shifted to Head to raise a fact question on the issue of standing. Appellees contend that Head failed to raise a fact question because he did not submit any evidence in response to the plea to the jurisdiction. Appellees' contentions are based on the procedure outlined in *Mission Consolidated Independent School District v. Garcia*, 372 S.W.3d at 636; *see Tooker v. Alief Indep. Sch. Dist.*, 522 S.W.3d 545, 553 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

Head filed a response to the plea to the jurisdiction. He asserted that Ascendant could not have repossessed Head's membership interest because it is a “general intangible” that is incapable of either possession or repossession. Head also asserts that Ascendant did not dispose of the collateral in a method permitted by Article 9 of the Uniform Commercial Code. *See* TEX. BUS. & COM. CODE ANN. § 9.610 (West 2011). ...

Head relies on the documents attached to Appellees' plea to the jurisdiction for his contention that his membership interest was incapable of being repossessed. Section 9.609 of the UCC provides that, after default, a secured party may take possession of the collateral without judicial process, if it proceeds without breach of the peace. BUS. & COM. § 9.609. “The Uniform Commercial Code provides that unless otherwise agreed, upon default a secured party has the right to take possession of the collateral.” *Cohen v. Rains*, 769 S.W.2d 380, 384 (Tex. App.—Fort Worth 1989, writ denied) (citing the predecessor to Section 9.609). The security agreement executed by Head and Ascendant did not provide that Head's membership interest could not be repossessed. Accordingly, we disagree with Head's assertion that his membership interest was incapable of being repossessed. *See 395 Lampe, LLC v. Kawish, LLC*, No. C12-1503RAJ, 2014 WL 221814, at \*6 (W.D. Wash. Jan. 21, 2014) (holding that a secured party could take possession under the UCC of the debtor's ownership interest in a limited liability company).

The evidence that Appellees attached to their plea to the jurisdiction conclusively established that Head no longer owned a membership interest in Ascendant because the evidence showed that Ascendant repossessed it. Thus, Head had the burden to raise a fact question that he retained ownership. Head did not meet this burden. While Head asserts that Ascendant improperly disposed of his membership interest after it repossessed it, he did not present any evidence concerning Ascendant’s later disposition, if any, of his membership interest. In this regard, the UCC “either expressly permits a secured party to take full ownership of collateral (‘record or legal title’) without effecting a ‘disposition [for Article 9 purposes],’ or, at a minimum, it does not prohibit a secured party from doing so.” *Id.*; see *Spellman v. Indep. Bankers’ Bank of Fla.*, 161 So. 3d 505, 508 (Fla. Dist. Ct. App. 2014) (citing *395 Lampe, LLC* for this proposition). Accordingly, the trial court did not err in granting Appellees’ plea to the jurisdiction on Head’s causes of action for breach of fiduciary duty, negligence, the request for a declaratory judgment, and the appointment of a receiver.

With respect to Head’s direct claim for an inspection of the books and records, the court of appeals similarly concluded that, after the repossession of his membership interest, he lacked standing to assert the claim:

We must next determine whether Head had standing to bring his direct claim to compel an inspection of Appellees’ books and records. With respect to Ascendant’s books, the Delaware Code provides that a member of a limited liability company has the right, subject to reasonable standards established by the limited liability company agreement, a manager, or members, to make a reasonable demand to inspect the records of the company for “any purpose reasonably related to the member’s interest as a member of the limited liability company.” 6 DEL. CODE ANN. § 18-305. Section 18-305’s corporate analogue, 8 Delaware Code Section 220, guides the scope of Section 18-305. See 8 DEL. CODE ANN. § 220. Section 220 “‘plain[ly] and unambiguous[ly]’ limits inspection rights to current stockholders and directors.” *Prokupek v. Consumer Capital Partners LLC*, C.A. No. 9918-VCN, 2014 WL 7452205, at \*6 (Del. Ch. Dec. 30, 2014) (alterations in original) (quoting *King v. DAG SPE Managing Member, Inc.*, C.A. No. 7770-VCP, 2013 WL 6870348, at \*6 (Del. Ch. Dec. 23, 2013) (mem. op.)). Thus, Head no longer had standing to inspect Ascendant’s books after he no longer held an ownership interest in Ascendant. See *id.* at \*7 (By its plain language, Delaware Code Section 18-305(a) of the LLC Act “confers inspection rights only on current members of an LLC.”).

Head also did not have standing to inspect the books of CAW Resources or the three subsidiaries. Head did not have an ownership interest in any of these entities. His only basis for requesting an inspection of the records of these other entities was his ownership of an interest in Ascendant—an ownership interest that no longer exists. Accordingly, the trial court did not err in granting Appellees’ plea to the jurisdiction on Head’s direct claim.

#### **O. Attorney’s Fees**

*KC Pharmacy, LLC v. JPMorgan Chase Bank, N.A.*, No. 01-20-00409-CV, 2021 WL 1095905 (Tex. App.—Houston [1st Dist.] Mar. 23, 2021, no pet. h.) (mem. op.) (noting that “section 38.001 does not authorize the recovery of attorney’s fees in a breach-of-contract action against a limited liability company (“LLC”)”).

*Ben E. Keith Co. v. Dining Alliance, Inc.*, No. 4:20-CV-133-A, 2021 WL 951021 (N.D. Tex. Mar. 12, 2021) (dismissing claim for statutory attorney’s fees, stating that the defendant did not disagree with the contention that attorney’s fees are not recoverable against limited liability companies under Tex. Civ. Prac. & Rem Code § 38.001).

*Kalisek v. Hays City Corporation*, No. 08-20-00031-CV, 2021 WL 527121 (Tex. App.—El Paso Feb. 12, 2021, pet. denied) (mem. op.).

The individual guarantor of an LLC’s indebtedness contended that he could not be held liable for attorney’s fees under Tex. Civ. Prac. & Rem Code § 38.001 because attorney’s fees could not be awarded against the LLC

under the statute. The creditor responded that Section 38.001 authorizes recovery of attorney’s fees for a quantum-meruit claim involving “furnished material,” and the individual presented no arguments that the judgment erroneously awarded quantum-meruit damages against him individually, and the concluded that Section 38.001(3) authorized recovery of reasonable attorney’s fees against the individual, who was adjudged liable for a valid claim for furnished materials and not merely in his capacity as guarantor.

*Spicer v. Maxus Healthcare Partners, LLC*, 616 S.W.3d 59 (Tex. App.—Fort Worth 2020, no pet. h.) (“Section 38.001 provides that a person may recover reasonable attorney’s fees “from an individual or corporation” for, among other things, a claim for an oral or written contract. Tex. Civ. Prac. & Rem. Code Ann. § 38.001(8). Although this court has not yet addressed whether attorney’s fees can be recovered under this provision from an LLC, several of our sister courts have addressed this issue and have concluded that based on the statute’s plain language and the distinctions between corporations and LLCs, such a recovery is not allowed. ... Convinced by our sister courts’ reasoning, we hold that an LLC is not liable for attorney’s fees under Section 38.001 and sustain this portion of Appellants’ sixth issue.”).

*Craig v. B. Riley FBR, Inc.*, Civil Action No. 3:19-CV-0058-G, 2020 WL 6889018 (N.D. Tex. Nov. 23, 2020) (“The court also rejects Craig’s claim for attorney’s fees against GACP II because § 38.001 applies only to successful claims against ‘individuals’ and ‘corporations’ of which GACP II (a limited liability company) is neither. Craig also appears to argue that attorney’s fees may be granted as an equitable remedy not subject to the conditions of § 38.001. However, under Texas law, which follows the ‘American Rule,’ ‘litigants may recover attorney’s fees only if specifically provided for by statute or contract.’ *Epps v. Fowler*, 351 S.W.3d 862, 865 (Tex. 2011). No statute or contract provision provides for such relief here. Accordingly, Craig’s claim for attorney’s fees is denied.”).

*Z Auto Place, LLC v. Cars.com, LLC*, No. 01-19-00477-CV, 2020 WL 5666074 (Tex. App.—Houston [1st Dist.] Sept. 24, 2020, no pet.) (mem. op.).

“In its third issue, Z Auto Place contends that the trial court erred in awarding attorney’s fees under Chapter 38 of the Texas Civil Practice and Remedies Code because the statute only allows recovery against an individual or corporation, not an LLC.

Section 38.001 provides: ‘A person may recover reasonable attorney’s fees from an individual or corporation ... if that claim is for ... an oral or written contract.’ TEX. CIV. PRAC. & REM. CODE § 38.001(8). This Court has determined that section 38.001 ‘does not authorize the recovery of attorney’s fees in a breach of contract action against an LLC [limited liability company].’ *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176, 188 (Tex. App.—Houston [1st Dist.] 2018, pet. denied) (“Under the plain language of section 38.001, a trial court cannot order limited liability partnerships (L.L.P.), limited liability companies (L.L.C.), or limited partnerships (L.P.) to pay attorneys’ fees.”) (quoting *Varel Int’l Indus., L.P. v. PetroDrillbits Int’l, Inc.*, No. 05-14-01556-CV, 2016 WL 4535779, at \*7 (Tex. App.—Dallas Aug. 30, 2016, pet. denied) (mem. op.)). Z Auto Place is not an individual or a corporation; it is a limited liability company. Thus, Cars.com may not recover attorney’s fees under section 38.001 against Z Auto Place, a limited liability company, as a matter of law.

Cars.com argues that the trial court properly awarded attorney’s fees because Cars.com pleaded for and requested attorney’s fees based on the agreement between the parties in addition to section 38.001. In its first amended petition, Cars.com alleged, ‘Plaintiff would show the Court that the recovery of attorneys’ fees is authorized, made and provided, under and according to the provisions of Chapter 38, Texas Civil Practice and Remedies Code, the agreement between the parties, and the principles of equity.’ Section 2 of the agreements, entitled ‘Fees,’ states, in relevant part, ‘Customer agrees to pay all of Cars.com’s costs, including attorney’s fees, incurred in collecting overdue amounts.’ However, Cars.com moved for summary judgment on its claim for attorney’s fees solely on the basis of section 38.001. ... Because Cars.com did not move to recover attorney’s fees based on the parties’ agreement, the trial court could not have awarded attorney’s fees to Cars.com on that basis.

Cars.com argues that Z Auto Place waived its right to object to Cars.com’s request for attorney’s fees under Chapter 38. This is so, it reasons, because Z Auto Place did not argue in its summary judgment response that Cars.com could not recover attorney’s fees under Chapter 38 because Z Auto Place is an LLC. A motion for summary judgment must stand or fall on the grounds it specifically and expressly sets forth. A movant bears the

burden of establishing its right to summary judgment as a matter of law on the grounds set forth in his motion, regardless of whether the nonmovant files a response to the summary judgment motion. As the summary judgment movant, Cars.com had the burden to prove that it was entitled to recover attorney's fees as a matter of law. Because Cars.com was not entitled to recover attorney's fees from Z Auto Place under section 38.001, the trial court erred in granting summary judgment on this claim as a matter of law."

***Insurance Distribution Consulting, LLC v. Freedom Equity Group, LLC***, Civ. A. No. 3:20-CV-00096, 2020 WL 5803249 (S.D. Tex. Sept. 4, 2020).

"IDC seeks attorney's fees under Section 38.001 of the Texas Civil Practice & Remedies Code. Section 38.001 enables a plaintiff to 'recover reasonable attorney's fees from an individual or corporation' if the claim is for 'an oral or written contract.' TEX. CIV. PRAC. & REM. CODE. § 38.001. FEG moves for summary judgment, arguing that the statute does not authorize a prevailing plaintiff to recover attorney's fees from a limited liability company like itself. FEG is correct. Both state and federal courts in the State of Texas have consistently held that under the plain language of Section 38.001, a trial court cannot order limited liability companies to pay attorney's fees.

Backed into a corner grasping for air, IDC tries a desperation punch. Because IDC could recover attorney's fees under Section 38.001 against the original party to the agreement, Freedom Inc. (a corporation), IDC claims that it should be entitled to recover attorney's fees against the successor-in-interest, FEG [an LLC]. IDC's argument conveniently overlooks the statutory mandate of Section 38.001, which provides that attorney's fees for breach of contract actions are only recoverable against individuals and corporations. Make no bones about it: IDC is asking to recover attorney's fees from a limited liability company. There is simply no statutory language, nor any case law, remotely suggesting that a limited liability company can be ordered to pay attorney's fees under Section 38.001 if it is the successor-in-interest to a contracting party who would be liable for attorney's fees. I, therefore, recommend that IDC's claim for attorney's fees under Section 38.001 be dismissed."

***D. Webb Industries, LLC v. Permian Equipment Rentals, LLC***, No. 11-18-00221-CV, 2020 WL 4875879 (Tex. App.—Eastland Aug. 20, 2020, no pet.) (mem. op.) ("Chapter 38 of the Texas Civil Practice and Remedies Code addresses attorney's fees. Section 38.001 provides that '[a] person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for ... (7) a sworn account.' Because a limited liability company is not a listed entity under Section 38.001, attorney's fees may not be awarded under Chapter 38 against a limited liability company. We see no reason to rehash the statutory construction principles expressed in these cases by our sister courts, and we adopt the reasoning set forth in them. We decline Permian's invitation to hold contrary to what seems to be the unanimous position of the Texas Courts of Appeals that have addressed the issue. We hold that attorney's fees under Chapter 38 are not recoverable against D. Webb Industries, LLC, a limited liability company.").

***Bierscheid v. JPMorgan Chase Bank***, 606 S.W.3d 493 (Tex. App.—Houston [1st Dist.] 2020, pet. filed).

"The Working Interest Owners argue that because the Japhets cannot recover damages on their claims for breach of the 1919 Assignment they cannot recover attorney's fees. They further argue that the declaratory relief sought by the Japhets 'merely duplicated issues already before the trial court' and were 'recast' contract claims. They argue that the Japhets cannot use the Declaratory Judgments Act 'merely as a vehicle to recover attorney's fees.' The Texas Supreme Court has held that 'a party cannot use the [Declaratory Judgments] Act as a vehicle to obtain otherwise impermissible attorney's fees.' See *MBM Fin. Corp. v. Woodlands Operating Co., L.P.*, 292 S.W.3d 660, 669–70 (Tex. 2009) (holding, in case in which party did not recover damages on its breach of contract claim, and therefore could not recover attorney's fees under Chapter 38, party could not use Chapter 37 and 'a claim for declaratory relief [that] is merely tacked onto a standard suit based on a matured breach of contract'). We disagree with the Working Interest Owners that the Japhets merely 'recast' or 'tacked on' their requests for declaratory relief to their breach of contract action, such that the Japhets were using the Declaratory Judgments Act to recover attorney's fees that they could not recover on their breach of contract claims.

First, as we have held above, the Japhets were entitled to, and did, recover money damages on their breach of contract claim. This is, therefore, not a situation in which the Japhets were not entitled to any award of attorney's fees under Chapter 38 and therefore used the Declaratory Judgments Act as a method to recover attorney's fees to which they were otherwise not entitled. The Japhets, as prevailing parties, are entitled to attorney's fees under

Chapter 38 for their breach of contract claim. Furthermore, while the Japhets sought declarations that they owned the Net Profits Interest and that the 1919 Assignment was binding on the Working Interest Owners, declarations relevant to their breach of contract claims, they also sought, and obtained, additional declarations ....

The Japhets' declaratory relief claims were more than 'recast' contract claims, and we agree with the Japhets that they did not seek recovery of attorney's fees under the Declaratory Judgments Act simply because they could not obtain attorney's fees on any other basis. Because the Japhets obtained an award of damages and declaratory relief, they are entitled to attorney's fees under both section 38.001 and 37.009, and the trial court did not err in awarding attorney's fees to the Japhets. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (providing that plaintiff may recover reasonable attorney's fees, in addition to amount of valid claim, if claim is for oral or written contract); *id.* § 37.009 (providing that, in proceeding under Declaratory Judgments Act, court may award reasonable and necessary attorney's fees as are equitable and just).

[While section 38.001 has, as the Working Interest Owners contend, been interpreted to bar the recovery of attorney's fees from limited liability companies and limited partnerships, section 37.009 of the Declaratory Judgments Act contains no such restriction. *See Choice! Power, L.P. v. Feeley*, 501 S.W.3d 199, 214 (Tex. App.—Houston [1st Dist.] 2016, no pet.) (holding that section 38.001 does not permit recovery of attorney's fees from limited partnerships); *Alta Mesa Holdings, L.P. v. Ives*, 488 S.W.3d 438, 452–55 (Tex. App.—Houston [14th Dist.] 2016, pet. denied) (holding that section 38.001 does not permit recovery of attorney's fees from limited liability company).]

***T&C Construction, Ltd. v. Brown Mechanical Servs., Inc.***, No. 01-19-00041-CV, 2020 WL 3866659 (Tex. App.—Houston [1st Dist.] July 9, 2020, no pet.) (mem. op.).

“T&C [general contractor] argues that the trial court erred by awarding attorney's fees to Brown Mechanical [subcontractor] based on section 38.001 of the Civil Practice and Remedies Code because T&C is a limited partnership. ‘A person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for ... an oral or written contract.’ TEX. CIV. PRAC. & REM. CODE § 38.001. ‘Under the plain language of section 38.001, a trial court cannot order limited liability partnerships (L.L.P.), limited liability companies (L.L.C.), or limited partnerships (L.P.) to pay [attorney's] fees.’ Because T&C is a limited partnership, the trial court erred by awarding Brown Mechanical attorney's fees on the basis of section 38.001....

T&C argues that the trial court erred by awarding attorney's fees to Brown Mechanical based on section 28.005 of the Property Code because San Jacinto River Authority [T&C's client who T&C constructed a water plant for] is a governmental entity. Chapter 28 of the Property Code requires owners to promptly pay contractors for work performed, and it requires contractors to promptly pay subcontractors for their work upon receipt of payment from the owner. *See* TEX. PROP. CODE § 28.002. The statute defines ‘owner’ as ‘a person or entity, other than a governmental entity, with an interest in real property that is improved, for whom an improvement is made, and who ordered the improvement to be made.’ *Id.* § 28.001(4). In an action to enforce the right to prompt payment under chapter 28, ‘the court may award costs and reasonable attorney's fees as the court determines equitable and just.’ *Id.* § 28.005.

Brown Mechanical pleaded for attorney's fees based on section 28.005. But with respect to the subcontract for Project 2, the owner was San Jacinto River Authority, a governmental entity. Because the owner is a governmental entity, chapter 28 of the Property Code does not apply.

In its live pleading, Brown Mechanical pleaded for attorney's fees based on section 38.001 of the Civil Practice and Remedies Code and section 28.005 of the Property Code. We have concluded that neither statute authorizes the award of attorney's fees in this case. We therefore hold that the trial court erred by rendering judgment for Brown Mechanical for attorney's fees.”

***Accresa Health LLC v. Hint Health Inc.***, Civ. A. No. 4:18-cv-00536, 2020 WL 4644459 (E.D. Tex. Mar. 19, 2020), report and recommendation adopted, 2020 WL 2610908 (E.D. Tex. May 22, 2020) (“Under § 38.001 of the Texas Civil Practice and Remedies Code, ‘[a] person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for: ... (8) an oral or written contract.’ TEX. CIV. PRAC. & REM. CODE § 38.001(8). Texas law authorizes a party to collect attorneys' fees in some types of actions—but only from an individual or a corporation. ‘Under the plain language of section 38.001, a trial court cannot order limited liability partnerships, limited liability companies, or limited partnerships

to pay attorney's fees.' District Judge Mazzant has also held § 38.001 does not authorize a party to collect attorneys' fees from a limited liability company. Here, Accresa is a limited liability company. Considering Accresa is a limited liability company, and further considering this Court has held § 38.001 does not authorize a party to collect attorneys' fees from a limited liability company, the Court recommends this part of Accresa's motion for summary judgment be granted.").

**P. Standing or Capacity to Sue**

*In re UBS Financial Services Inc.*, No. 14-20-00087-CV, 2020 WL 5902955 (Tex. App.—Houston [14th Dist.] Oct. 6, 2020, no pet.) (mem. op.).

The court of appeals conditionally granted UBS's petition for writ of mandamus and directed the trial court to vacate its January 8, 2020 order granting a request to take presuit depositions of UBS employees. The court of appeals concluded that the managing member of an LLC did not have standing to bring claims in her own name that belonged to the LLC.

Fleur Holdings LLC opened two accounts in UBS's Yield Enhancement Strategy ("YES"), which is an options overlay trading strategy that aims to generate investment income through the sale of S&P 500 Index options. Deneige Dooley is Fleur Holdings' managing member. Dooley signed the documents setting up Fleur Holdings' accounts as managing member.

In September 2019, Dooley's attorney wrote UBS, advising that he was investigating whether UBS's actions regarding the investment of his "Client's" assets in YES were actionable. Dooley was referred to as the "Client" in the letter. Dooley's attorney requested information regarding YES and also demanded that UBS preserve evidence. In addition, Dooley's attorney requested tape-recorded interviews of UBS employees Debra Pelham and Kreg Pearless.

In response, UBS's attorney advised that UBS had no obligation to produce discovery at that time and declined to do so. UBS further stated that, in the event arbitration were commenced, both parties would be subject to the discovery rules and procedures of the arbitral forum and enclosed copies of the documents signed by Dooley on behalf of Fleur Holdings.

In November 2019, Dooley filed a verified petition requesting depositions duces tecum before suit, seeking to investigate facts regarding the investment of some of Dooley's funds in YES by deposing Pelham and Pearless. UBS objected on the grounds that (1) Dooley lacked standing because she does not own the potential claims; and (2) Fleur Holdings, through its managing member, Dooley, agreed to binding private arbitration of the potential claims, precluding the use of Rule 202.

On January 3, 2020, UBS filed an emergency motion for protection and motion to quash Dooley's subpoenas that commanded Pelham and Pearless to appear for deposition. The trial court held a hearing on January 6, 2020 and ultimately signed a January 8 order that granted Dooley's petition and allowed the depositions of Pelham and Pearless.

UBS filed a petition for writ of mandamus, asking for the January 8 order to be set aside. It argued that Dooley lacked standing to request a presuit deposition because Fleur Holdings was the owner of the accounts. The court of appeals agreed:

It is well-settled that the trial court must have subject-matter jurisdiction over the anticipated action to properly order a presuit deposition. This limitation on presuit discovery is due to a court's inherent jurisdictional limitations: "a court cannot grant relief when it lacks jurisdiction of the subject matter," so "[i]t would make no sense to insist that a court ordering discovery to perpetuate testimony for a later-filed suit to be one ... [without] subject-matter jurisdiction." "Indeed, allowing courts to authorize Rule 202 depositions for potential suits over which they lack jurisdiction would untether presuit discovery from the suit it purports to be in aid of."

"Standing is implicit in the concept of subject-matter jurisdiction, and subject-matter jurisdiction is essential to the authority of a court to decide a case." Standing is specific to each individual plaintiff and to each of the plaintiff's individual claims. Standing requires a concrete injury to the plaintiff and a real controversy between the parties that will be resolved by the court. Questions of standing are reviewed de novo.

UBS maintains that the trial court did not have jurisdiction to grant Dooley's Rule 202 petition because Dooley does not have standing to bring the Rule 202 proceeding or, if suit is ultimately brought, to pursue the claims for which discovery is sought. Specifically, UBS contends that the undisputed evidence shows that Fleur Holdings owns the YES accounts and Dooley is merely the managing member of Fleur Holdings, with no ownership interest in the accounts.

A limited liability company is a separate entity from a member or manager of the company. A member of a limited liability company does not have an interest in any specific property the company owns. Tex. Bus. Orgs. Ann. § 101.106.

A member of a limited liability company may be a party in an action brought by or against the company ... if the action is brought to enforce the member's right against or liability to the company. Tex. Bus. Orgs. Ann. § 101.113. Therefore, a member of a limited liability company lacks standing to assert claims individually when the cause of action belongs to the company.

In the September 25, 2019 letter, Dooley's counsel advised UBS that he had been hired to represent Dooley in investigating UBS's actions in managing Dooley's YES account and requested documents related to Dooley's YES account. Dooley is named as the petitioner, and the petition repeatedly refers to Dooley's YES investment, even though Fleur Holdings owns the YES accounts.

In her response to UBS's petition for writ of mandamus, Dooley asserts that the doctrine of misnomer is applicable here where Dooley was named as petitioner instead of Fleur Holdings. "[A] 'misnomer occurs when a party misnames itself or another party, but the correct parties are involved.'" Generally, courts allow parties to correct a misnomer if it is not misleading.

This case does not involve a misnomer. A similar situation was addressed by the San Antonio Court of Appeals. *See Barrera v. Cherer*, No. 04-13-00612-CV, 2014 WL 1713522 (Tex. App.—San Antonio Apr. 30, 2014, no pet.). (mem. op.). In *Barrera*, the member of a limited liability company brought a forcible detainer action in his own name even though the company owned the property. The trial court awarded the member possession of the property. On appeal, the defendants contended that the member lacked standing in the forcible detainer action because the cause of action belonged to the company. The member responded that this was an issue of misnomer. The court rejected the member's misnomer argument because the member did not have standing to assert claims individually where the cause of action belonged solely to the company.

Here, Dooley, as managing member, does not have individual standing to maintain claims against UBS for actions it may or may not have taken with regard to its management of the YES accounts owned by Fleur Holdings. Therefore there has been no misnomer because Dooley has never been the correct party to request the Rule 202 depositions.

The trial court abused its discretion by granting Dooley's petition for the Rule 202 depositions. UBS also does not have an adequate remedy by appeal.

***RLB Contracting, Inc. v. Genesis Energy, L.P.***, Civ. A. No. H-18-3844, 2020 WL 5880918 (S.D. Tex. Oct. 2, 2020) ("RLB argues that the shareholder standing rule ... prevents Genesis Energy from raising a claim on behalf of its subsidiaries. The shareholder standing rule 'is a longstanding equitable restriction that generally prohibits shareholders from initiating actions to enforce the rights of the corporation.' ... The shareholder standing rule is 'phrased in terms of corporations and shareholders, [but] it applies with equal force to limited partnerships' and 'limited liability companies' like Genesis Energy and its subsidiaries.").

***Bradley J. Fish, Inc. v. Lesar Electric & Design LLC***, No. 01-19-00064-CV, 2020 WL 4589758 (Tex. App. —Houston [1st Dist.] Aug. 27, 2020, no pet.) (mem. op.).

Appellant, Bradley J. Fish, Inc., doing business as Sullair of Houston ("Sullair"), challenged the trial court's rendition of summary judgment in favor of appellee, Lesar Electric & Design LLC ("Lesar"), in Lesar's suit against Sullair for breach of contract. The court of appeals affirmed the grant of summary judgment and concluded in part that the contracts were enforceable even though Lesar was not identified as an LLC.

Lesar, a licensed electrical contractor, alleged that it entered into two contracts with Sullair to perform electrical work. Sullair paid Lesar twenty-five percent of the balance due under each contract as a down payment and agreed to pay the remaining seventy-five percent owed when the work was complete. Lesar performed and



completed the work under the contracts, but Sullair did not pay the remaining \$68,289 owed. Lesar sued for breach of contract.

Sullair denied that it had a contract with Lesar. Instead, Sullair alleged that it signed contracts with Phillip Rodriguez and Aaron Burns, employees of Lesar, who represented themselves as being partners providing services under the trade name “Lesar Electric & Design.” Sullair also alleged that neither Lesar nor Rodriguez and Burns had filed “the Texas Assumed Name Certificate as required by Texas law,” that Lesar was not “in good standing with the Texas Comptroller of Public Accounts,” and that Lesar had “forfeited its right to do business in the State of Texas, including the right to file litigation in Texas courts.” Sullair further argued that it had made payments to AES Construction, the trade name of Aaron Burns.

Lesar moved for summary judgment and attached copies of its contracts. Each listed “Lesar Electric and Design” at the top and stated Lesar’s address at the bottom. The contracts noted that Lesar Electric & Design would invoice for the work. Lesar also attached as an exhibit to its summary judgment motion a copy of an Assumed Name Certificate, filed with the Harris County Clerk, authorizing use of the name “Lesar Electric & Design” for the period from April 11, 2016 to April 1, 2026. In addition, Lesar included a copy of an Application for Reinstatement and Request to Set Aside Revocation or Forfeiture filed with the Texas Secretary of State on May 18, 2018, accompanied by a May 17, 2018 tax clearance letter showing Lesar “ha[d] met all franchise tax requirements and [was] eligible for reinstatement.”

The trial court granted summary judgment for Lesar. On appeal, Sullair argued that the trial court erred in granting Lesar summary judgment because it challenged Lesar’s standing and capacity under the contracts “as not being a proper party,” which was an essential element of recovery on Lesar’s breach-of-contract claim. Sullair admitted that “[i]f the contract[s] identified ‘Lesar Electric & Design[ ] LLC’ as a party and the lawsuit named ‘Lesar Electric & Design[ ] LLC’ as [the] [p]laintiff, then no fact issue [would be] presented.” Sullair, however, denied that it had contracted with Lesar; rather, it asserted that it contracted with Rodriguez and Burns, a partnership doing business as “Lesar Electric & Design.” The court of appeals rejected the argument:

Here, the contracts signed by Sullair expressly direct payment to Lesar Electric & Design. In accordance with the contracts, Sullair made down payments to Lesar Electric & Design before the work began. Sullair asserts that “[t]he omission of the LLC on the face of the contract[s] together with the names of the natural persons [Burns and Rodriguez] as the signing party and authorized contact persons” raise a fact issue as to whether there was a partnership between Burns and Rodriguez. But the contracts themselves indisputably direct Sullair to pay Lesar Electric & Design. Sullair points to no authority that Lesar had any obligation to identify its corporate form or its formal corporate name in the contracts. The appearance of Rodriguez’s and Burns’s names in the contracts does not raise a fact issue as to Lesar’s corporate form or whether payment was due to Burns or Rodriguez and not Lesar Electric & Design. Corporations can act only through individuals. *Tri v. J.T.T.*, 162 S.W.3d 552, 562 (Tex. 2005).

With respect to the assumed name certificate, Sullair cited *Smith v. CDI Rental Equipment, Ltd.*, 310 S.W.3d 559, 564 (Tex. App.—Texarkana 2010, no pet.), for the proposition that a “company is prohibited from maintaining an action in a Texas court arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed.” The court of appeals observed, however, that Lesar had filed with its summary judgment motion an Assumed Name Certificate showing that Lesar was certified to do business as “Lesar Electric & Design.” According to the court, “[t]he valid assumed name certificate ... conclusively shows that Lesar had standing to sue in its corporate name.”

The court of appeals then addressed Sullair’s argument that Lesar had forfeited its right to do business in Texas due to its failure to pay franchise taxes. Because the delinquent taxes had been paid, the argument was rejected:

Under Texas law, a corporation that has forfeited its corporate privileges is denied the right to sue in state court unless its corporate privileges are revived. *See* TEX. TAX CODE ANN. § 171.252(1). But “[t]he purpose of [section 171.252] is to enforce collection of state franchise taxes, not to prohibit a corporate cause of action.” *Flameout Design & Fabrication, Inc. v. Pennzoil Caspian Corp.*, 994 S.W.2d 830, 839 (Tex. App.—Houston [1st Dist.] 1999, no pet.). A

corporation's payment of delinquent taxes and reinstatement of status will relate back and revive whatever rights the corporation had when the suit was previously filed. *Bluebonnet Farms, Inc. v. Gibraltar Sav. Ass'n*, 618 S.W.2d 81, 85 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

Here, Lesar provided evidence showing that it had paid its tax debt and had applied to have its corporate privileges reinstated while its suit was pending in the trial court, showing that it had legal capacity to sue Sullair. We conclude that Lesar's payment of its tax debt renders moot Sullair's argument that "Lesar ... forfeited its right to do business in Texas under [Texas] Tax Code section 171.252." We hold that the trial court did not err in granting Lesar summary judgment.

Finally, the court addressed Sullair's argument that the contracts were ambiguous because Lesar was identified solely as "Lesar Electric & Design." Although this argument was not presented to the trial court, the court of appeals observed that "[p]atent ambiguity of a contract may be considered for the first time on appeal from a motion for summary judgment." *Arredondo v. City of Dall.*, 79 S.W.3d 657, 666 (Tex. 2002). Unfortunately for Sullair, this argument was also rejected:

Sullair's assertion that Lesar's use of its trade name in its contracts renders the contracts ambiguous is unavailing. It is well settled that

[m]odern law has departed from the strict rules of the common law as to use of the corporate name. As corporations are now able to contract almost as freely as natural persons, it is held that a departure from the strict name of a corporation will not avoid its contract if its identity substantially appears.

*Hous. Land & Loan Co. v. Danley*, 131 S.W. 1143, 1145 (Tex. Civ. App. 1910, no writ) (internal quotations omitted); *see also W.B. Clarkson & Co. v. Gans S.S. Line*, 187 S.W. 1106, 1110 (Tex. Civ. App.—Galveston 1916, writ ref'd) (observing "[i]t has long been settled that it is not necessary, in order that a corporation may be bound by its contracts, that the contract shall be made in its exact corporate name" and "when the true name is to be collected from the instrument involved, or is shown by proper averments, the contract is not invalidated thereby" (internal quotations omitted)).

Sullair made its initial payment to "Lesar Electric & Design" as required by the contracts' payment terms, and Lesar accepted payment under that name. Ultimately, Lesar filed suit under its legal name as required by Texas Rule of Civil Procedure 28, and the sole difference between Lesar's assumed name and its legal name is the addition of "LLC" at the end of its legal name. The Assumed Name Certificate, attached as an exhibit to Lesar's summary-judgment motion, establishes that "Lesar Electric & Design" and "Lesar Electric & Design LLC" are in fact the same entity.

Nothing shows that the parties modified the contract terms. As noted before, any confusion Sullair may have had as to Lesar's form as a business entity does not raise a fact issue as to whether the contracts required Sullair to pay the balance owed to "Lesar Electric & Design." And Sullair's assertion that Burns and Rodriguez represented themselves to be a partnership is immaterial to whether the contracts contained an ambiguity in identifying the payee. *See Lost Maples Gen. Store, LLC v. Ascentium Capital, LLC*, No. 14-18-00215-CV, 2019 WL 1966671, at \*5 (Tex. App.—Houston [14th Dist.] May 2, 2019, no pet.) (mem. op.) ("Assuming without deciding that partnership by estoppel is a viable theory," party asserting partnership by estoppel "has the burden of establishing the following elements: (1) a representation that the one sought to be bound is a partner, and (2) the one to whom the representation is made relied on the representation."). Sullair asserts that Burns and Rodriguez represented themselves to be "a partnership operating under the trade name of Lesar Electric & Design," but even if true, the payee did not change: the contracts still required Sullair to pay Lesar Electric & Design. And Sullair does not show that reliance on any representation led it to pay "ASE Construction" or "AES Construction" instead of Lesar Electric & Design in accordance with the contracts. Thus, we conclude that [the] contracts unambiguously require Sullair to pay Lesar.

We hold that the trial court did not err in granting Lesar summary judgment.

***Head v. Ascendant Petroleum Holding, LLC***, \_\_ S.W.3d \_\_, 2020 WL 4379195 (Tex. App.—Eastland 2020, no pet.).

The court of appeals affirmed the trial court’s grant of a plea to the jurisdiction. Because plaintiff’s membership interest had been repossessed, he lacked standing to assert derivative and direct claims.

In 2011, Tom L. Stover, the Oil and Gas Properties Manager for Ascendant, offered John Head the opportunity to acquire one membership unit in Ascendant. Head accepted Stover’s offer, and the parties executed three documents: a secured promissory note in the amount of \$50,000, a security agreement, and the Ascendant Petroleum Holding, LLC Limited Liability Company Agreement (“Company Agreement”). The Company Agreement specifically provided that it was to be governed by the law of the State of Delaware. Conversely, the note and the security agreement provided that they would be governed by Texas law.

Under the terms of the secured promissory note and the security agreement, Ascendant accepted Head’s membership unit in Ascendant as collateral for the payment of the promissory note and Head’s performance of the security agreement and the Company Agreement. One of the conditions of the promissory note was that the balance of the note would immediately become due and payable upon Head’s insolvency.

On July 19, 2017, a Colorado court rendered a judgment for \$912,720.58 plus postjudgment interest of \$105.99 a day in favor of Stover against Head individually and against his law firm, Head and Associates, PC. These amounts remain unpaid.

Appearing pro se, Head filed suit against Ascendant, the manager of Ascendant (CAW Resources, LLC), Bobby Pugh (manager of CAW Resources), and three subsidiaries of Ascendant (collectively the “Appellees”). He asserted a number of claims, including breach of fiduciary duty against CAW Resources and Pugh and a demand for an inspection of the books and records of Ascendant and its subsidiaries.

After Head filed suit, Ascendant’s attorney sent a letter to Head on March 7, 2018 notifying him that he was in breach of the security agreement and the promissory note’s solvency requirements because Head had failed to pay what he owed under the Colorado judgment and that he was presumed insolvent. The letter demanded that Head provide Ascendant “with reasonable and sufficient evidence of [Head’s] solvency” within ten days. The letter further provided that Ascendant would take possession of Head’s membership unit in Ascendant if Head did not provide evidence of his solvency.

Head did not provide the requested evidence of his solvency. Ascendant’s attorney then sent Head another letter on April 3, 2018 notifying him that Ascendant had taken possession of Head’s membership unit and that Head was no longer a member of Ascendant.

After taking possession of Head’s membership interest, Appellees filed a plea to the jurisdiction asking the trial court to dismiss Head’s claims because Head no longer had standing due to the loss of his membership interest in Ascendant. After a hearing, the trial court granted Appellees’ plea to the jurisdiction and dismissed Head’s claims in their entirety. Head appealed, arguing, among other things, that the trial court improperly granted Appellees’ plea to the jurisdiction because Head was still a member of Ascendant.

The court of appeals began by noting that Ascendant was a Delaware LLC; therefore, Delaware law controlled the interpretation of the Company Agreement. The Company Agreement itself also provided that it was to be interpreted under Delaware law. The court observed that in filing a plea to the jurisdiction challenging Head’s standing to maintain his lawsuit, Appellees had challenged the trial court’s subject matter jurisdiction. Because subject matter jurisdiction is a question of law, the court conducted a de novo review of the trial court’s granting of the plea.

Since standing is determined on a claim-by-claim basis, the court was required to determine whether Head’s claims were direct or derivative. The court cited the Delaware opinion of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and expressed the standard as follows:

... the test we use to determine whether a limited liability company member’s claim is direct or derivative turns solely on the following questions: (1) who suffered the alleged harm (the limited liability company or the suit member, individually) and (2) who would receive the benefit of any recovery or other remedy (the limited liability company or the members, individually)? As explained by the court in *Kelly v. Blum* [No. 4516-VCP, 2010 WL 629850 (Del. Ch. Feb. 24, 2010)]:

Specifically, the Court evaluates whether the nature of the alleged injury is such that it falls directly on the LLC as a whole and only secondarily on an individual

member as a function of and in proportion to his pro rata investment in the LLC, in which case the claim would be derivative, or whether the injury inflicts direct harm on the rights of the member as an individual.

Applying that test, the court of appeals concluded that Head's breach of fiduciary duty claims were "all based on alleged injuries to the limited liability company as a whole" and were premised "on the general allegation that mismanagement of Ascendant and its subsidiaries [had] occurred." Head could not prove his alleged injuries without proving injury to Ascendant. Accordingly, the claims were derivative. In contrast, the court determined that Head's demand for an inspection of the books and records was a direct claim.

Because the derivative claims required the plaintiff to be a member, the court concluded that the trial court properly dismissed the claims for lack of standing:

The Delaware LLC Act creates a statutory right to bring a derivative action. *CML V, LLC v. Bax*, 6 A.3d 238, 241 (Del. Ch. 2010), *aff'd*, 28 A.3d 1037 (Del. 2011) (citing 6 Del. C. §§ 18–1001 & 18–1002). Additionally, "[Delaware] case law governing corporate derivative suits is equally applicable to suits on behalf of an LLC." *VGS, Inc. v. Castiel*, No. C.A. 17995, 2003 WL 723285, at \*11 (Del. Ch. Mar. 10, 2003) (mem. op.) (noting that the Delaware LLC Act's provisions for a derivative action originated "from the well-developed body of Delaware law governing derivative suits by stockholders of a corporation").

Delaware follows the continuous ownership requirement for derivative suits, requiring that a derivative plaintiff must not only be a stockholder at the time of the alleged wrong and at the time of the commencement of suit but must also maintain his shareholder status throughout the litigation. The rationale behind this rule is that "shareholders sue in a representative capacity only," and "a plaintiff's derivative claim is regarded as a property right belonging to the corporation instead of the shareholder." *Ala. By-Prods. Corp. v. Cede & Co. ex rel. Shearson Lehman Bros., Inc.*, 657 A.2d 254, 265 (Del. 1995).

Standing then, for the derivative action plaintiff, is not so much a matter of the plaintiff having a personal stake in the outcome of the controversy as a matter of the plaintiff having an interest in the corporation which justifies the plaintiff's bringing suit on its behalf. When the interest is extinguished, so is the plaintiff's justification for maintaining a derivative action.

Head acknowledges that he must continue to have an ownership interest in Ascendant in order to continue to have standing to prosecute his claims. In their plea to the jurisdiction, Appellees argued that Head was no longer a member of Ascendant because Ascendant repossessed Head's membership unit on April 3, 2018. ...

Appellees assert that the evidence they submitted with their plea to the jurisdiction negated the existence of a jurisdictional fact—that Head remained a member of Ascendant. Appellees further assert that the burden shifted to Head to raise a fact question on the issue of standing. Appellees contend that Head failed to raise a fact question because he did not submit any evidence in response to the plea to the jurisdiction. Appellees' contentions are based on the procedure outlined in *Mission Consolidated Independent School District v. Garcia*, 372 S.W.3d at 636; *see Tooker v. Alief Indep. Sch. Dist.*, 522 S.W.3d 545, 553 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

Head filed a response to the plea to the jurisdiction. He asserted that Ascendant could not have repossessed Head's membership interest because it is a "general intangible" that is incapable of either possession or repossession. Head also asserts that Ascendant did not dispose of the collateral in a method permitted by Article 9 of the Uniform Commercial Code. *See* TEX. BUS. & COM. CODE ANN. § 9.610 (West 2011). ...

Head relies on the documents attached to Appellees' plea to the jurisdiction for his contention that his membership interest was incapable of being repossessed. Section 9.609 of the UCC provides that, after default, a secured party may take possession of the collateral without judicial process, if it proceeds without breach of the peace. BUS. & COM. § 9.609. "The Uniform Commercial Code provides that unless otherwise agreed, upon default a secured party has the right to take possession of the collateral." *Cohen v. Rains*, 769 S.W.2d 380, 384 (Tex. App.—Fort Worth

1989, writ denied) (citing the predecessor to Section 9.609). The security agreement executed by Head and Ascendant did not provide that Head's membership interest could not be repossessed. Accordingly, we disagree with Head's assertion that his membership interest was incapable of being repossessed. *See 395 Lampe, LLC v. Kawish, LLC*, No. C12-1503RAJ, 2014 WL 221814, at \*6 (W.D. Wash. Jan. 21, 2014) (holding that a secured party could take possession under the UCC of the debtor's ownership interest in a limited liability company).

The evidence that Appellees attached to their plea to the jurisdiction conclusively established that Head no longer owned a membership interest in Ascendant because the evidence showed that Ascendant repossessed it. Thus, Head had the burden to raise a fact question that he retained ownership. Head did not meet this burden. While Head asserts that Ascendant improperly disposed of his membership interest after it repossessed it, he did not present any evidence concerning Ascendant's later disposition, if any, of his membership interest. In this regard, the UCC "either expressly permits a secured party to take full ownership of collateral ('record or legal title') without effecting a 'disposition [for Article 9 purposes],' or, at a minimum, it does not prohibit a secured party from doing so." *Id.*; *see Spellman v. Indep. Bankers' Bank of Fla.*, 161 So. 3d 505, 508 (Fla. Dist. Ct. App. 2014) (citing 395 Lampe, LLC for this proposition). Accordingly, the trial court did not err in granting Appellees' plea to the jurisdiction on Head's causes of action for breach of fiduciary duty, negligence, the request for a declaratory judgment, and the appointment of a receiver.

With respect to Head's direct claim for an inspection of the books and records, the court of appeals similarly concluded that, after the repossession of his membership interest, he lacked standing to assert the claim:

We must next determine whether Head had standing to bring his direct claim to compel an inspection of Appellees' books and records. With respect to Ascendant's books, the Delaware Code provides that a member of a limited liability company has the right, subject to reasonable standards established by the limited liability company agreement, a manager, or members, to make a reasonable demand to inspect the records of the company for "any purpose reasonably related to the member's interest as a member of the limited liability company." 6 DEL. CODE ANN. § 18-305. Section 18-305's corporate analogue, 8 Delaware Code Section 220, guides the scope of Section 18-305. *See* 8 DEL. CODE ANN. § 220. Section 220 " 'plain[ly] and unambiguous[ly]' limits inspection rights to current stockholders and directors." *Prokupek v. Consumer Capital Partners LLC*, C.A. No. 9918-VCN, 2014 WL 7452205, at \*6 (Del. Ch. Dec. 30, 2014) (alterations in original) (quoting *King v. DAG SPE Managing Member, Inc.*, C.A. No. 7770-VCP, 2013 WL 6870348, at \*6 (Del. Ch. Dec. 23, 2013) (mem. op.)). Thus, Head no longer had standing to inspect Ascendant's books after he no longer held an ownership interest in Ascendant. *See id.* at \*7 (By its plain language, Delaware Code Section 18-305(a) of the LLC Act "confers inspection rights only on current members of an LLC.").

Head also did not have standing to inspect the books of CAW Resources or the three subsidiaries. Head did not have an ownership interest in any of these entities. His only basis for requesting an inspection of the records of these other entities was his ownership of an interest in Ascendant—an ownership interest that no longer exists. Accordingly, the trial court did not err in granting Appellees' plea to the jurisdiction on Head's direct claim.

***Selinger v. City of McKinney***, No. 05-19-00545-CV, 2020 WL 3566722 (Tex. App.—Dallas July 1, 2020, no pet.) (mem. op.).

"Here, appellants' claims are predicated on the City's denying Selinger's plat after he refused to agree to pay roughly \$482,000 in water and sewer impact fees if City water and sewer lines were ever extended to the property. Appellants claim to have been injured by this denial. They assert, for example, that the City's conduct is an exaction that 'reduce[d] the value of the property by at least 25%.' They also seek costs and attorney's fees under various laws.

The City's mootness argument relies on evidence that a new plat for the same property was submitted at the same time appellants appealed in this case. Specifically, Norhill Energy, LLC submitted the plat. The City has

submitted evidence to us showing that Selinger is Norhill's organizer and manager. The City's evidence also shows that Norhill has sued the City over its plat on claims unrelated to appellants' claims in this case. The City argues that the attempted 'do over' plat moots the claims arising from the first plat.

Appellants make several responses, including: (i) they are not Norhill, which is a separate entity, (ii) they are suing for damages that have already accrued, regardless of what happens to Norhill's plat, (iii) Norhill's plat proposes to connect to the City's water and sewer, but that doesn't mean that the City didn't mishandle Selinger's plat, which did not contain such a proposal, and (iv) the City's treatment of Norhill's plat cannot undo its wrongful actions on Selinger's plat.

We agree with appellants. A limited liability company is a legal entity separate from its members. *Sherman v. Boston*, 486 S.W.3d 88, 94 (Tex. App.—Houston [14th Dist.] 2016, pet. denied). The fact that Norhill has filed a new plat fails to establish that appellants did not suffer the damages they claim from the City's treatment of Selinger's plat. Nor does it affect appellants' claims that the City's conduct violated statutes and constitutional provisions or that the City's subdivision ordinance is itself illegal and unconstitutional."

***Gill v. Grewal***, Civ. A. No. 4:14-CV-2502, 2020 WL 3171360 (S.D. Tex. June 15, 2020).

The court granted in part and denied in part motions for summary judgment. Among other conclusions, the court determined that TBOC § 101.463 (allowing a derivative proceeding to be brought as a direct action) does not provide an absolute right for a shareholder to recover directly for claims based on company injuries.

Jaswant Singh Gill ("J. Gill") and Jagmohan Grewal attended college together in the late 1960s and reconnected in September 2010. Shortly after reuniting, Grewal pitched J. Gill an entrepreneurial venture wherein the proposed company would provide phone consultations to patients located in the United States by doctors based in India. The parties formed Healthema, LLC in October 2010.

On November 1, 2010, Grewal and Healthema entered into an Employment Agreement in which Healthema hired Grewal as a strategic advisor. On November 20, 2010, the parties executed the Operating Agreement. Under the terms of the Operating Agreement: (1) Grewal and JGBG, LLC (an LLC owned by J. Gill) would serve as members of Healthema; (2) members would make an initial capital contribution to the business in the agreed value of \$1 million; and (3) J. Gill would serve as Chairman; J. Gill's son, S. Gill, would hold the position of Chief Executive Manager; and Grewal would be the Strategic Advisor to the Chairman.

On the same day, the parties signed the Organizational Resolutions of the Managers of Healthema, LLC, which specified that JGBG would own 70% of the company in exchange for its staggered \$1 million contribution, and Grewal would own 30% in exchange for his goodwill and intellectual property. (A future increase in Grewal's equity position was contemplated after the company achieved profitability.) The Operating Agreement and Organizational Resolutions were signed in each party's capacity as either a member or manager of Healthema.

On November 21, 2010, J. Gill and Grewal signed a one-page Addendum to the Operating Agreement wherein they reaffirmed Grewal's 30% equity position and agreed that his interest would increase after Healthema achieved profitability. It was further agreed that during the pre-operational phase and the first three years of operations, Grewal would have the primary responsibility and authority for making operational decisions with advice from both J. Gill and S. Gill. In the event of conflicts between the Addendum and the Operating Agreement, J. Gill and Grewal agreed that the Addendum would prevail. The Addendum was signed by Grewal in his individual capacity and by J. Gill either in his individual capacity or on behalf of JGBG.

As the company began taking steps towards becoming operational, various problems arose including the inability of Indian doctors to prescribe medications to U.S. patients and the need for permits in "Special Economic Zones" ("SEZs") in India. Grewal formed Healthema India Private Limited ("HIPL") to gain access to permits which, according to Grewal, would require \$750,000 of Healthema's cash contributions from JGBG to be transferred to HIPL's accounts. The Gills objected, stating that Grewal had given himself more managerial capacity in creating HIPL than he would have had under the Operating Agreement, that the \$750,000 requirement was not on the checklist provided by the SEZ permit consultant, and that Grewal had sole access to the HIPL bank account.

The Gills subsequently attempted to renegotiate the terms of their agreement by drafting an additional memorandum of understanding (MOU) requiring the approval of J. Gill, S. Gill, or both before certain expenditures could be made. The next day S. Gill sent an email threatening to cancel their contractual relationship if Grewal did not sign the MOU. Grewal responded stating that he would seek alternative funding and would return the funds to the Gills. He further indicated that he would like to dissolve Healthema and run the business on his own. In response, S. Gill, acting on behalf of Healthema, sent a letter to Grewal terminating his Employment Agreement

and the Gills withdrew \$697,149.74 from Healthema's account. HIPL's SEZ approval was denied for lack of funding, and Grewal had to pay HIPL's employees out of pocket.

After an Indian court enjoined HIPL from disposing of any assets and ordered the deposit for the business lease to be returned to Healthema, Grewal sent a demand letter to the Gills demanding payment of his capital contribution (which Grewal argued was the value of his 30% equity stake in Healthema) and 38 months of salary. Two separate suits—an action filed by the Gills seeking a declaratory judgment and an action by Grewal alleging various damages claims—were consolidated to form this case.

After resolving some jurisdictional issues, which resulted in Healthema and Doc Call Live, LLC (a related company) being removed as parties, the court addressed motions for summary judgment on whether Grewal was entitled to bring claims on Healthema's behalf. The court observed that Texas law holds that a member of a limited liability company lacks standing to assert claims individually when the cause of action belongs to the company. However, those with ownership interests in certain business associations may bring derivative actions to afford a means by which owners who are powerless to bring a direct civil action at law against faithless directors and managers may seek to vindicate their corporate right that the corporation itself has refused to enforce. Despite this procedural mechanism, the cause of action remains vested in the company.

The Gills claimed that Grewal had abandoned all causes of action brought derivatively on behalf of Healthema. Grewal claimed that he was permitted to bring an action that may be considered derivative as a direct action under Texas Business Organizations Code § 101.463(c). This section allows a derivative proceeding brought by a member of an LLC to be treated as a direct action brought by the member for the member's own benefit. A recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the LLC if necessary to protect the interests of creditors or other LLC members.

The court found that Grewal misunderstood the role of these provisions, as the provisions did not provide an absolute right for a shareholder to recover directly for claims based on corporate injuries. A court may treat a derivative proceeding like a direct action and allow the shareholder to recover directly, but the proceeding must be derivative. Therefore, even if the court allowed Grewal to pursue causes of action which belonged to the company as a direct action belonging to him, he was still required to bring the suit as a derivative action, which he had not done. A review of the case history showed that Grewal had abandoned his derivative claims years before and that Grewal's Second Amended Counterclaim did not allege any derivative claims. Additionally, Grewal failed to comply with the heightened minimum pleading standards for derivative suits found in F.R.C.P. 23.1, which requires that the complaint (1) be verified, (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack, and (3) state with particularity the effort by the plaintiff to obtain the desired action from the directors or comparable authority. The court speculated that Grewal could not bring his suit as a derivative action and maintain diversity jurisdiction, as an LLC's citizenship is determined by the citizenship of its members. Thus, in any suit in which an LLC sues, or is sued by, one of its members, the LLC and the opposing party will hold the same citizenship.

In the alternative, Grewal argued that he could bring Healthema-related claims because Healthema no longer existed, and in certain circumstances individual shareholders can sue on causes of action that belong to a terminated entity. However, even if the court agreed that Healthema was fully dissolved, the suit must still be a derivative one, and Grewal filed his suit in his own name and not on behalf of the company. Additionally, the court was not convinced that Healthema no longer existed.

The court concluded that Grewal had not brought the suit as a derivative action. As a result, he was only entitled to recover for harms incurred individually. Similarly, he lacked standing to assert claims individually when the cause of action belonged to the company.

The court then proceeded to consider Grewal's Second Amended Counterclaim. Several causes of action were discussed, including the following:

#### A. Grewal's Breach of Contract Actions

Grewal's Second Amended Counterclaim alleged that the Gills breached the governing documents by: (1) misappropriating substantially all of Healthema's assets; (2) failing and refusing to distribute to Grewal his alleged share of any liquidating distributions; (3) repudiating the contract and refusing continued performance unless Grewal signed one or more new agreements that would radically alter the terms of their deal; (4) preventing Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum;

(5) excluding Grewal from the management and affairs of Healthema; (6) preventing Grewal from exercising his authority as a manager of Healthema; (7) failing to prudently and properly manage the company; (8) improperly delegating and/or usurping management powers and responsibilities; (9) failing and/or refusing to continue and/or allow the continuation of Healthema's business; (10) dissolving or attempting to dissolve Healthema without notice to Grewal and without the required vote; (11) expending Healthema's funds for personal benefit and/or outside business interests; and (12) committing other wrongful acts to usurp or deny Grewal's membership and management interests in Healthema.

The Gills responded that these alleged breaches fell into two categories—claims that constituted injury to Healthema, which Grewal shared in only derivatively, and claims that may constitute direct injury to Grewal that were caused by Healthema, who was no longer a defendant in the case. With the exception of claim 4, the court agreed with the Gills and granted summary judgment. The court found that Grewal could only individually maintain one of his pleaded breach of contract actions, claim 4, which alleged that the Gills prevented Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum. Unlike the other contracts, the Addendum was apparently signed by J. Gill and Grewal in their individual capacities, or by J. Gill in his capacity as an agent of JGBG. There was no suggestion that the obligation under the addendum was transferred to Healthema by adoption, assignment, novation, or otherwise; therefore, the court could not grant summary judgment as to J. Gill or JGBG on this claim.

#### B. Grewal's Breach of Fiduciary Duty Claims

Grewal also alleged an action for breach of fiduciary duty. To maintain a breach of fiduciary duty claim in Texas, the plaintiff must establish: (1) a fiduciary relationship existed between the plaintiff and defendant; (2) the defendant breached its fiduciary duty to the plaintiff; and (3) the defendant's breach resulted in injury to the plaintiff or benefit to the defendant. Texas courts recognize an informal fiduciary duty that arises from a moral, social, domestic, or purely personal relationship of trust and confidence. However, courts do not create such relationships lightly, and not every relationship involving a high degree of trust and confidence rises to the level of a fiduciary relationship. In a business transaction, a special relationship of trust and confidence must exist prior to, and apart from, any agreement which forms the basis for the suit. There was no such prior relationship with S. Gill, so the court granted summary judgment with respect to claims against him. However, Grewal claimed his and J. Gill's history of close friendship and high degree of personal trust was sufficient to establish an informal fiduciary duty. The court disagreed, finding that long-lost college friends could not be expected to place their friend's interest above their own. Mere subjective trust is not sufficient to transform a business arrangement into a fiduciary relationship. The court therefore also granted summary judgment for claims against J. Gill.

#### C. Grewal's Conversion Claim

Grewal asserted a cause of action for conversion alleging that he had the right to immediate possession of any distributions made by Healthema and that the Gills wrongfully exercised dominion over those funds. The court determined that the claim had limitations problems. Even if timely filed, however, the court found that the claim failed for lack of standing:

The Court finds Grewal does not possess standing to bring an action for conversion. Texas has a specific definition of conversion. "The unauthorized and wrongful assumption and exercise of dominion and control over the personal property of another, to the exclusion of or inconsistent with the owner's rights, is in law a conversion." *Waisath v. Lack's Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971). Under Texas Business Organizations Code § 101.106(b), "a member of a limited liability company ... does not have an interest in any specific property of the company." For this reason, any funds that were withdrawn from Healthema were converted from Healthema, not Grewal. In accord with these two legal premises, Texas courts have held that a member of an LLC may not bring a conversion action for funds that were improperly withdrawn from the LLC's bank account. *See Ghosh v. Grover*, 412 S.W.3d 749, 755-56 (Tex. App.—Houston [14th Dist.] 2013, no pet.). As Grewal is bringing this action individually, he may not seek to vindicate Healthema's rights to these funds.



The court noted that Grewal may have been able to argue that Healthema did not act properly in failing to pay Grewal his purported distribution to him directly, but such a claim would have to be made against Healthema, who was no longer a defendant. Therefore, the court granted summary judgment on Grewal’s conversion claim as to all counter-defendants.

The court also addressed the Gills’ First Amended Complaint. The Gills alleged that Grewal breached his fiduciary duties of obedience, loyalty, and due care as a manager and member of Healthema. The court observed that, in Texas, members of an LLC do not owe a formal fiduciary duty to one another. With respect to an informal fiduciary duty, the court did not find facts sufficient to establish one. Moreover, the Gills did not plead the claim derivatively. Healthema was not a party to the suit and the Gills could not sue on its behalf any more than Grewal could. Therefore, the Court granted the motion for summary judgment against the Gills.

The Gills also alleged that Grewal breached the terms of his employment contract with Healthema and that they could not be liable under the Healthema/Grewal Employment Agreement. Under TBOC § 101.114, unless the company agreement specifically provides otherwise, a member or manager is not liable for the debts, obligations, or liabilities of an LLC. Nothing in the Operating Agreement abridged the Gill’s limited liability with respect to the employment agreement. The court made no finding on the merits of Grewal’s breach of employment contract action against Healthema but granted the Gills’ motion for summary judgment as to the claims against them.

***Lomix Limited Partnership v. Compass Bank***, Civ. A. No. 1:15-CV-00050, 2018 WL 11152159 (S.D. Tex. Oct. 9, 2018) (Although the court issued this opinion in 2018, it is included in this year’s update because it did not appear in the Westlaw database until recently.).

“Compass Bank argues that the Guarantors are not real parties in interest and, as a result, lack capacity to bring this lawsuit. Applying the principal that corporate shareholders cannot recover damages for wrongs done to the corporation, Compass Bank asserts that only MD Ventures—the limited liability company that owned the hospital—could have incurred injury from the alleged wrongs.

Compass Bank correctly notes that corporate shareholders cannot advance claims for wrongs done to the corporation. *See Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990). If the alleged harm solely includes a diminution in stock value, the cause of action rests with the company, to benefit all stockholders if the company prevails. These principles apply to a limited liability company and its shareholders.

Texas law also establishes, however, that shareholders may advance personal claims for wrongs done to them as individuals. *Wingate*, 795 S.W.2d at 719; *see also, Sneed v. Webre*, 465 S.W.3d 169, 188 (Tex. 2015) (endorsing *Wingate*’s approval of personal-wrongs claims). In *Wingate*, the Texas Supreme Court held that a shareholder may recover damages ‘for wrongs done to him individually ‘where the wrongdoer violates’ ‘ a contractual or other duty that he owes ‘ ‘directly ... to the [share]holder.’ ‘

Here, the Guarantors allege that Compass Bank harmed them individually by disclosing their financial information to third parties, including Pineda. Because the Guarantors are asserting direct claims as signatories to the contract, not derivative claims as shareholders, their causes of action are within the permissible claims that shareholders may assert, as demonstrated in *Wingate* and *Sneed*. As a result, the Guarantors possess the requisite capacity to form real parties in interest.”

*See also Chase v. Hodge*, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021); ***Infinity Emergency Management Group, LLC v. Neighbors Health System, Inc. (In re Neighbors Legacy Holdings, Inc.)***, \_\_ B.R. \_\_, 2021 WL 1042867 (Bankr. S.D. Tex. 2021); ***Patterson Midstream Services, LLC v. Five Point Energy, LLC***, No. 01-19-00643-CV, 2020 WL 7213348 (Tex. App.—Houston [1st Dist.] Dec. 8, 2020, no pet. h.) (mem. op.) summarized below under “Direct and Derivative Claims.”

## **Q. Direct and Derivative Claims**

***Chase v. Hodge***, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021).

The magistrate concluded that the plaintiff did not have standing to pursue breach-of-fiduciary-duty claims that alleged harm to an LLC because the plaintiff was never a member of the LLC, as indicated by his complaint that he was never made a member when he was promised an ownership interest in the LLC, and even if he were

a member, he would not have standing to bring the claims individually because a claim of harm to the entity must be brought directly or derivatively by the entity suffering harm.

In this dispute about the ownership of Helping Hands Capital, LLC (“Helping Hands” or the “Company”), a Texas limited liability company that makes non-recourse loans to cover living expenses for parties involved in personal injury claims and suits, Dean Chase, a Florida citizen, asserted claims against Ryan Hodge, an attorney licensed in and residing in Kansas and the sole member of Helping Hands. Hodge also asserted claims against Hodge’s former spouse, Stephanie, and Helping Hands. Chase filed the suit in Travis County district court, and the defendants removed it to federal court based on diversity. Hodge sought to be dismissed based on lack of personal jurisdiction, and Hodge and Helping Hands sought dismissal of claims based on failure to state a claim.

Chase alleged that Hodge, Chase, and another individual (Guedri) who was not a party, decided to start a business to provide loans to litigants that would be secured by future recoveries in lawsuits. At the time, the three men were partners in a separate business that provided case expense loans. Chase claimed that Hodge, acting as an attorney for Chase and Guedri, formed the new entity, and that the parties agreed to treat it as an equal partnership in which each owned one third of the company and would share profits in thirds. In 2013, Hodge formed Helping Hands, listing himself on the certificate of formation as the managing member and making no mention of Chase or Guedri in the filing.

From 2013 through 2016, the Company typically reinvested profits into the Company, but funds were occasionally distributed to the three partners on the one-third basis initially agreed upon. In 2016, Guedri tendered his interest back to the Company, and Chase alleged that Hodge acknowledged to Chase in writing that going forward they were “50/50 partners.” In 2016 and 2017, distributions to Hodge and Chase were allegedly made on a 50/50 basis. According to Hodge and Chase, they worked together cooperatively until early 2018, when Chase began to press for more financial information and Hodge eventually sent a communication to Chase advising that Chase’s interest in the Company was an “economic benefit only” and not “legal ownership.” Chase contended that Hodge asserted for the first time in 2018 that the Company was “owned 100% by a trust” and that Hodge had no ownership in Helping Hands himself. Chase alleged that Hodge began excluding Chase from the business during this time frame in the spring of 2018. According to Chase, he tried to resolve the issues with Hodge throughout 2019 until Hodge emailed Chase in September of 2019 and offered to buy Chase’s “interests” in Helping Hands for \$25,000, or otherwise he would “transfer” his money out of Helping Hands and sell the assets and wind down the Company. Chase argued this offer was patently disingenuous, because the Company had made and received millions of dollars in loans over the past two years.

Chase asserted claims against Hodge for (1) breach of fiduciary duty; (2) breach of contract; (3) violations of the Texas Securities Act; (4) common law and statutory fraud; (5) a declaration of Chase’s rights in Helping Hands; and (6) the appointment of a receiver. He sued Helping Hands for (1) violations of the Texas Securities Act; (2) knowing participation in breach of fiduciary duty; (3) statutory fraud; (4) a declaration of Chase’s rights in Helping Hands; and (5) appointment of a receiver. Chase asserted that Hodge was involved in a hotly contested divorce and that Hodge may be wasting or transferring assets and revenues of the Company in an effort to hide the money from both Chase and Hodge’s ex-wife, Stephanie Hodge, also named as a defendant in the case. According to Chase, Hodge engaged in a consistent scheme of self-dealing, usurpation of corporate opportunities, and wasting of company assets. In turn, Hodge and Helping Hands asserted that Chase was never a member of Helping Hands, that he was compensated similarly to a contractor, and that he was not entitled to relief on his claims. Additionally, Helping Hands argued that Chase failed to name Chase First Chance Trust II, the sole member of the Company, as a party.

The court first addressed Hodge’s motion to dismiss on the basis that the court lacked personal jurisdiction over Hodge and concluded that Hodge had sufficient minimum contacts to support the exercise of personal jurisdiction and that considerations of fairness did not preclude exercise of jurisdiction.

The court next addressed motions to dismiss by both Hodge and Helping Hands for failure to state a claim under Rule 12(b)(6). Turning to Chase’s claims for breach of fiduciary duty, the court listed numerous counts in which Chase asserted acts of usurpation of business opportunities from Helping Hands, self dealing, transfers of assets, manipulation of the books, and failure to provide information.

Hodge argued that six of the ten alleged acts constituting a breach of fiduciary duty described harm to Helping Hands and not Chase individually and that these six claims must be dismissed based on the principle that “a shareholder may not sue directly for breaches of duties by officers and directors of a company, as those injuries are suffered by the corporation and thus a suit to recover those damages may only be brought as a derivative suit

on behalf of the corporation,” citing both corporate and LLC case law. The court agreed that the harms alleged in those six instances were suffered by Helping Hands and not Chase and must be brought in a derivative action, if at all. The court characterized the issue of standing in a case in federal court as a “threshold jurisdictional question” under Article III that must raise *sua sponte* when necessary. The court explained the rationale for dismissing the claims that rested on harm to Helping Hands as follows:

According to the allegations in the First Amended Complaint, Chase is not an owner or member of Helping Hands, LLC. Dkt. No. 54 at 2 (stating, “Hodge then formed Helping Hands Capital, LLC, as a Texas limited liability company on March 28, 2013. Hodge was listed on the Certificate of Formation as the Managing Member of Helping Hands ... the initial Company Agreement listed Hodge as 100% owner of the 10,000 member units.”). Indeed, the essence of Chase’s complaint is that he was never made a member of the LLC although he was promised an ownership interest. Thus he asks that the Court declare he was in fact a partner in Helping Hands and entitled to all profits, payments, and rights attendant to that partnership. However, as the First Amended Complaint states, Chase is not a named member of Helping Hands and any interest he may have in it is outside its status as an LLC. As a result, though Chase may have other claims through which he can seek to recover against Hodge for these actions, he has no standing to sue Hodge for Hodge allegedly breaching his fiduciary duty to Helping Hands.

And even if he were a member of the LLC, Chase would still not have standing to bring these claims. A claim of harm to a corporate entity must be brought, directly or derivatively, by the entity suffering the harm. *See Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990); *Eye Site, Inc. v. Blackburn*, 796 S.W.2d 160, 161 (Tex. 1990) (stating if a wrong has been done to the corporation, it is the corporation which must be compensated for the wrong, and even if also wronged an individual may not recover personally – no direct individual action is possible). The harms alleged in (a), (d), (g), (h), (i), and (j) above were suffered by Helping Hands and not Chase, and must be brought in a derivative action, if at all.

The court also found that Chase failed to adequately plead an injury to either Helping Hands or himself for alleged acts of transferring ownership of Helping Hands to a Nevada trust and transferring proceeds from an SBA loan to a Nevada entity and then back to Helping Hands. The Court found that Chase did not have standing to bring these breach-of-fiduciary-duty claims because he failed to assert the requisite injury to himself necessary to support these claims.

With regard to the claim that Hodge refused to provide Chase information about the business and stopped paying him, the court stated:

Hodge argues that as the managing member of Helping Hands, he does not owe Chase a fiduciary duty and this claim should sound in contract rather than tort. The Court agrees. *See Gill v. Grewal*, 2020 WL 3171360, at \*20 (S.D. Tex. June 15, 2020) (stating that in Texas, members in a limited liability company do not owe a formal fiduciary duty to one another) (citing *Guevara v. Lackner*, 447 S.W.3d 566, 580 (Tex. App.—Corpus Christi 2014, no pet.)); *Higher Perpetual Energy, LLC v. Higher Power Energy, LLC*, 2018 WL 3020328, at \*9 (E.D. Tex. June 18, 2018) (holding that under Texas law, a formal fiduciary relationship does not exist between managers and members of an LLC).

The last breach-of-fiduciary-duty claim addressed by the court related to Chase’s allegation that Hodge breached a fiduciary duty to him when Hodge omitted Chase’s name from the corporate formation documents of Helping Hands, LLC. Chase pled that “unbeknownst to Plaintiff [Hodge] named himself the 100% owner of Helping Hands and deliberately omitted Plaintiff from Helping Hands’ corporate documents.” The court stated that this claim could only be against Hodge in his alleged capacity as Chase’s attorney since Helping Hands did not exist at the time this occurred, and Hodge was not yet the managing member of Helping Hands. Chase pleaded that Hodge “served as Plaintiff’s attorney in Texas in connection with the formation and launch of the business that became Helping Hands.” Hodge argued that this claim should be dismissed because Chase made inconsistent allegations in his original petition. The court stated that the allegation in the original complaint that Chase knew

he was omitted from the formation documents was troubling, and cast doubt on the veracity of the current allegation, but it did not mandate dismissal of the current allegation.

***Infinity Emergency Management Group, LLC v. Neighbors Health System, Inc. (In re Neighbors Legacy Holdings, Inc.)***, \_\_ B.R. \_\_, 2021 WL 1042867 (Bankr. S.D. Tex. 2021).

This case involved a complicated structure (which the court characterized as “convoluted”) involving multiple entities, including “series LLCs.” The Trustee of the Debtors’ Unsecured Creditor Trust challenged the standing of Infinity Emergency Management Group, LLC (“Infinity”) to bring derivative claims, asserting that Infinity’s claims sought relief for harm to debtor entities and thus belonged to the Unsecured Creditor Trust. Infinity maintained that its claims sought redress only on behalf of two “series LLCs,” which were non-debtor entities (although the LLC that apparently created the series was a debtor entity). The bankruptcy court concluded that some of Infinity’s claims alleged harm to debtor limited partnerships and that Infinity lacked standing as to those claims. In order to assert the remaining claims, the court concluded that Infinity would need to re-plead to make clear that the alleged harms were suffered by the series LLCs in which Infinity held interests.

The dispute in this case revolved around two of 22 free-standing emergency centers that were operated by debtor Neighbors Legacy Holdings, Inc. and its subsidiaries and affiliates (the “Neighbors Network”). Each emergency center was owned by a separate limited partnership, and each limited partnership had a 1% general partner—Neighbors GP, LLC—and a 99% limited partner—NHS Emergency Centers, LLC (“NHS”). The court stated that “NHS established individual series LLCs to operate (but not to own) each emergency center,” and “each series LLC was owned by two classes of shareholders.” According to the court, “[t]he Class A owners of each series LLC were to be founding members of the Neighbors Network,” and “[t]he Class B owners of each series LLC were physicians that ‘purchased interests in [the] profits and losses [of a] specific series LLC[ ]. ... The management and administration of each emergency center, as well as the entities associated with each center, was carried out by five other Neighbors Network affiliates.’”

The court further described the structure of the two emergency centers involved in this dispute as follows:

Those emergency centers are NEC Eastside Emergency Center, LP and NEC Zaragoza Emergency Center, LP (together, the “Center LPs”). NHS, a Debtor entity, was the sole limited partner of both Center LPs. (ECF Nos. 59-24 at 2, 10; 61-13 at 2, 10). Each Center LP is a Debtor. (ECF No. 80 at 8–9). The series LLCs associated with the Center LPs were Series 114 – Eastside, LLC and Series 115 – Zaragoza, LLC (together, the “Series LLCs”). Neither Series LLC is a Debtor. (ECF No. 80 at 8–9). The Class A shareholder of each Series LLC was Neighbors Investment, which held a 34% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). The Class B shareholder was Infinity, which held a 65% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Investment and Infinity were the sole members of the Series LLCs. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Health provided management and administrative services to the Center LPs, the Series LLCs, and NHS. (ECF Nos. 62-12; 59-29; 59-10; 62-10; 62-24).

In practical terms, the emergency centers were “brick and mortar” stores for the Neighbors Network. The Center LPs were created to own these stores. To that end, the Center LPs provided facilities for Neighbors Network physicians, who provided healthcare services to patients and generated revenue through provision of these services. NHS was created to hold the majority ownership stake in the Center LPs. NHS created the Series LLCs to oversee the day-to-day operations of the Center LPs. While the Series LLCs were created to “operate” the Center LPs, the management and administration of the Center LPs—the “nuts and bolts” of day-to-day operations—was entrusted to Neighbors Health (a Debtor entity). Infinity, a member of the Series LLCs, was supposed to provide physicians to staff the emergency centers in exchange for a cut of the revenue generated by the “brick and mortar” centers. Perhaps inevitably, this convoluted structure produced litigation over which entity or successor could sue for the alleged mismanagement of the Center LPs.

The court next described the process by which Infinity invested in this arrangement and highlighted certain provisions of the series agreements executed by Infinity as well as the NHS operating agreement and the Center LP limited partnership agreements.

The court characterized the “6500 Class B shares in the Series LLCs” as “ownership interests” that “were offered by NHS,” and the court stated that Infinity acquired a “65% interest in both Series LLCs,” each of which was created for the purpose of operating its corresponding free-standing emergency center. Infinity purchased its interests pursuant to two identical “Series Purchase Agreements,” each of which reserved the profits and losses of the relevant emergency center for the corresponding series owners. The purchase agreements required Infinity to provide clinical staffing for the emergency centers, but the clinical staff members were to be employed as independent contractors of a specified Neighbors PLLC rather than as employees of the Series LLCs or any other Neighbors Network affiliate.

The “Series Agreements” executed by Infinity described the basic structure of the Series LLCs and identified the property associated with each Series LLC. Under the series agreements, Infinity acknowledged that the Series LLCs were created to operate the “Series Business[es],” which were the Center LPs. The Series LLCs were to receive “profits, losses, distributions, and other benefits received by NHS” from the Center LPs, and these “profits, losses, [etc.]” were identified as “Series Property.” Infinity was entitled to receive distributions derived from the Series Property, and Neighbors Health—the manager of the Series LLCs—was responsible for making these distributions.

Along with the series agreements, the NHS Operating Agreement defined the Series Property from which Infinity was to receive distributions. The Series LLCs were established by the NHS Operating Agreement, under which NHS was authorized to acquire interests in Texas limited partnerships. NHS was to “allocate or attribute” the “profits, losses, distributions, and allocations” from the limited partnerships to the Series LLCs. Once received or “determined” by NHS, the “profits, losses, distributions, and allocations” from the limited partnerships were considered Series Property.

Under the Center LP Limited Partnership Agreements, the “income, gain, loss, deduction, and credit of the Partnership[s]” were to be allocated 1% to Neighbors GP (the general partner of each Center LP) and 99% to NHS (the limited partner of each Center LP). Additionally, partnership revenues, which included all gross receipts of the partnership received by the partnership, were to be distributed to Neighbors GP and NHS in accordance with their respective allocations. The Center LPs were the “Series Business[es]” from which NHS was supposed to receive the “profits, losses, distributions, and other benefits,” which were to be distributed to the Series LLCs.

Four years after Infinity purchased its interests in the Series LLCs, certain entities in the Neighbors Network filed for Chapter 11 relief. The Center LPs and the general and limited partners of the Center LPs, including NHS, were debtors. Neither Neighbors Investment (the Class A interest owner of the Series LLCs) nor the Series LLCs were debtors. [Interestingly, the court did not address whether the series should be included as debtors by virtue of NHS’s status as a debtor (since the series that were created by NHS would not actually be separate entities from NHS under Texas law).]

At issue in this case was whether Infinity could pursue derivative claims filed against Neighbors Health and Neighbors Health’s directors and officers or whether the claims belonged to the Unsecured Creditor Trust. Infinity asserted its claims on behalf of the Series LLCs based on alleged breaches of fiduciary duty, abuses of control, gross mismanagement, and waste of corporate assets by Neighbors Health and its officers and directors. The wrongs of which Infinity complained stemmed from the directors’ and officers’ alleged failure to “properly oversee the operations and finances of” the Series LLCs. Infinity based the derivative claims on the defendants’ actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; (3) limited partner shares of the Center LPs to be wrongly collateralized; (4) fees billed by the Center LPs to be held in Center LP accounts and never “pushed back” to the Series LLCs; (5) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; and (6) Series LLC funds to be transferred to other “unprofitable series entities.” Infinity asserted that these actions resulted in losses of revenue and profit to the Series LLCs, but the Creditor Trustee argued that the Center LPs, rather than the Series LLCs, suffered the harm alleged. The court stated that the core of the issue was which entity owned the profits that were diminished by the defendants’ alleged mismanagement. Infinity claimed that the non-debtor Series LLCs owned the business operations of the emergency centers and that it was thus the Series LLCs’ profits that were impaired by the mismanagement, but the Creditor Trustee contended that the Center LPs associated with the

emergency centers owned the centers' operations and suffered the loss of profits, thus vesting claims for redress in the debtor Center LPs.

The court discussed at length the “web of agreements” defining what the Series LLCs owned. Although Infinity contended that the agreements clearly established that the Series LLCs owned the emergency centers' business operations, and, by implication, the profits from those business operations, the court agreed with the Creditor Trustee that the Series LLCs only had an interest in distributions from Center LP profits. According to the court, the agreements made clear that certain property identified in Infinity's complaint was, at the time it was damaged, owned by the Center LPs. Because this alleged damage occurred while the property was owned by the Center LPs, the Trustee was vested with the exclusive right to seek redress for this damage. Specifically, Infinity did not have standing to seek redress for the defendants' actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; and (3) fees billed by the Center LPs to be held in Center LP accounts and never “pushed back” to the Series LLCs.

The court concluded that it was unclear whether Infinity had a viable derivative claim based on the three remaining alleged harms, i.e., that the defendants caused: (1) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; (2) Series LLC funds to be transferred to other “unprofitable series entities;” and (3) limited partner shares of the Center LPs to be wrongly collateralized. As to the first two of these harms, Infinity's complaint did not make clear whether the Series LLCs owned the physician fees and the funds that were allegedly wrongfully transferred. As to the claim that Center LP shares were wrongfully collateralized, Infinity's failure to specify whether the defendants were acting as managers of the Series LLCs or of NHS was significant in that the series agreement contained a provision by which the members appeared to give NHS the right to encumber the Series Property, including Center LP shares acquired by NHS and allocated to the Series LLCs. Nevertheless, the court stated that Infinity might have a contractual claim based on the defendants' “wrongful collateralization” based on the management agreement between the Series LLC and Neighbors Health, which restricted Neighbors Health's ability to borrow money or execute promissory notes on the Series LLCs' behalf. Because Infinity's complaint did not make clear its standing to pursue these claims, the court stated that Infinity must re-plead its allegations as to these claims.

Finally, the court addressed Infinity's assertion that it could invoke Section 101.463 of the Texas Business Organizations Code, which provides special rules for closely held LLCs. The court discussed these provision in this context and ultimately concluded that the issues raised (whether the fact that the defendants were no longer governing persons and officers affected Infinity's ability to rely on these provisions and whether Infinity should recover directly) were not yet ripe:

Generally, to assert a derivative claim, a limited liability company's member must comply with sections 101.452 through 101.460. *See* TEX. BUS. ORGS. CODE ANN. § 101.463(b). However, under section 101.463, “[s]ections 101.452-101.460 do not apply to a claim or a derivative proceeding by a member of a *closely held* limited liability company against a governing person, member, or officer of the limited liability company. *Id.* § 101.463(b) (emphasis added). If a member's derivative claim is asserted “against a person *who is not* a governing person, member, or officer,” sections 101.452 through 101.460 still apply. *Id.* § 101.463(b) (emphasis added).

Section 101.463 also allows courts to treat derivative claims asserted by members of closely held limited liability companies as direct claims “if justice requires.” *Id.* § 101.463(c). To further enable members to vindicate their derivative claims, any recovery from such a proceeding “may be paid directly to the plaintiff or [company] if necessary to protect the interests of creditors or other members.” *Id.* This authorization does not, however, “transform the derivative action into a direct action.” *Gill v. Grewal*, 4:14-CV-2502, 2020 WL 3171360, at \*4 (S.D. Tex. June 15, 2020); *Black Elk Energy*, 2016 WL 4055044, at \*2. Moreover, the Court retains the authority to direct any recovery to the entity that suffered the injury rather than to the derivative plaintiff. *Swank*, 258 S.W.3d at 665 (holding that, under the corporate analog to section 101.463(c), “the trial court has *discretion* to award damages in a derivative proceeding directly to the shareholder.” (emphasis added)).

At bottom, section 101.463 “offers procedural benefits to members of limited liability companies, allowing them to pursue derivative actions for their own benefit.” *Black Elk Energy*, 2016 WL 4055044, at \*2; *see also In re LoneStar Logo & Signs, LLC*, 552 S.W.3d 342, 349–50

(Tex. App.—Austin 2018, no pet.) (quoting *Sneed v. Webre*, 465 S.W.3d 169, 181 (Tex. 2015)) (Section 101.463 authorizes “a shareholder of a closely held corporation [to] bring a derivative proceeding ... free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply ...” (internal quotation marks omitted, brackets in original)). In enacting these procedural benefits, the Texas Legislature removed the ability of independent directors “to decide whether continuing the derivative proceeding is in the best interest of the corporation.” See *Sneed*, 465 S.W.3d at 185–87 (examining the predecessor statute to the statute authorizing shareholder derivative proceedings against closely held corporations); See *LoneStar Logo*, 552 S.W.3d at 349–50 (relying on the Texas Supreme Court’s opinion in *Sneed* to interpret section 101.463). Section 101.463 enables members of closely held limited liability companies to bring derivative litigation without the impediments that burden other derivative suits.

However, plaintiff-members must qualify for access to this fast-tracked derivative relief under section 101.463. Specifically, the derivative action must be asserted against “a governing person, member, or officer.” TEX. BUS. ORGS. CODE ANN. § 101.463(b). Only then are the procedural benefits of section 101.463 unlocked.

Infinity’s standing to assert its purported derivative claim turns on the applicability of section 101.463(b). That is, whether Infinity was required to comply with sections 101.452 through 101.460 in asserting a derivative claim against Defendants on behalf of the Series LLCs. See *id.* § 101.463(b). Central to Infinity’s asserted standing under section 101.463(b) is the Defendants’ status in relation to the Series LLCs.

At the time Infinity initiated this proceeding in state court, it was an action against “governing person[s], member[s], or officer[s].” (See ECF No. 1-23 at 1–4). Since then, however, the Neighbors D&Os resigned their positions as officers and directors of all Neighbors entities. (See Case No. 18-33836, ECF Nos. 772 at 34; 862 at 1). The Liquidating Trustee took over management of Neighbors Health and NHS. (See Case No. 18-33836, ECF No. 772 at 8, 11, 34). And Neighbors Health rejected all unassumed executory contracts, which may have included the Management Agreement between Neighbors Health and the Series LLCs. (Case No. 18-33836, ECF No. 772 at 36). As it stands, Infinity’s derivative claim is no longer asserted against “governing person[s], member[s], or officer[s].” (ECF No. 80 at 1–4).

However, based on Infinity’s pleadings, it remains unclear whether the Series LLCs suffered injuries for which Infinity could seek derivative relief. Whether Defendants’ changes in status divested Infinity of its ability to rely on section 101.463 is a question that is not yet ripe.

It would also be premature to reach Infinity’s request under section 101.463 that, should Infinity recover on its derivative claim, any recovery be paid directly to Infinity under section 101.463(c)(2). First, Infinity has yet to plead a viable derivative claim, accompanied by the requisite showing standing. Second, it is not clear whether justice will require Infinity to be paid directly should it recover on its derivative claim. See TEX. BUS. ORGS. CODE ANN. § 101.463(c). The appropriate relief, if any, will be determined at a future date. It is sufficient that Infinity is aware that its efforts may not result in any direct recovery.

***Patterson Midstream Services, LLC v. Five Point Energy, LLC***, No. 01-19-00643-CV, 2020 WL 7213348 (Tex. App.—Houston [1st Dist.] Dec. 8, 2020, no pet. h.) (mem. op.).

The court of appeals held that the alleged usurpation of company opportunities by the majority-in-interest member of a Delaware limited liability company is a derivative claim.

Marty Patterson and Patterson Midstream Services, LLC (collectively, “Patterson”), minority members of Redwood Midstream Partners, LLC (“Redwood”), sued the majority member and its related entities, Five Point Capital Midstream Funds, I and II, L.P., their manager, Five Point Energy LLC, David N. Capobianco, and Matthew Morrow (collectively, “Five Point”), alleging breach of Redwood’s operating agreement, or, alternatively, if there is no enforceable contract, fraud, unjust enrichment, quantum meruit, and conversion. Five Point is a private equity firm specializing in the midstream segment of the oil-and-gas industry. Five Point invests through two entities, Five Point Capital Midstream Funds I & II. David Capobianco and Matthew Morrow are Five Point’s managing partners. Marty Patterson has worked for several decades in the energy industry—mostly in the midstream segment—and

is the sole owner of Patterson Midstream Services, LLC. In 2013, Five Point and Patterson formed Redwood, a Delaware limited liability company, to operate midstream energy assets.

The operating agreement of Redwood contained two provisions relevant to this dispute: Article 2.11, entitled “Limited Duty of Loyalty,” and Article 4.1, entitled “Limitation of Liability.”

Article 2.11 stated:

Each Member acknowledges that the Five Point Member and its Associates are free to engage or invest in an unlimited number of other activities or businesses, any one or more of which may be related to or competitive with the Business, without having or incurring any obligation under this Agreement to offer any interest in such activities to Company or any Member and neither this Agreement nor any activity undertaken pursuant to this Agreement shall prevent the Five Point Member or its Affiliates from engaging in such activities, or require the Five Point Member to permit Company or any Member or its Affiliates to participate in any such activities, and as a material part of the consideration for the execution of this Agreement by the Five Point Member, each other Member hereby waives, relinquishes, and renounces any such right or claim of participation under this Agreement.

Article 4.1 provided in pertinent part:

To the fullest extent permitted by the Act, no Member, Manager or Officer shall be personally liable to the Company, the other Members, or any other Person for any loss, damages, or claims arising out of or incurred by reason of any act or omission by such Member, Manager, or Officer (including any loss, damages, or claims based on the proposition that such Member, Manager, or Officer owes any fiduciary or other duties to any Person); provided, however, this Section 4.1 shall not limit the liability of a Member, Manager, or Officer for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. Except for the duties expressly set forth in this Agreement, a Member, Manager, or Officer shall not be subject to any duties (including fiduciary duties) with respect to the management of [the] Company.

Between 2014 and 2018, Five Point acquired interests in four businesses. Redwood was not a party to any of these investment opportunities although Patterson claimed that it identified these investment opportunities for Five Point. Patterson brought suit, primarily asserting a claim for breach of contract, specifically breach of the implied duty of good faith and fair dealing under Delaware law. Alternatively—in the event that there was no enforceable contract—Patterson asserted extra-contractual claims for fraud, unjust enrichment, conversion, and quantum meruit. Patterson argued that, while Five Point was “free to invest in their own separate deals apart from Redwood, [ ] they were not to be allowed to steal from [Patterson] their share in the upside on deals Patterson and Patterson LLC sourced for investment[.]” In other words, Patterson alleged that all investment opportunities that it “found, identified, and targeted” belonged to Redwood and that Five Point breached its duty of good faith and fair dealing by usurping those opportunities.

Five Point moved to dismiss Patterson’s claims under Tex. R. Civ. P. 91a, arguing that Patterson’s petition did not provide a legal basis upon which a court could grant relief. After a non-evidentiary hearing, the trial court granted Five Point’s motion to dismiss. Patterson appealed.

In its first point of error, Patterson argued that the trial court erred by concluding that Patterson lacked standing to assert its breach of contract claim. Five Point responded that the trial court correctly determined that, even assuming Five Point’s actions did breach the operating agreement, Redwood—not Patterson—suffered the harm.

Patterson relied on a 2015 Delaware chancery court decision for the proposition that Patterson had a direct claim because it was a “direct signing party” to the operating agreement; however, the court distinguished the facts in the case relied on by Patterson and further pointed out that the Delaware Supreme Court subsequently confirmed (*see El Paso Pipeline GP Co., LLC v. Brinckerhoff*, 152 A.3d 1248, 1260 (Del. 2016)), that the analysis in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.* applies to companies governed by operating agreements (i.e., LLCs and limited partnerships), rejecting the position that any claim for breach of contract is direct by default.



The *Tooley* test provides a two-pronged analysis for differentiating between direct and derivative claims. The first prong requires the court to determine whether the company or its members suffered the alleged harm. The second prong requires the court to determine whether the company or its members would receive the benefit of any recovery.

The court reasoned that to prevail on the first prong, Patterson would need to show that it could prevail without showing an injury to Redwood. The court determined that Patterson could not do so. The court stated that the gist of Patterson's complaint was that Five Point usurped investment opportunities from Redwood, and, because Redwood did not make any money on the usurped investments, Patterson, as a member of Redwood, did not make any money. Thus, Patterson could not show any injury without first demonstrating that Five Point improperly excluded Redwood. The *Tooley* first prong thus indicated that Patterson's claim was derivative.

Applying the second prong of *Tooley*, the court stated that Patterson sought "recovery of damages to the extent of the value of their proper share of distributions that have been, or are anticipated to be made from" the alleged usurped investments. In other words, had the investments been made by Redwood as Patterson claimed they should have been, Patterson would have received its share of the distributions. However, Redwood could not make distributions of value to anyone, including Patterson, without first recovering from Five Point. Consequently, the second *Tooley* prong also indicated that Patterson pursued a derivative claim.

In sum, both of the *Tooley* test's prongs indicated that Patterson's breach of contract claim was derivative under Delaware law. As such, the court held that the trial court properly concluded that Patterson lacked standing to bring the claim.

***Head v. Ascendant Petroleum Holding, LLC***, \_\_ S.W.3d \_\_, 2020 WL 4379195 (Tex. App.—Eastland 2020, no pet.).

The court of appeals affirmed the trial court's grant of a plea to the jurisdiction. Because plaintiff's membership interest had been repossessed, he lacked standing to assert derivative and direct claims.

In 2011, Tom L. Stover, the Oil and Gas Properties Manager for Ascendant, offered John Head the opportunity to acquire one membership unit in Ascendant. Head accepted Stover's offer, and the parties executed three documents: a secured promissory note in the amount of \$50,000, a security agreement, and the Ascendant Petroleum Holding, LLC Limited Liability Company Agreement ("Company Agreement"). The Company Agreement specifically provided that it was to be governed by the law of the State of Delaware. Conversely, the note and the security agreement provided that they would be governed by Texas law.

Under the terms of the secured promissory note and the security agreement, Ascendant accepted Head's membership unit in Ascendant as collateral for the payment of the promissory note and Head's performance of the security agreement and the Company Agreement. One of the conditions of the promissory note was that the balance of the note would immediately become due and payable upon Head's insolvency.

On July 19, 2017, a Colorado court rendered a judgment for \$912,720.58 plus postjudgment interest of \$105.99 a day in favor of Stover against Head individually and against his law firm, Head and Associates, PC. These amounts remain unpaid.

Appearing pro se, Head filed suit against Ascendant, the manager of Ascendant (CAW Resources, LLC), Bobby Pugh (manager of CAW Resources), and three subsidiaries of Ascendant (collectively the "Appellees"). He asserted a number of claims, including breach of fiduciary duty against CAW Resources and Pugh and a demand for an inspection of the books and records of Ascendant and its subsidiaries.

After Head filed suit, Ascendant's attorney sent a letter to Head on March 7, 2018 notifying him that he was in breach of the security agreement and the promissory note's solvency requirements because Head had failed to pay what he owed under the Colorado judgment and that he was presumed insolvent. The letter demanded that Head provide Ascendant "with reasonable and sufficient evidence of [Head's] solvency" within ten days. The letter further provided that Ascendant would take possession of Head's membership unit in Ascendant if Head did not provide evidence of his solvency.

Head did not provide the requested evidence of his solvency. Ascendant's attorney then sent Head another letter on April 3, 2018 notifying him that Ascendant had taken possession of Head's membership unit and that Head was no longer a member of Ascendant.

After taking possession of Head's membership interest, Appellees filed a plea to the jurisdiction asking the trial court to dismiss Head's claims because Head no longer had standing due to the loss of his membership interest in Ascendant. After a hearing, the trial court granted Appellees' plea to the jurisdiction and dismissed Head's claims

in their entirety. Head appealed, arguing, among other things, that the trial court improperly granted Appellees' plea to the jurisdiction because Head was still a member of Ascendant.

The court of appeals began by noting that Ascendant was a Delaware LLC; therefore, Delaware law controlled the interpretation of the Company Agreement. The Company Agreement itself also provided that it was to be interpreted under Delaware law. The court observed that in filing a plea to the jurisdiction challenging Head's standing to maintain his lawsuit, Appellees had challenged the trial court's subject matter jurisdiction. Because subject matter jurisdiction is a question of law, the court conducted a de novo review of the trial court's granting of the plea.

Since standing is determined on a claim-by-claim basis, the court was required to determine whether Head's claims were direct or derivative. The court cited the Delaware opinion of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and expressed the standard as follows:

... the test we use to determine whether a limited liability company member's claim is direct or derivative turns solely on the following questions: (1) who suffered the alleged harm (the limited liability company or the suit member, individually) and (2) who would receive the benefit of any recovery or other remedy (the limited liability company or the members, individually)? As explained by the court in *Kelly v. Blum* [No. 4516-VCP, 2010 WL 629850 (Del. Ch. Feb. 24, 2010)]:

Specifically, the Court evaluates whether the nature of the alleged injury is such that it falls directly on the LLC as a whole and only secondarily on an individual member as a function of and in proportion to his pro rata investment in the LLC, in which case the claim would be derivative, or whether the injury inflicts direct harm on the rights of the member as an individual.

Applying that test, the court of appeals concluded that Head's breach of fiduciary duty claims were "all based on alleged injuries to the limited liability company as a whole" and were premised "on the general allegation that mismanagement of Ascendant and its subsidiaries [had] occurred." Head could not prove his alleged injuries without proving injury to Ascendant. Accordingly, the claims were derivative. In contrast, the court determined that Head's demand for an inspection of the books and records was a direct claim.

Because the derivative claims required the plaintiff to be a member, the court concluded that the trial court properly dismissed the claims for lack of standing:

The Delaware LLC Act creates a statutory right to bring a derivative action. *CML V, LLC v. Bax*, 6 A.3d 238, 241 (Del. Ch. 2010), *aff'd*, 28 A.3d 1037 (Del. 2011) (citing 6 Del. C. §§ 18-1001 & 18-1002). Additionally, "[Delaware] case law governing corporate derivative suits is equally applicable to suits on behalf of an LLC." *VGS, Inc. v. Castiel*, No. C.A. 17995, 2003 WL 723285, at \*11 (Del. Ch. Mar. 10, 2003) (mem. op.) (noting that the Delaware LLC Act's provisions for a derivative action originated "from the well-developed body of Delaware law governing derivative suits by stockholders of a corporation").

Delaware follows the continuous ownership requirement for derivative suits, requiring that a derivative plaintiff must not only be a stockholder at the time of the alleged wrong and at the time of the commencement of suit but must also maintain his shareholder status throughout the litigation. The rationale behind this rule is that "shareholders sue in a representative capacity only," and "a plaintiff's derivative claim is regarded as a property right belonging to the corporation instead of the shareholder." *Ala. By-Prods. Corp. v. Cede & Co. ex rel. Shearson Lehman Bros., Inc.*, 657 A.2d 254, 265 (Del. 1995).

Standing then, for the derivative action plaintiff, is not so much a matter of the plaintiff having a personal stake in the outcome of the controversy as a matter of the plaintiff having an interest in the corporation which justifies the plaintiff's bringing suit on its behalf. When the interest is extinguished, so is the plaintiff's justification for maintaining a derivative action.

Head acknowledges that he must continue to have an ownership interest in Ascendant in order to continue to have standing to prosecute his claims. In their plea to the jurisdiction,

Appellees argued that Head was no longer a member of Ascendant because Ascendant repossessed Head's membership unit on April 3, 2018. ...

Appellees assert that the evidence they submitted with their plea to the jurisdiction negated the existence of a jurisdictional fact—that Head remained a member of Ascendant. Appellees further assert that the burden shifted to Head to raise a fact question on the issue of standing. Appellees contend that Head failed to raise a fact question because he did not submit any evidence in response to the plea to the jurisdiction. Appellees' contentions are based on the procedure outlined in *Mission Consolidated Independent School District v. Garcia*, 372 S.W.3d at 636; see *Tooker v. Alief Indep. Sch. Dist.*, 522 S.W.3d 545, 553 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

Head filed a response to the plea to the jurisdiction. He asserted that Ascendant could not have repossessed Head's membership interest because it is a "general intangible" that is incapable of either possession or repossession. Head also asserts that Ascendant did not dispose of the collateral in a method permitted by Article 9 of the Uniform Commercial Code. See TEX. BUS. & COM. CODE ANN. § 9.610 (West 2011). ...

Head relies on the documents attached to Appellees' plea to the jurisdiction for his contention that his membership interest was incapable of being repossessed. Section 9.609 of the UCC provides that, after default, a secured party may take possession of the collateral without judicial process, if it proceeds without breach of the peace. BUS. & COM. § 9.609. "The Uniform Commercial Code provides that unless otherwise agreed, upon default a secured party has the right to take possession of the collateral." *Cohen v. Rains*, 769 S.W.2d 380, 384 (Tex. App.—Fort Worth 1989, writ denied) (citing the predecessor to Section 9.609). The security agreement executed by Head and Ascendant did not provide that Head's membership interest could not be repossessed. Accordingly, we disagree with Head's assertion that his membership interest was incapable of being repossessed. See *395 Lampe, LLC v. Kawish, LLC*, No. C12-1503RAJ, 2014 WL 221814, at \*6 (W.D. Wash. Jan. 21, 2014) (holding that a secured party could take possession under the UCC of the debtor's ownership interest in a limited liability company).

The evidence that Appellees attached to their plea to the jurisdiction conclusively established that Head no longer owned a membership interest in Ascendant because the evidence showed that Ascendant repossessed it. Thus, Head had the burden to raise a fact question that he retained ownership. Head did not meet this burden. While Head asserts that Ascendant improperly disposed of his membership interest after it repossessed it, he did not present any evidence concerning Ascendant's later disposition, if any, of his membership interest. In this regard, the UCC "either expressly permits a secured party to take full ownership of collateral ('record or legal title') without effecting a 'disposition [for Article 9 purposes],' or, at a minimum, it does not prohibit a secured party from doing so." *Id.*; see *Spellman v. Indep. Bankers' Bank of Fla.*, 161 So. 3d 505, 508 (Fla. Dist. Ct. App. 2014) (citing *395 Lampe, LLC* for this proposition). Accordingly, the trial court did not err in granting Appellees' plea to the jurisdiction on Head's causes of action for breach of fiduciary duty, negligence, the request for a declaratory judgment, and the appointment of a receiver.

With respect to Head's direct claim for an inspection of the books and records, the court of appeals similarly concluded that, after the repossession of his membership interest, he lacked standing to assert the claim:

We must next determine whether Head had standing to bring his direct claim to compel an inspection of Appellees' books and records. With respect to Ascendant's books, the Delaware Code provides that a member of a limited liability company has the right, subject to reasonable standards established by the limited liability company agreement, a manager, or members, to make a reasonable demand to inspect the records of the company for "any purpose reasonably related to the member's interest as a member of the limited liability company." 6 DEL. CODE ANN. § 18-305. Section 18-305's corporate analogue, 8 Delaware Code Section 220, guides the scope of Section 18-305. See 8 DEL. CODE ANN. § 220. Section 220 " 'plain[ly] and unambiguous[ly]' limits inspection rights to current stockholders and directors." *Prokupek v. Consumer Capital*

*Partners LLC*, C.A. No. 9918-VCN, 2014 WL 7452205, at \*6 (Del. Ch. Dec. 30, 2014) (alterations in original) (quoting *King v. DAG SPE Managing Member, Inc.*, C.A. No. 7770-VCP, 2013 WL 6870348, at \*6 (Del. Ch. Dec. 23, 2013) (mem. op.)). Thus, Head no longer had standing to inspect Ascendant’s books after he no longer held an ownership interest in Ascendant. *See id.* at \*7 (By its plain language, Delaware Code Section 18-305(a) of the LLC Act “confers inspection rights only on current members of an LLC.”).

Head also did not have standing to inspect the books of CAW Resources or the three subsidiaries. Head did not have an ownership interest in any of these entities. His only basis for requesting an inspection of the records of these other entities was his ownership of an interest in Ascendant—an ownership interest that no longer exists. Accordingly, the trial court did not err in granting Appellees’ plea to the jurisdiction on Head’s direct claim.

***Gill v. Grewal***, Civ. A. No. 4:14-CV-2502, 2020 WL 3171360 (S.D. Tex. June 15, 2020).

The court granted in part and denied in part motions for summary judgment. Among other conclusions, the court determined that TBOC § 101.463 (allowing a derivative proceeding to be brought as a direct action) does not provide an absolute right for a shareholder to recover directly for claims based on company injuries.

Jaswant Singh Gill (“J. Gill”) and Jagmohan Grewal attended college together in the late 1960s and reconnected in September 2010. Shortly after reuniting, Grewal pitched J. Gill an entrepreneurial venture wherein the proposed company would provide phone consultations to patients located in the United States by doctors based in India. The parties formed Healthema, LLC in October 2010.

On November 1, 2010, Grewal and Healthema entered into an Employment Agreement in which Healthema hired Grewal as a strategic advisor. On November 20, 2010, the parties executed the Operating Agreement. Under the terms of the Operating Agreement: (1) Grewal and JGBG, LLC (an LLC owned by J. Gill) would serve as members of Healthema; (2) members would make an initial capital contribution to the business in the agreed value of \$1 million; and (3) J. Gill would serve as Chairman; J. Gill’s son, S. Gill, would hold the position of Chief Executive Manager; and Grewal would be the Strategic Advisor to the Chairman.

On the same day, the parties signed the Organizational Resolutions of the Managers of Healthema, LLC, which specified that JGBG would own 70% of the company in exchange for its staggered \$1 million contribution, and Grewal would own 30% in exchange for his goodwill and intellectual property. (A future increase in Grewal’s equity position was contemplated after the company achieved profitability.) The Operating Agreement and Organizational Resolutions were signed in each party’s capacity as either a member or manager of Healthema.

On November 21, 2010, J. Gill and Grewal signed a one-page Addendum to the Operating Agreement wherein they reaffirmed Grewal’s 30% equity position and agreed that his interest would increase after Healthema achieved profitability. It was further agreed that during the pre-operational phase and the first three years of operations, Grewal would have the primary responsibility and authority for making operational decisions with advice from both J. Gill and S. Gill. In the event of conflicts between the Addendum and the Operating Agreement, J. Gill and Grewal agreed that the Addendum would prevail. The Addendum was signed by Grewal in his individual capacity and by J. Gill either in his individual capacity or on behalf of JGBG.

As the company began taking steps towards becoming operational, various problems arose including the inability of Indian doctors to prescribe medications to U.S. patients and the need for permits in “Special Economic Zones” (“SEZs”) in India. Grewal formed Healthema India Private Limited (“HIPL”) to gain access to permits which, according to Grewal, would require \$750,000 of Healthema’s cash contributions from JGBG to be transferred to HIPL’s accounts. The Gills objected, stating that Grewal had given himself more managerial capacity in creating HIPL than he would have had under the Operating Agreement, that the \$750,000 requirement was not on the checklist provided by the SEZ permit consultant, and that Grewal had sole access to the HIPL bank account.

The Gills subsequently attempted to renegotiate the terms of their agreement by drafting an additional memorandum of understanding (MOU) requiring the approval of J. Gill, S. Gill, or both before certain expenditures could be made. The next day S. Gill sent an email threatening to cancel their contractual relationship if Grewal did not sign the MOU. Grewal responded stating that he would seek alternative funding and would return the funds to the Gills. He further indicated that he would like to dissolve Healthema and run the business on his own. In response, S. Gill, acting on behalf of Healthema, sent a letter to Grewal terminating his Employment Agreement and the Gills withdrew \$697,149.74 from Healthema’s account. HIPL’s SEZ approval was denied for lack of funding, and Grewal had to pay HIPL’s employees out of pocket.

After an Indian court enjoined HIPL from disposing of any assets and ordered the deposit for the business lease to be returned to Healthema, Grewal sent a demand letter to the Gills demanding payment of his capital contribution (which Grewal argued was the value of his 30% equity stake in Healthema) and 38 months of salary. Two separate suits—an action filed by the Gills seeking a declaratory judgment and an action by Grewal alleging various damages claims—were consolidated to form this case.

After resolving some jurisdictional issues, which resulted in Healthema and Doc Call Live, LLC (a related company) being removed as parties, the court addressed motions for summary judgment on whether Grewal was entitled to bring claims on Healthema's behalf. The court observed that Texas law holds that a member of a limited liability company lacks standing to assert claims individually when the cause of action belongs to the company. However, those with ownership interests in certain business associations may bring derivative actions to afford a means by which owners who are powerless to bring a direct civil action at law against faithless directors and managers may seek to vindicate their corporate right that the corporation itself has refused to enforce. Despite this procedural mechanism, the cause of action remains vested in the company.

The Gills claimed that Grewal had abandoned all causes of action brought derivatively on behalf of Healthema. Grewal claimed that he was permitted to bring an action that may be considered derivative as a direct action under Texas Business Organizations Code § 101.463(c). This section allows a derivative proceeding brought by a member of an LLC to be treated as a direct action brought by the member for the member's own benefit. A recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the LLC if necessary to protect the interests of creditors or other LLC members.

The court found that Grewal misunderstood the role of these provisions, as the provisions did not provide an absolute right for a shareholder to recover directly for claims based on corporate injuries. A court may treat a derivative proceeding like a direct action and allow the shareholder to recover directly, but the proceeding must be derivative. Therefore, even if the court allowed Grewal to pursue causes of action which belonged to the company as a direct action belonging to him, he was still required to bring the suit as a derivative action, which he had not done. A review of the case history showed that Grewal had abandoned his derivative claims years before and that Grewal's Second Amended Counterclaim did not allege any derivative claims. Additionally, Grewal failed to comply with the heightened minimum pleading standards for derivative suits found in F.R.C.P. 23.1, which requires that the complaint (1) be verified, (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack, and (3) state with particularity the effort by the plaintiff to obtain the desired action from the directors or comparable authority. The court speculated that Grewal could not bring his suit as a derivative action and maintain diversity jurisdiction, as an LLC's citizenship is determined by the citizenship of its members. Thus, in any suit in which an LLC sues, or is sued by, one of its members, the LLC and the opposing party will hold the same citizenship.

In the alternative, Grewal argued that he could bring Healthema-related claims because Healthema no longer existed, and in certain circumstances individual shareholders can sue on causes of action that belong to a terminated entity. However, even if the court agreed that Healthema was fully dissolved, the suit must still be a derivative one, and Grewal filed his suit in his own name and not on behalf of the company. Additionally, the court was not convinced that Healthema no longer existed.

The court concluded that Grewal had not brought the suit as a derivative action. As a result, he was only entitled to recover for harms incurred individually. Similarly, he lacked standing to assert claims individually when the cause of action belonged to the company.

The court then proceeded to consider Grewal's Second Amended Counterclaim. Several causes of action were discussed, including the following:

#### A. Grewal's Breach of Contract Actions

Grewal's Second Amended Counterclaim alleged that the Gills breached the governing documents by: (1) misappropriating substantially all of Healthema's assets; (2) failing and refusing to distribute to Grewal his alleged share of any liquidating distributions; (3) repudiating the contract and refusing continued performance unless Grewal signed one or more new agreements that would radically alter the terms of their deal; (4) preventing Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum; (5) excluding Grewal from the management and affairs of Healthema; (6) preventing Grewal from exercising his authority as a manager of Healthema; (7) failing to prudently and properly manage the company; (8) improperly

delegating and/or usurping management powers and responsibilities; (9) failing and/or refusing to continue and/or allow the continuation of Healthema's business; (10) dissolving or attempting to dissolve Healthema without notice to Grewal and without the required vote; (11) expending Healthema's funds for personal benefit and/or outside business interests; and (12) committing other wrongful acts to usurp or deny Grewal's membership and management interests in Healthema.

The Gills responded that these alleged breaches fell into two categories—claims that constituted injury to Healthema, which Grewal shared in only derivatively, and claims that may constitute direct injury to Grewal that were caused by Healthema, who was no longer a defendant in the case. With the exception of claim 4, the court agreed with the Gills and granted summary judgment. The court found that Grewal could only individually maintain one of his pleaded breach of contract actions, claim 4, which alleged that the Gills prevented Grewal from exercising primary responsibility and authority for making operational decisions pursuant to the Addendum. Unlike the other contracts, the Addendum was apparently signed by J. Gill and Grewal in their individual capacities, or by J. Gill in his capacity as an agent of JGBG. There was no suggestion that the obligation under the addendum was transferred to Healthema by adoption, assignment, novation, or otherwise; therefore, the court could not grant summary judgment as to J. Gill or JGBG on this claim.

#### B. Grewal's Breach of Fiduciary Duty Claims

Grewal also alleged an action for breach of fiduciary duty. To maintain a breach of fiduciary duty claim in Texas, the plaintiff must establish: (1) a fiduciary relationship existed between the plaintiff and defendant; (2) the defendant breached its fiduciary duty to the plaintiff; and (3) the defendant's breach resulted in injury to the plaintiff or benefit to the defendant. Texas courts recognize an informal fiduciary duty that arises from a moral, social, domestic, or purely personal relationship of trust and confidence. However, courts do not create such relationships lightly, and not every relationship involving a high degree of trust and confidence rises to the level of a fiduciary relationship. In a business transaction, a special relationship of trust and confidence must exist prior to, and apart from, any agreement which forms the basis for the suit. There was no such prior relationship with S. Gill, so the court granted summary judgment with respect to claims against him. However, Grewal claimed his and J. Gill's history of close friendship and high degree of personal trust was sufficient to establish an informal fiduciary duty. The court disagreed, finding that long-lost college friends could not be expected to place their friend's interest above their own. Mere subjective trust is not sufficient to transform a business arrangement into a fiduciary relationship. The court therefore also granted summary judgment for claims against J. Gill.

#### C. Grewal's Conversion Claim

Grewal asserted a cause of action for conversion alleging that he had the right to immediate possession of any distributions made by Healthema and that the Gills wrongfully exercised dominion over those funds. The court determined that the claim had limitations problems. Even if timely filed, however, the court found that the claim failed for lack of standing:

The Court finds Grewal does not possess standing to bring an action for conversion. Texas has a specific definition of conversion. "The unauthorized and wrongful assumption and exercise of dominion and control over the personal property of another, to the exclusion of or inconsistent with the owner's rights, is in law a conversion." *Waisath v. Lack's Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971). Under Texas Business Organizations Code § 101.106(b), "a member of a limited liability company ... does not have an interest in any specific property of the company." For this reason, any funds that were withdrawn from Healthema were converted from Healthema, not Grewal. In accord with these two legal premises, Texas courts have held that a member of an LLC may not bring a conversion action for funds that were improperly withdrawn from the LLC's bank account. *See Ghosh v. Grover*, 412 S.W.3d 749, 755-56 (Tex. App.—Houston [14th Dist.] 2013, no pet.). As Grewal is bringing this action individually, he may not seek to vindicate Healthema's rights to these funds.

The court noted that Grewal may have been able to argue that Healthema did not act properly in failing to pay Grewal his purported distribution to him directly, but such a claim would have to be made against Healthema, who was no longer a defendant. Therefore, the court granted summary judgment on Grewal's conversion claim as to all counter-defendants.

The court also addressed the Gills' First Amended Complaint. The Gills alleged that Grewal breached his fiduciary duties of obedience, loyalty, and due care as a manager and member of Healthema. The court observed that, in Texas, members of an LLC do not owe a formal fiduciary duty to one another. With respect to an informal fiduciary duty, the court did not find facts sufficient to establish one. Moreover, the Gills did not plead the claim derivatively. Healthema was not a party to the suit and the Gills could not sue on its behalf any more than Grewal could. Therefore, the Court granted the motion for summary judgment against the Gills.

The Gills also alleged that Grewal breached the terms of his employment contract with Healthema and that they could not be liable under the Healthema/Grewal Employment Agreement. Under TBOC § 101.114, unless the company agreement specifically provides otherwise, a member or manager is not liable for the debts, obligations, or liabilities of an LLC. Nothing in the Operating Agreement abridged the Gill's limited liability with respect to the employment agreement. The court made no finding on the merits of Grewal's breach of employment contract action against Healthema but granted the Gills' motion for summary judgment as to the claims against them.

***Gill v. Grewal***, Civ. A. No. 4:14-CV-2502, 2020 WL 8408969 (S.D. Tex. Mar. 20, 2020).

The court ordered the parties (the two members of an LLC and persons related to one of the members) to submit briefing to show cause why the entire case should not be dismissed due to the absence of the LLC as a party in light of the causes of action asserted by the parties against each other. The concerns expressed by the court related to the ability of the defendant to assert counterclaims against the plaintiffs for breach of the operating agreement (in light of the limited liability of members for the LLC's obligations), breaches of fiduciary duties (stating that fiduciary duties are normally owed to the LLC, and derivative action requires joinder of the business organization), unjust enrichment and money had and received (because the existence of contracts governing a relationship preclude such actions), conversion (in view of a member's inability to recover for the conversion of the LLC's funds), conspiracy (because a party cannot recover under a conspiracy theory where there is no valid underlying tort claim against one of the named defendants that remains), and declaratory judgment for winding up of the LLC and regarding funds of the LLC (stating that these claims appeared to involve claims on behalf of (i.e., derivative claims) or against the LLC). Similarly, the court was concerned that the plaintiffs' declaratory judgment claims could not be maintained because the LLC was the party to the employment contract that was the subject of one of the plaintiffs' claims, and the LLC appeared to be an indispensable party to the plaintiffs' claim that the defendant was not owed money for his alleged equity stake in the LLC.

***Lomix Limited Partnership v. Compass Bank***, Civ. A. No. 1:15-CV-00050, 2018 WL 11152159 (S.D. Tex. Oct. 9, 2018) (Although the court issued this opinion in 2018, it is included in this year's update because it did not appear in the Westlaw database until recently.).

"Compass Bank argues that the Guarantors are not real parties in interest and, as a result, lack capacity to bring this lawsuit. Applying the principal that corporate shareholders cannot recover damages for wrongs done to the corporation, Compass Bank asserts that only MD Ventures—the limited liability company that owned the hospital—could have incurred injury from the alleged wrongs.

Compass Bank correctly notes that corporate shareholders cannot advance claims for wrongs done to the corporation. *See Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990). If the alleged harm solely includes a diminution in stock value, the cause of action rests with the company, to benefit all stockholders if the company prevails. These principles apply to a limited liability company and its shareholders.

Texas law also establishes, however, that shareholders may advance personal claims for wrongs done to them as individuals. *Wingate*, 795 S.W.2d at 719; *see also, Sneed v. Webre*, 465 S.W.3d 169, 188 (Tex. 2015) (endorsing *Wingate's* approval of personal-wrongs claims). In *Wingate*, the Texas Supreme Court held that a shareholder may recover damages 'for wrongs done to him individually 'where the wrongdoer violates' ' a contractual or other duty that he owes ' 'directly ... to the [share]holder.' '

Here, the Guarantors allege that Compass Bank harmed them individually by disclosing their financial information to third parties, including Pineda. Because the Guarantors are asserting direct claims as signatories to the contract, not derivative claims as shareholders, their causes of action are within the permissible claims that

shareholders may assert, as demonstrated in *Wingate* and *Sneed*. As a result, the Guarantors possess the requisite capacity to form real parties in interest.”

*See also In re UBS Financial Services Inc.*, No. 14-20-00087-CV, 2020 WL 5902955 (Tex. App.—Houston [14th Dist.] Oct. 6, 2020, no pet.) (mem. op.) and *RLB Contracting, Inc. v. Genesis Energy, L.P.*, Civ. A. No. H-18-3844, 2020 WL 5880918 (S.D. Tex. Oct. 2, 2020) summarized above under “Standing or Capacity to Sue.”

## **R. Bankruptcy**

*Infinity Emergency Management Group, LLC v. Neighbors Health System, Inc. (In re Neighbors Legacy Holdings, Inc.)*, \_\_ B.R. \_\_, 2021 WL 1042867 (Bankr. S.D. Tex. 2021).

This case involved a complicated structure (which the court characterized as “convoluted”) involving multiple entities, including “series LLCs.” The Trustee of the Debtors’ Unsecured Creditor Trust challenged the standing of Infinity Emergency Management Group, LLC (“Infinity”) to bring derivative claims, asserting that Infinity’s claims sought relief for harm to debtor entities and thus belonged to the Unsecured Creditor Trust. Infinity maintained that its claims sought redress only on behalf of two “series LLCs,” which were non-debtor entities (although the LLC that apparently created the series was a debtor entity). The bankruptcy court concluded that some of Infinity’s claims alleged harm to debtor limited partnerships and that Infinity lacked standing as to those claims. In order to assert the remaining claims, the court concluded that Infinity would need to re-plead to make clear that the alleged harms were suffered by the series LLCs in which Infinity held interests.

The dispute in this case revolved around two of 22 free-standing emergency centers that were operated by debtor Neighbors Legacy Holdings, Inc. and its subsidiaries and affiliates (the “Neighbors Network”). Each emergency center was owned by a separate limited partnership, and each limited partnership had a 1% general partner—Neighbors GP, LLC—and a 99% limited partner—NHS Emergency Centers, LLC (“NHS”). The court stated that “NHS established individual series LLCs to operate (but not to own) each emergency center,” and “each series LLC was owned by two classes of shareholders.” According to the court, “[t]he Class A owners of each series LLC were to be founding members of the Neighbors Network,” and “[t]he Class B owners of each series LLC were physicians that ‘purchased interests in [the] profits and losses [of a] specific series LLC[ ]. ... The management and administration of each emergency center, as well as the entities associated with each center, was carried out by five other Neighbors Network affiliates.’”

The court further described the structure of the two emergency centers involved in this dispute as follows:

Those emergency centers are NEC Eastside Emergency Center, LP and NEC Zaragoza Emergency Center, LP (together, the “Center LPs”). NHS, a Debtor entity, was the sole limited partner of both Center LPs. (ECF Nos. 59-24 at 2, 10; 61-13 at 2, 10). Each Center LP is a Debtor. (ECF No. 80 at 8–9). The series LLCs associated with the Center LPs were Series 114 – Eastside, LLC and Series 115 – Zaragoza, LLC (together, the “Series LLCs”). Neither Series LLC is a Debtor. (ECF No. 80 at 8–9). The Class A shareholder of each Series LLC was Neighbors Investment, which held a 34% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). The Class B shareholder was Infinity, which held a 65% “Sharing Ratio” in each Series LLC. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Investment and Infinity were the sole members of the Series LLCs. (ECF Nos. 59-8 at 1; 59-19 at 1). Neighbors Health provided management and administrative services to the Center LPs, the Series LLCs, and NHS. (ECF Nos. 62-12; 59-29; 59-10; 62-10; 62-24).

In practical terms, the emergency centers were “brick and mortar” stores for the Neighbors Network. The Center LPs were created to own these stores. To that end, the Center LPs provided facilities for Neighbors Network physicians, who provided healthcare services to patients and generated revenue through provision of these services. NHS was created to hold the majority ownership stake in the Center LPs. NHS created the Series LLCs to oversee the day-to-day operations of the Center LPs. While the Series LLCs were created to “operate” the Center LPs, the management and administration of the Center LPs—the “nuts and bolts” of day-to-day operations—was entrusted to Neighbors Health (a Debtor entity). Infinity, a member of the Series



LLCs, was supposed to provide physicians to staff the emergency centers in exchange for a cut of the revenue generated by the “brick and mortar” centers. Perhaps inevitably, this convoluted structure produced litigation over which entity or successor could sue for the alleged mismanagement of the Center LPs.

The court next described the process by which Infinity invested in this arrangement and highlighted certain provisions of the series agreements executed by Infinity as well as the NHS operating agreement and the Center LP limited partnership agreements.

The court characterized the “6500 Class B shares in the Series LLCs” as “ownership interests” that “were offered by NHS,” and the court stated that Infinity acquired a “65% interest in both Series LLCs,” each of which was created for the purpose of operating its corresponding free-standing emergency center. Infinity purchased its interests pursuant to two identical “Series Purchase Agreements,” each of which reserved the profits and losses of the relevant emergency center for the corresponding series owners. The purchase agreements required Infinity to provide clinical staffing for the emergency centers, but the clinical staff members were to be employed as independent contractors of a specified Neighbors PLLC rather than as employees of the Series LLCs or any other Neighbors Network affiliate.

The “Series Agreements” executed by Infinity described the basic structure of the Series LLCs and identified the property associated with each Series LLC. Under the series agreements, Infinity acknowledged that the Series LLCs were created to operate the “Series Business[es],” which were the Center LPs. The Series LLCs were to receive “profits, losses, distributions, and other benefits received by NHS” from the Center LPs, and these “profits, losses, [etc.]” were identified as “Series Property.” Infinity was entitled to receive distributions derived from the Series Property, and Neighbors Health—the manager of the Series LLCs—was responsible for making these distributions.

Along with the series agreements, the NHS Operating Agreement defined the Series Property from which Infinity was to receive distributions. The Series LLCs were established by the NHS Operating Agreement, under which NHS was authorized to acquire interests in Texas limited partnerships. NHS was to “allocate or attribute” the “profits, losses, distributions, and allocations” from the limited partnerships to the Series LLCs. Once received or “determined” by NHS, the “profits, losses, distributions, and allocations” from the limited partnerships were considered Series Property.

Under the Center LP Limited Partnership Agreements, the “income, gain, loss, deduction, and credit of the Partnership[s]” were to be allocated 1% to Neighbors GP (the general partner of each Center LP) and 99% to NHS (the limited partner of each Center LP). Additionally, partnership revenues, which included all gross receipts of the partnership and received by the partnership, were to be distributed to Neighbors GP and NHS in accordance with their respective allocations. The Center LPs were the “Series Business[es]” from which NHS was supposed to receive the “profits, losses, distributions, and other benefits,” which were to be distributed to the Series LLCs.

Four years after Infinity purchased its interests in the Series LLCs, certain entities in the Neighbors Network filed for Chapter 11 relief. The Center LPs and the general and limited partners of the Center LPs, including NHS, were debtors. Neither Neighbors Investment (the Class A interest owner of the Series LLCs) nor the Series LLCs were debtors. [Interestingly, the court did not address whether the series should be included as debtors by virtue of NHS’s status as a debtor (since the series that were created by NHS would not actually be separate entities from NHS under Texas law).]

At issue in this case was whether Infinity could pursue derivative claims filed against Neighbors Health and Neighbors Health’s directors and officers or whether the claims belonged to the Unsecured Creditor Trust. Infinity asserted its claims on behalf of the Series LLCs based on alleged breaches of fiduciary duty, abuses of control, gross mismanagement, and waste of corporate assets by Neighbors Health and its officers and directors. The wrongs of which Infinity complained stemmed from the directors’ and officers’ alleged failure to “properly oversee the operations and finances of” the Series LLCs. Infinity based the derivative claims on the defendants’ actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; (3) limited partner shares of the Center LPs to be wrongly collateralized; (4) fees billed by the Center LPs to be held in Center LP accounts and never “pushed back” to the Series LLCs; (5) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; and (6) Series LLC funds to be transferred to other “unprofitable series entities.” Infinity asserted that these actions resulted in losses of revenue and profit to the Series LLCs, but the Creditor Trustee argued that the Center LPs, rather than

the Series LLCs, suffered the harm alleged. The court stated that the core of the issue was which entity owned the profits that were diminished by the defendants' alleged mismanagement. Infinity claimed that the non-debtor Series LLCs owned the business operations of the emergency centers and that it was thus the Series LLCs' profits that were impaired by the mismanagement, but the Creditor Trustee contended that the Center LPs associated with the emergency centers owned the centers' operations and suffered the loss of profits, thus vesting claims for redress in the debtor Center LPs.

The court discussed at length the "web of agreements" defining what the Series LLCs owned. Although Infinity contended that the agreements clearly established that the Series LLCs owned the emergency centers' business operations, and, by implication, the profits from those business operations, the court agreed with the Creditor Trustee that the Series LLCs only had an interest in distributions from Center LP profits. According to the court, the agreements made clear that certain property identified in Infinity's complaint was, at the time it was damaged, owned by the Center LPs. Because this alleged damage occurred while the property was owned by the Center LPs, the Trustee was vested with the exclusive right to seek redress for this damage. Specifically, Infinity did not have standing to seek redress for the defendants' actions that caused: (1) the Center LPs to enter into real property leases at above market rates; (2) Series LLC funds to be held in Center LP accounts; and (3) fees billed by the Center LPs to be held in Center LP accounts and never "pushed back" to the Series LLCs.

The court concluded that it was unclear whether Infinity had a viable derivative claim based on the three remaining alleged harms, i.e., that the defendants caused: (1) physician fees billed by the physicians to be held and distributed to entities other than the Series LLCs; (2) Series LLC funds to be transferred to other "unprofitable series entities;" and (3) limited partner shares of the Center LPs to be wrongly collateralized. As to the first two of these harms, Infinity's complaint did not make clear whether the Series LLCs owned the physician fees and the funds that were allegedly wrongfully transferred. As to the claim that Center LP shares were wrongfully collateralized, Infinity's failure to specify whether the defendants were acting as managers of the Series LLCs or of NHS was significant in that the series agreement contained a provision by which the members appeared to give NHS the right to encumber the Series Property, including Center LP shares acquired by NHS and allocated to the Series LLCs. Nevertheless, the court stated that Infinity might have a contractual claim based on the defendants' "wrongful collateralization" based on the management agreement between the Series LLC and Neighbors Health, which restricted Neighbors Health's ability to borrow money or execute promissory notes on the Series LLCs' behalf. Because Infinity's complaint did not make clear its standing to pursue these claims, the court stated that Infinity must re-plead its allegations as to these claims.

Finally, the court addressed Infinity's assertion that it could invoke Section 101.463 of the Texas Business Organizations Code, which provides special rules for closely held LLCs. The court discussed these provision in this context and ultimately concluded that the issues raised (whether the fact that the defendants were no longer governing persons and officers affected Infinity's ability to rely on these provisions and whether Infinity should recover directly) were not yet ripe:

Generally, to assert a derivative claim, a limited liability company's member must comply with sections 101.452 through 101.460. *See* TEX. BUS. ORGS. CODE ANN. § 101.463(b). However, under section 101.463, "[s]ections 101.452-101.460 do not apply to a claim or a derivative proceeding by a member of a *closely held* limited liability company against a governing person, member, or officer of the limited liability company. *Id.* § 101.463(b) (emphasis added). If a member's derivative claim is asserted "against a person *who is not* a governing person, member, or officer," sections 101.452 through 101.460 still apply. *Id.* § 101.463(b) (emphasis added).

Section 101.463 also allows courts to treat derivative claims asserted by members of closely held limited liability companies as direct claims "if justice requires." *Id.* § 101.463(c). To further enable members to vindicate their derivative claims, any recovery from such a proceeding "may be paid directly to the plaintiff or [company] if necessary to protect the interests of creditors or other members." *Id.* This authorization does not, however, "transform the derivative action into a direct action." *Gill v. Grewal*, 4:14-CV-2502, 2020 WL 3171360, at \*4 (S.D. Tex. June 15, 2020); *Black Elk Energy*, 2016 WL 4055044, at \*2. Moreover, the Court retains the authority to direct any recovery to the entity that suffered the injury rather than to the derivative plaintiff. *Swank*, 258 S.W.3d at 665 (holding that, under the corporate analog to section 101.463(c), "the

trial court has *discretion* to award damages in a derivative proceeding directly to the shareholder.” (emphasis added)).

At bottom, section 101.463 “offers procedural benefits to members of limited liability companies, allowing them to pursue derivative actions for their own benefit.” *Black Elk Energy*, 2016 WL 4055044, at \*2; *see also In re LoneStar Logo & Signs, LLC*, 552 S.W.3d 342, 349–50 (Tex. App.—Austin 2018, no pet.) (quoting *Sneed v. Webre*, 465 S.W.3d 169, 181 (Tex. 2015)) (Section 101.463 authorizes “a shareholder of a closely held corporation [to] bring a derivative proceeding ... free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply ...” (internal quotation marks omitted, brackets in original)). In enacting these procedural benefits, the Texas Legislature removed the ability of independent directors “to decide whether continuing the derivative proceeding is in the best interest of the corporation.” *See Sneed*, 465 S.W.3d at 185–87 (examining the predecessor statute to the statute authorizing shareholder derivative proceedings against closely held corporations); *See LoneStar Logo*, 552 S.W.3d at 349–50 (relying on the Texas Supreme Court’s opinion in *Sneed* to interpret section 101.463). Section 101.463 enables members of closely held limited liability companies to bring derivative litigation without the impediments that burden other derivative suits.

However, plaintiff-members must qualify for access to this fast-tracked derivative relief under section 101.463. Specifically, the derivative action must be asserted against “a governing person, member, or officer.” TEX. BUS. ORGS. CODE ANN. § 101.463(b). Only then are the procedural benefits of section 101.463 unlocked.

Infinity’s standing to assert its purported derivative claim turns on the applicability of section 101.463(b). That is, whether Infinity was required to comply with sections 101.452 through 101.460 in asserting a derivative claim against Defendants on behalf of the Series LLCs. *See id.* § 101.463(b). Central to Infinity’s asserted standing under section 101.463(b) is the Defendants’ status in relation to the Series LLCs.

At the time Infinity initiated this proceeding in state court, it was an action against “governing person[s], member[s], or officer[s].” (*See* ECF No. 1-23 at 1–4). Since then, however, the Neighbors D&Os resigned their positions as officers and directors of all Neighbors entities. (*See* Case No. 18-33836, ECF Nos. 772 at 34; 862 at 1). The Liquidating Trustee took over management of Neighbors Health and NHS. (*See* Case No. 18-33836, ECF No. 772 at 8, 11, 34). And Neighbors Health rejected all unassumed executory contracts, which may have included the Management Agreement between Neighbors Health and the Series LLCs. (Case No. 18-33836, ECF No. 772 at 36). As it stands, Infinity’s derivative claim is no longer asserted against “governing person[s], member[s], or officer[s].” (ECF No. 80 at 1–4).

However, based on Infinity’s pleadings, it remains unclear whether the Series LLCs suffered injuries for which Infinity could seek derivative relief. Whether Defendants’ changes in status divested Infinity of its ability to rely on section 101.463 is a question that is not yet ripe.

It would also be premature to reach Infinity’s request under section 101.463 that, should Infinity recover on its derivative claim, any recovery be paid directly to Infinity under section 101.463(c)(2). First, Infinity has yet to plead a viable derivative claim, accompanied by the requisite showing standing. Second, it is not clear whether justice will require Infinity to be paid directly should it recover on its derivative claim. *See* TEX. BUS. ORGS. CODE ANN. § 101.463(c). The appropriate relief, if any, will be determined at a future date. It is sufficient that Infinity is aware that its efforts may not result in any direct recovery.

***In re Two Wheels Properties, LLC***, 625 B.R. 869 (Bankr. S.D. Tex. 2020).

The bankruptcy court held that a limited liability company whose charter was forfeited pursuant to the Texas Tax Code (for failure to report or pay franchise taxes) was required under Texas law to wind up and thus did not have standing to file a Chapter 11 case to continue its business and affairs.

The charter of Two Wheels Properties, LLC (the “LLC” or “Debtor”), was forfeited by the Texas Secretary of the State on February 2, 2018, and the LLC filed its petition under Chapter 11 of the Bankruptcy Code on November 2, 2020. At its initial status conference with the Debtor, the court *sua sponte* questioned the Debtor’s

standing to file a Chapter 11 proceeding given forfeiture of its Texas corporate charter. In this opinion, the court concluded that the LLC was not eligible to be a debtor under Chapter 11.

The LLC relied on two cases in which the courts opined whether debtors may seek bankruptcy relief in the name of the forfeited corporation. In one case, the court held that a forfeited corporation under the Texas Tax Code was eligible for bankruptcy relief within three years of dissolution because Texas law provides that dissolved corporations continue their existence for three years following dissolution for limited purposes of liquidation and distribution of assets. *In re ABZ Ins. Servs.*, 245 B.R. 255, 261–62 (Bankr. N.D. Tex. 2000). In the other case, the court held that a corporation that was forfeited under the Texas Tax Code more than ten years earlier could not file for bankruptcy under Chapter 7 because its existence as a dissolved corporation for purposes of winding down its operations continued for only three years following its dissolution. *In re Am. Heartland Sagebrush Secs. Invs., Inc.*, 334 B.R. 848, 852–53 (Bankr. N.D. Tex. 2005). Thus, the LLC argued that it was properly a debtor in this case because three years have not lapsed since its forfeiture.

The court turned to the question of whether the LLC, which it characterized as “a corporate entity dissolved pre-petition by forfeiture of its corporate charter,” was a “person” who may be a debtor under Chapter 11. The court stated that the resolution of the question hinged on state law, and the court pointed out that the effect of a forfeiture under Tex. Tax Code §171.251 is that (1) the corporation is denied the right to sue or defend in a Texas court; and (2) each director or officer of the corporation is liable for a debt of the corporation. The LLC, however, relied on Section 11.356 of the Texas Business Organizations Code, which provides:

(a) Notwithstanding the termination of a domestic filing entity under this chapter, *the terminated filing entity continues in existence until the third anniversary of the effective date of the entity's termination only for purposes of:*

- (1) prosecuting or defending in the terminated filing entity's name an action or proceeding brought by or against the terminated entity;
- (2) permitting the survival of an existing claim by or against the terminated filing entity;
- (3) *holding title to and liquidating property that remained with the terminated filing entity at the time of termination or property that is collected by the terminated filing entity after termination;*
- (4) *applying or distributing property, or its proceeds*, as provided by § 11.053; and
- (5) settling affairs not completed before termination.

Under this provision, the LLC argued that it was permitted it to “continue in existence until the third anniversary of the effective date for limited tasks such as liquidating, applying or distributing property.”

The court pointed out, however, that *In re ABZ Insurance Services*, the only case favorably cited by the LLC, considered an entity’s ability to file a Chapter 7 bankruptcy petition. The court stated that the distinction between Chapter 7 and Chapter 11 is important because of the provisions of Sections 11.053, 11.356, and 11.201 of the Texas Business Organizations Code. Although forfeited entities survive for limited purposes after termination, an entity’s limited survival continues for the entity to wind up, for which there exists a statutory procedure.

The court went on to conclude that an entity that is forfeited under the Tax Code for failure to report or pay its franchise taxes may not be reinstated and may only wind up and apply its property to its liabilities and obligations. The court reached this conclusion based on the inability of an entity to reinstate its corporate charter under Sections 11.201 (“[a] terminated entity may not be reinstated under [Section 11.201] if the termination occurred as a result of ... forfeiture under the Tax Code”) and 11.356(b) (“[a] terminated filing entity may not continue its existence for the purpose of continuing the business or affairs for which the terminated filing entity was formed unless the terminated filing entity is reinstated under Subchapter E”) of the Texas Business Organizations Code. [The court did not address Section 11.254 of the Texas Business Organizations Code, which acknowledges the ability of an entity that has been forfeited under the Texas Tax Code to reinstate under the Texas Tax Code.]

In conclusion, the court stated that an entity that forfeits its corporate charter is permitted to prosecute a Chapter 7 bankruptcy case within three years of its forfeiture because it is liquidating its assets to satisfy its liabilities and obligations. The court held that the LLC in this case could not properly be a debtor under Chapter 11 to continue its business or affairs through the pendency of the case and post-confirmation of any plan of reorganization. Thus, the court dismissed the case.

*Swift Financial, LLC v. Opoku (In re Opoku)*, Case No. 19-40260, Adversary No. 19-4064, 2020 WL 7133350 (Bankr. E.D. Tex. Dec. 2, 2020).

The court discharged the individual debtor's liability on a guaranty for a business loan to the debtor's wholly owned limited liability company. The court rejected the creditor's claims that the debtor acquired the loan through a fraudulent misrepresentation and then converted the loan proceeds for his personal use.

Samuel Opoku organized Spring Stars, LLC ("Spring Stars") as an Ohio limited liability company in 2013. Opoku was the sole member. Spring Stars operated as a licensed and bonded freight hauler. The company struggled financially in its early years because it relied primarily on expensive rented trucks. As a result, the company suffered intermittent cash flow problems, and Opoku regularly used personal accounts to pay company expenses. Consequently, the line of demarcation between Opoku in his individual capacity and Spring Stars often blurred.

As a licensed and bonded freight hauler, obtaining and maintaining insurance was key to Spring Stars' business. Transportation regulations bar freight haulers from operating uninsured, but maintaining adequate insurance was a persistent problem for Spring Stars.

For a period beginning in July 2017, the prospects of Spring Stars seemed to brighten. The company secured regular business providing shipping services to a Cincinnati company called Lasership. Eventually, Lasership accounted for about 70% of Spring Stars' business. Spring Stars took advantage of its upswing by securing financing to buy its vehicles, but the company's good fortune did not last. Around May 1, 2018, Lasership informed Spring Stars that it had lost a bid for a major contract. Shortly thereafter, Spring Stars learned that its insurance company would not renew its policy. Spring Stars now faced two existential threats: the loss of most of its business and a lapse in insurance which would sideline its entire fleet.

Spring Stars began to search for a source of operating capital, and Opoku received an unsolicited advertisement from Swift Financial, LLC ("Swift Financial") promoting business capital loans. Opoku applied for the loan online on Spring Stars' behalf and answered all of the application questions truthfully. The loan application did not inquire about any existing circumstances that could affect an applicant's ability to repay the loan. Thus, Opoku did not disclose either Spring Stars' pending loss of Lasership's business or its looming lapse in insurance coverage. The court found credible and compelling Opoku's testimony that he only knew to answer the questions he was asked, and that he would have answered any other question about the business operations of Spring Stars if asked. Swift Financial approved Spring Stars for \$100,000 in financing. Spring Stars was to repay the loan in 52 equal, weekly installments of approximately \$2,300. Opoku executed an individual guaranty for the loan.

Concurrent with the search for new financing, Opoku and Spring Stars also sought an answer to the company's persistent insurance challenges. At some point, Opoku learned that a newly formed entity was likely to have an easier time acquiring insurance than Spring Stars. After failing to identify a feasible alternative, Opoku formed a new LLC ("Merger Stars") the day before Spring Stars' insurance policy expired. Like Spring Stars, Opoku was the sole manager and officer of Merger Stars.

All of Spring Stars' business came to a halt on July 3, 2018 with the expiration of its insurance policy. But Merger Stars was able to secure insurance on July 15, and Merger Stars began fulfilling the contractual obligations of Spring Stars using Spring Stars' business assets. While Merger Stars did not compensate Spring Stars for the use of its assets, Merger Stars did not collect revenue on the contracts either. Apparently, Merger Stars did not even open a bank account.

While the Merger Stars arrangement appeared to allay the insurance concern, Spring Stars' loss of Lasership revenue began to be felt. Spring Stars' business continued to struggle, culminating in a creditor freezing its bank account on October 8, 2018. As a consequence, Spring Stars missed its biweekly Swift Financial loan payment, eventually defaulting. Spring Stars ceased operations shortly thereafter.

On January 31, 2019, Opoku filed for bankruptcy under Chapter 7, including his guaranty on the Swift Financial loan in his liabilities schedule. Swift Financial argued that the court should except Opoku's guaranty from discharge on several grounds. The central thrust of Swift Financial's argument was that Opoku fraudulently concealed Spring Stars' true financial position in order to obtain the loan and then formed Merger Stars as a vehicle to appropriate Spring Stars' assets.

The court found that Opoku was "not a sophisticated businessman and, as is true with many closely-held entities, legal niceties were often ignored and the line of demarcation between the corporate entity and its individual owner often became blurred." Opoku regularly transferred funds among bank accounts of Spring Stars and Opoku, and the court found the evidentiary record insufficient to adequately evaluate the legitimacy of the myriad transfers between Opoku and Spring Stars' accounts.

On the other hand, despite the use of multiple accounts by Opoku and Spring Stars, Swift Financial offered insufficient evidence to substantiate that the sums were diverted to personal use or were used for anything other than a business purpose. The court found that the weight of evidence supported a determination that Opoku made extraordinary efforts to meet Spring Stars' obligations and keep the company operating. Rather than an unauthorized sale of assets, the court determined that Spring Stars' arrangement with Merger Stars constituted an informal, uncompensated licensing agreement that allowed Spring Stars to continue generating revenue, notwithstanding its inability to procure insurance. Further, by instituting this licensing agreement, Spring Stars was able to continue meeting its obligations to Swift Financial for an additional three months.

Based on the court's findings of facts summarized above, the court analyzed the elements of Swift Financial's claims that Opoku's guaranty was nondischargeable and concluded that Swift Financial failed to prove by a preponderance of the evidence that the debt owed by Opoku: (1) was procured by false representations, false pretenses or actual fraud under § 523(a)(2)(A) of the Bankruptcy Code; (2) was obtained by a false statement in writing respecting the financial condition of the debtor or of an insider of the debtor under § 523(a)(2)(B) of the Bankruptcy Code; (3) arose from a fraud or a defalcation committed in a fiduciary capacity, from an act of embezzlement, or from an act of larceny under § 523(a)(4) of the Bankruptcy Code; or (4) arose from the infliction of a willful and malicious injury under § 523(a)(6) of the Bankruptcy Code. Having failed to prove each of these bases for nondischargeability of Opoku's debt, the court rendered judgment for Opoku on each.

## **S. Securities Laws**

*Chase v. Hodge*, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021).

The magistrate concluded that the plaintiff's claim for violation of the anti-fraud provision of the Texas Securities Act failed because there must be an actual sale of a security to the plaintiff for the provision to apply, and the plaintiff did not allege that the LLC defendant sold him any securities. Rather, the plaintiff complained that he was promised an ownership interest in the LLC by the individual who formed the LLC but named himself as the 100% member.

In this dispute about the ownership of Helping Hands Capital, LLC ("Helping Hands" or the "Company"), a Texas limited liability company that makes non-recourse loans to cover living expenses for parties involved in personal injury claims and suits, Dean Chase, a Florida citizen, asserted claims against Ryan Hodge, an attorney and the sole member of Helping Hands.

Chase alleged that Hodge, Chase, and another individual (Guedri) who was not a party, decided to start a business to provide loans to litigants that would be secured by future recoveries in lawsuits. At the time, the three men were partners in a separate business that provided case expense loans. Chase claimed that Hodge, acting as an attorney for Chase and Guedri, formed the new entity, and that the parties agreed to treat it as an equal partnership in which each owned one third of the company and would share profits in thirds. In 2013, Hodge formed Helping Hands, listing himself on the certificate of formation as the managing member and making no mention of Chase or Guedri in the filing.

From 2013 through 2016, the Company typically reinvested profits into the Company, but funds were occasionally distributed to the three partners on the one-third basis initially agreed upon. In 2016, Guedri tendered his interest back to the Company, and Chase alleged that Hodge acknowledged to Chase in writing that going forward they were "50/50 partners." In 2016 and 2017, distributions to Hodge and Chase were allegedly made on a 50/50 basis. According to Hodge and Chase, they worked together cooperatively until early 2018, when Chase began to press for more financial information and Hodge eventually sent a communication to Chase advising that Chase's interest in the Company was an "economic benefit only" and not "legal ownership." Chase contended that Hodge asserted for the first time in 2018 that the Company was "owned 100% by a trust" and that Hodge had no ownership in Helping Hands himself. Chase alleged that Hodge began excluding Chase from the business during this time frame in the spring of 2018. According to Chase, he tried to resolve the issues with Hodge throughout 2019 until Hodge emailed Chase in September of 2019 and offered to buy Chase's "interests" in Helping Hands for \$25,000, or otherwise he would "transfer" his money out of Helping Hands and sell the assets and wind down the Company. Chase argued this offer was patently disingenuous, because the Company had made and received millions of dollars in loans over the past two years.

Chase sued Hodge and Helping Hands asserting numerous claims, including a claim for violation of the Texas Securities Act. Chase alleged that Hodge and Helping Hands violated the Texas Securities Act, when Hodge

promised Chase that he would: (a) provide ample capital for Helping Hands to operate; (b) use Chase’s contacts—lawyers seeking loans and investors providing capital—to fund litigation loans through Helping Hands; (c) engage in the business of providing litigation financing through Helping Hands; and (d) split the profits from the business with Chase. Chase alleged that he would not have agreed to form Helping Hands or do business with Hodge but for these promises.

Chase alleged that his “ownership interests” in Helping Hands qualified as “securities” under the Texas Securities Act, that Helping Hands was the “seller” of the securities, and that Hodge was the “aider and abettor” for purposes of Article 581-33(A)(2) of the Act, which provides that any person “who offers or sells a security by means of an untrue statement of material fact or an omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, is liable to the person selling the security to him.” The court stated that this theory was not actionable under the statute because an actual sale must take place before a buyer has a claim under the statute. According to the court, “it is clear that article 581-33A(2) contemplates that the sale must have been effected because the buyer may sue either at law or in equity for rescission, or for damages.” Chase’s pleadings stated that Hodge retained a 100% interest in Helping Hands; therefore, Chase did not allege that any securities were actually sold to him, and Helping Hands was not a “seller” of “securities.” Because Helping Hands was not a “seller,” the “aider and abettor” provision of the statute was inapplicable to Hodge. Tex. Rev. Civ. Stat. Ann., Art. 581-33(F)(2).

## **T. Arbitration**

*Sullivan v. Feldman*, Civ. A. No. H-20-2236, 2020 WL 4734982 (S.D. Tex. Aug. 14, 2020).

“The Doctors argue that the Lawyers’ motion to compel should be denied as to Janus Insurance Corp., Cerberus Insurance Corp, Orion Insurance Corp., and St. Charles Holdings, L.L.C., Center for Restorative Breast Surgery, LLC, Sunrise Productions, L.L.C., and Sigma Delta Billing, LLC, because they are nonsignatories to both the Engagement Letter and the Capstone Services Agreement. The Lawyers respond that the other entities may be compelled to arbitrate because they are ... included within the definition of ‘Affiliates’ in the Capstone Services Agreement ....

The Capstone Services Agreement includes the Doctors and St. Charles Surgical Hospital as parties as well as their ‘respective ‘Affiliates’ (as such term is defined herein).’ ‘Affiliates’ is defined as including ‘any person directly or indirectly controlled by or under common control with another person (whether such be an individual or an entity of any sort).’

Because St. Charles Holding, L.L.C., Center for Restorative Breast Surgery, LLC, and Sigma Delta Billing, LLC are owned and controlled by the individual doctors or by the St. Charles Surgical Hospital, all signatories to the Capstone Services Agreement, they are ‘Affiliates’ under the Agreement and the individual doctors signed on their behalf. These entities can be compelled to arbitrate their disputes relating to the Agreement in the Texas arbitration.

Janus Insurance Corp., Cerberus Insurance Corp, and Orion Insurance Corp. are also each owned and controlled by the individual doctors. These entities fall within the definition of ‘Affiliates’ in the Agreement and the individual doctors signed on their behalf. These entities can be compelled to arbitrate their disputes relating to the Agreement in the Texas arbitration.

The Doctors argue that the definition of ‘Affiliates’ does not include these entities because ‘Feldman and Capstone were aware of each of these entities and could have easily included them by name if the Capstone Services Agreement was intended to apply to them.’ But there is no requirement that the definition include these entities by name. The Agreement defines ‘Affiliates’ as entities ‘controlled by or under common control with’ the doctors or other parties to the Agreement. The contract terms do not also require specifically naming the entities, and the contract terms control.”

## **U. Diversity Jurisdiction**

The Fifth Circuit Court of Appeals and federal district courts continue to hold that the citizenship of a partnership or LLC is determined by the citizenship of each of its partners or members. (If the partners or members are themselves partnerships, LLCs, or corporations, their citizenship must be alleged in accordance with the rules of that entity, and the citizenship must be traced through however many layers of members or partners there may

be.) The cases stating this principle are too numerous to include in this paper, but several recent Fifth Circuit opinions reaffirming this principle are included below.

*Accordant Communications, L.L.C. v. Sayers Construction, L.L.C.*, No. 20-50169, No. 20-50513, 2020 WL 7663821 (5th Cir. Dec. 3, 2020).

Due to defective pleadings that failed to properly allege diversity jurisdiction in connection with an application to confirm an arbitration award, the court remanded the case to the district court for amendment of the allegations and supplementation of the record. The applications were deficient in that they listed the state of organization and principal place of business of the LLCs that were parties rather than listing the citizenship of each LLC's members. The mistake was not noticed or addressed by either party in the district court, but questions of subject matter jurisdiction cannot be waived. The court concluded that its precedent establishes that it is not permitted to receive new jurisdictional evidence on appeal but is not precluded from taking judicial notice of jurisdictional facts or exercising discretion to remand to the district court for amendment and to supplement the record if necessary. The court concluded that jurisdiction was not clear from the record, but there was some reason to believe that jurisdiction existed and remand was thus appropriate.

*Smith v. Toyota Motor Corp.*, 978 F.3d 280 (5th Cir. 2020) (“In this case, Smith’s amended complaint alleged that Plaintiff–Appellant Smith and Defendant–Appellee Diversity are citizens of the same state, Mississippi. Accordingly, the district court was correct in holding there is no diversity jurisdiction and thus no subject matter jurisdiction. Smith’s altering of the jurisdictional facts she alleges on appeal—omitting any mention of Diversity’s citizenship in her appellate brief and alleging only that Diversity is ‘located’ in Indiana in her appellate reply brief—does not alter our decision. Factual allegations not contained in the record may not be raised on direct appeal. Even assuming the altered jurisdictional facts are true, Smith has not met her burden of establishing complete diversity of the parties. The party asserting diversity jurisdiction ‘must ‘distinctly and affirmatively allege [ ]’ the citizenship of the parties.’ To adequately allege the citizenship of Toyota, a corporation, Smith needed to ‘set out the principal place of business of the corporation as well as the state of its incorporation.’ To adequately allege the citizenship of Diversity, a limited liability corporation, Smith needed to ‘specifically allege the citizenship of every member of every LLC or partnership involved in a litigation.’ ‘Failure adequately to allege the basis for diversity jurisdiction mandates dismissal.’ The district court’s dismissal without prejudice is AFFIRMED.”).

*Acadian Diagnostic Laboratories, LLC v. Quality Toxicology, LLC*, 965 F.3d 404 (5th Cir. 2020) (“Both Acadian and QT are LLCs. ‘[T]he citizenship of a[n] LLC is determined by the citizenship of all of its members.’ ‘So, to establish diversity jurisdiction, a party must specifically allege the citizenship of every member of every LLC.’ Both of Acadian’s members are Louisiana citizens. All the various members of QT and its various corporate parents are citizens of Texas. Thus, complete diversity exists to give the court jurisdiction to hear this state-law dispute. 28 U.S.C. § 1332(a).”).

## V. Personal Jurisdiction

*Chase v. Hodge*, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021).

The magistrate concluded that the fiduciary shield doctrine did not preclude the court’s exercise of personal jurisdiction over an LLC officer and recommended denial of the officer’s motion to dismiss for lack of personal jurisdiction.

In this dispute about the ownership of Helping Hands Capital, LLC (“Helping Hands” or the “Company”), a Texas limited liability company that makes non-recourse loans to cover living expenses for parties involved in personal injury claims and suits, Dean Chase, a Florida citizen, asserts claims against Ryan Hodge, an attorney licensed in and residing in Kansas and the sole member of Helping Hands. Hodge also asserted claims against Hodge’s former spouse, Stephanie, and Helping Hands. Chase filed the suit in Travis County district court, and the defendants removed it to federal court based on diversity. Hodge sought to be dismissed based on lack of personal jurisdiction, and Hodge and Helping Hands sought dismissal of claims based on failure to state a claim.

Chase alleged that Hodge, Chase, and another individual (Guedri) who was not a party, decided to start a business to provide loans to litigants that would be secured by future recoveries in lawsuits. At the time, the three



men were partners in a separate business that provided case expense loans. Chase claimed that Hodge, acting as an attorney for Chase and Guedri, formed the new entity, and that the parties agreed to treat it as an equal partnership in which each owned one third of the company and would share profits in thirds. In 2013, Hodge formed Helping Hands, listing himself on the certificate of formation as the managing member and making no mention of Chase or Guedri in the filing.

From 2013 through 2016, the Company typically reinvested profits into the Company, but funds were occasionally distributed to the three partners on the one-third basis initially agreed upon. In 2016, Guedri tendered his interest back to the Company, and Chase alleged that Hodge acknowledged to Chase in writing that going forward they were “50/50 partners.” In 2016 and 2017, distributions to Hodge and Chase were allegedly made on a 50/50 basis. According to Hodge and Chase, they worked together cooperatively until early 2018, when Chase began to press for more financial information and Hodge eventually sent a communication to Chase advising that Chase’s interest in the Company was an “economic benefit only” and not “legal ownership.” Chase contended that Hodge asserted for the first time in 2018 that the Company was “owned 100% by a trust” and that Hodge had no ownership in Helping Hands himself. Chase alleged that Hodge began excluding Chase from the business during this time frame in the spring of 2018. According to Chase, he tried to resolve the issues with Hodge throughout 2019 until Hodge emailed Chase in September of 2019 and offered to buy Chase’s “interests” in Helping Hands for \$25,000, or otherwise he would “transfer” his money out of Helping Hands and sell the assets and wind down the Company. Chase argued this offer was patently disingenuous, because the Company had made and received millions of dollars in loans over the past two years.

Chase asserted claims against Hodge for (1) breach of fiduciary duty; (2) breach of contract; (3) violations of the Texas Securities Act; (4) common law and statutory fraud; (5) a declaration of Chase’s rights in Helping Hands; and (6) the appointment of a receiver. He sued Helping Hands for (1) violations of the Texas Securities Act; (2) knowing participation in breach of fiduciary duty; (3) statutory fraud; (4) a declaration of Chase’s rights in Helping Hands; and (5) appointment of a receiver. Chase asserted that Hodge was involved in a hotly contested divorce and that Hodge may be wasting or transferring assets and revenues of the Company in an effort to hide the money from both Chase and Hodge’s ex-wife, Stephanie Hodge, also named as a defendant in the case. According to Chase, Hodge engaged in a consistent scheme of self-dealing, usurpation of corporate opportunities, and wasting of company assets. In turn, Hodge and Helping Hands asserted that Chase was never a member of Helping Hands, that he was compensated similarly to a contractor, and that he was not entitled to relief on his claims. Additionally, Helping Hands argued that Chase failed to name Chase First Chance Trust II, the sole member of the Company, as a party.

The court first addressed Hodge’s motion to dismiss on the basis that the court lacked personal jurisdiction over Hodges. Hodges relied on the “fiduciary shield doctrine.” The court described the fiduciary shield doctrine as generally precluding the exercise of jurisdiction over an individual predicated on jurisdiction over a corporation, i.e., “the fiduciary-shield which cloaks corporate agents and officers usually prevents a court from attributing actions made on behalf of the corporation to the agents or officers who performed them.” Thus, Hodge argued that his formation of Helping Hands, communications in Texas related to Helping Hands, and travel to Texas in connection with Helping Hands business could not form the basis for exercising personal jurisdiction over him individually.

Chase argued that the fiduciary shield doctrine is inapplicable in the context of jurisdictional analysis under the Due Process Clause. The court stated that it agreed with Chase but noted that the Fifth Circuit has not addressed the precise issue. However, there is case law in which the Fifth Circuit refused to find that the fiduciary shield doctrine prevented Texas plaintiffs from bringing a wage-and-hour lawsuit against an out-of-state owner of five hotels who hired the Texas employees to manage those hotels. More importantly, the court stated that the fiduciary shield doctrine has come under increasing criticism and has been rejected by the circuit courts that have addressed it. According to the court, “there is a broad consensus among federal courts that due process does not require the application of the fiduciary shield doctrine.” In any event, even assuming the doctrine survives, the court stated that courts have recognized an exception to the fiduciary shield doctrine when the agent perpetrates a fraud or other tortious act. Because Chase asserted a breach-of-fiduciary-duty and a fraud claim against Hodge, the court found the fiduciary shield doctrine did not apply. In addition, the court noted that most of the acts Chase pleaded to support his claims against Chase took place before and at the formation of Helping Hands, at which time Hodge could not have been acting as an officer of the company. For all of these reasons, the court concluded that the fiduciary shield doctrine did not bar the exercise of personal jurisdiction over Hodge.

The court proceeded to analyze minimum contacts and fairness and concluded that reaching out to Chase to form a Texas LLC, formation of the LLC, serving as manager of the LLC, visiting Texas in connection with the LLC and other businesses, and engaging in other business transactions in Texas supported the exercise of personal jurisdiction over Hodge.

***DGG Group, LLC v. Lockhart Fine Foods, LLC***, Case No. 1:20-CV-00330-RP, 2021 WL 308946 (W.D. Tex. Jan. 29, 2021).

The court held that a Delaware LLC that formed another LLC to acquire the assets of a business was the alter ego of the acquisition LLC for purposes of personal jurisdiction where the Delaware LLC, one month after the acquisition, entered into a management agreement with the acquisition LLC under which the Delaware LLC managed the business in exchange for all the net profits of the business, and the acquisition LLC transferred all its working capital assets to the Delaware LLC.

DGG Group, LLC (“DGG”) was a Texas limited liability company that manufactured cookies and cookie dough. Sinbad Foods, LLC (“Sinbad”), a Delaware limited liability company that maintained its principal place of business in California, decided to acquire DGG’s business. To effectuate the acquisition, Sinbad formed Lockhart Fine Foods, LLC (“Lockhart”), a Delaware LLC, to purchase DGG’s assets. After the sale, DGG claimed that Lockhart defaulted on its required payments under the asset purchase agreement and violated the agreement by delivering poorly maintained equipment, refusing to provide transition services, and failing to provide negotiated discounts. DGG also alleged that Lockhart, after it failed to make required payments to DGG, fraudulently transferred its assets to Sinbad by pledging its assets to secure a \$243,000 bank loan to Sinbad. DGG sued both Lockhart and Sinbad, and Sinbad challenged the court’s jurisdiction over Sinbad.

DGG argued that Lockhart’s contacts with Texas should be imputed to Sinbad as its alter ego or agent for the purpose of establishing specific jurisdiction. The court pointed out that the Fifth Circuit has held “that it is compatible with due process for a court to exercise personal jurisdiction over an individual or a corporation that would not ordinarily be subject to personal jurisdiction in that court when the individual or corporation is an alter ego or successor of a corporation that would be subject to personal jurisdiction in that court.” The court explained that in such a case the jurisdictional contacts of one are the jurisdictional contacts of the other. To apply the alter-ego doctrine in this manner, the Fifth Circuit generally demands “proof of control by [one corporation] over the internal business operations and affairs of another corporation to make the other its agent or alter ego, and hence fuse the two together for jurisdictional purposes.” The court listed the following nonexhaustive factors in determining whether a plaintiff asserting personal jurisdiction has overcome the presumption of corporate separateness: (1) the amount of stock owned by the parent of the subsidiary; (2) whether the entities have separate headquarters, directors and officers; (3) whether corporate formalities are observed; (4) whether the entities maintain separate accounting systems; and (5) whether the parent exercises complete control over the subsidiary’s general policies or daily activities.

The court concluded that there was sufficient proof that Sinbad controlled Lockhart to such a degree that they should be treated as alter egos for purposes of jurisdiction. It was undisputed that Lockhart “was formed to take advantage of a new business opportunity—purchasing [DGG’s] cookie-making operation and business model for Sinbad (an existing manufacturer).” A month after the sale closed, Lockhart entered into a management agreement with Sinbad under which Sinbad would manage all aspects of Lockhart’s cookie business in exchange for all of the net profits, payable as “management fees.” The same individual signed the management agreement as CEO of both Sinbad and Lockhart. Lockhart also transferred to Sinbad all its rights and ownership in the working capital assets acquired pursuant to the asset purchase agreement. Based on such proof, the court concluded that Lockhart’s contacts, which consisted of manufacturing and other business activities in the Texas market and purposefully directed tortious activities toward Texas, were properly imputed to Sinbad. Additionally, the court concluded that DGG’s causes of action arose out of the forum-related contacts, and the exercise of personal jurisdiction was fair and reasonable. Thus, the magistrate judge recommended that the district court deny Sinbad’s motion to dismiss.

***Hellmund v. Castello***, No. 14-19-00689-CV, 2020 WL 4760292 (Tex. App.—Houston [14th Dist.] Aug. 18, 2020, no pet.) (mem. op.).

The court of appeals affirmed the grant of a special appearance and concluded that the exercise of jurisdiction over a member and manager of a Texas LLC was inappropriate.

Celina Hellmund and Gabriel Castello were both residents of Switzerland. They were also the members and managers of Allegra LLC, a Texas limited liability company. Hellmund sued Castello in Harris County district court on numerous claims, and Castello filed a special appearance. Among other arguments, Castello contended that “his only connection to Texas [was] his membership in Allegra; and that his partial ownership of Allegra—an entity that owns property in Texas—[was] insufficient to call him into a Texas court because he never availed himself of the privilege of conducting business in Texas and because his Texas contacts [were] not substantially related to the operative facts of the litigation.” The trial court ultimately granted Castello’s special appearance and dismissed all of Hellmund’s claims without prejudice for lack of personal jurisdiction.

On appeal, Hellmund argued that “Castello did business in Texas because he [was] a member and manager of a Texas LLC and that jurisdiction [was] authorized based solely on that fact.” The court of appeals disagreed:

Texas courts may assert in personam jurisdiction over a nonresident if (1) the Texas long-arm statute authorizes the exercise of jurisdiction, and (2) the exercise of jurisdiction is consistent with federal and state constitutional due-process guarantees. The Texas long-arm statute authorizes Texas courts to exercise jurisdiction over a nonresident defendant who “does business” in the state. *See* Tex. Civ. Prac. & Rem. Code §§ 17.042, 17.043. The Legislature has described a non-exclusive list of acts that may constitute “doing business” in this state, such as contracting with a Texas resident and either party is to perform the contract in whole or in part in Texas, or committing a tort in whole or in part in Texas. *See id.* §§ 17.042(1), (2). Hellmund does not argue on appeal that Castelló did business in Texas under subsections 17.042(1) or (2), and her pleadings are likely inadequate to support jurisdiction under those provisions. She alleged and argues on appeal that Castelló did business in Texas because he is a member and manager of a Texas LLC and that jurisdiction is authorized based solely on that fact.

The exercise of jurisdiction is consistent with federal and state constitutional due-process guarantees when (1) the nonresident defendant has minimum contacts with the forum state and (2) the assertion of jurisdiction complies with traditional notions of fair play and substantial justice. Minimum contacts are sufficient for personal jurisdiction when the nonresident defendant purposefully avails itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protections of its laws. A nonresident defendant’s purposeful contacts with a forum state can give rise to either general or specific jurisdiction. Here, Hellmund invokes only specific jurisdiction. In analyzing specific jurisdiction, in addition to the “purposeful availment” question, we also focus on the relationship among the defendant, the forum, and the particular litigation at hand. As the Supreme Court of Texas has clarified, specific jurisdiction arises when: (1) the nonresident creates minimum contacts with Texas by purposefully availing himself of the privilege of conducting activities here; and (2) a “substantial connection” exists between those purposeful contacts and the operative facts of the litigation. If both of these circumstances are satisfied, then a Texas court may exercise personal jurisdiction over a nonresident defendant so long as doing so comports with traditional notions of fair play and substantial justice. ...

The key jurisdictional fact pleaded by Hellmund is her allegation that Castelló is a member of a Texas LLC, which Castelló admits. Although this activity is not one listed in section 17.042, we will assume for argument’s sake that a nonresident’s membership in a Texas LLC constitutes “doing business” in Texas sufficient to satisfy the purposeful-availment test for minimum contacts purposes. Presuming that element of specific jurisdiction is met, to reverse the order granting Castelló’s special appearance Hellmund must show on appeal that (1) a “substantial connection” exists between Castelló’s LLC membership and the operative facts of the litigation, and (2) the assertion of jurisdiction would comply with traditional notions of fair play and substantial justice. If the record supports an implicit finding or conclusion against Hellmund on either or both of these factors, then the trial court did not err in granting the special appearance. ...

In her appellate brief, Hellmund challenges only the purposeful-availment prong of the specific jurisdiction inquiry. Her brief contains no argument or authority addressing the “substantial connection” issue or asserting substantively that exercising jurisdiction over Castelló would comport with traditional notions of fair play and substantial justice. We have independently

reviewed the record and conclude that the trial court reasonably could have determined that exercising personal jurisdiction over Castelló for the claims alleged would offend traditional notions of fair play and substantial justice. Though the exercise of jurisdiction rarely fails the test of fair play and substantial justice when a defendant has established minimum contacts with the forum state, we think this case presents just such an exception based on the evidence before the trial court. ...

Castelló was the only party to submit evidence on this issue, and viewing the evidence together with the record as a whole we think the burden on him to litigate this matter in Texas is likely significant. He is a resident of Switzerland, as is Hellmund; he has never lived or resided in Houston and only visited Houston “a handful of times.” He owns no property and maintains no bank accounts in Texas.

Texas’s interest in adjudicating this dispute between two nonresident spouses is minimal at best. The lawsuit involves whether Castelló promised to fully fund the purchase and renovation of a single marital asset [a condominium]; Hellmund did not allege that these purported promises were made in Texas or to a Texas resident. Any promises that Castelló made were to Hellmund, who, like Castelló, is a Swiss resident. Though Hellmund ostensibly asserts claims on Allegra’s behalf, she notably requested the trial court to treat those claims as a direct action on her behalf and award damages directly to her. Currently, Hellmund and Castelló are parties to a divorce proceeding in Switzerland that will adjudicate the property’s disposition. Texas has no interest in adjudicating divorces between spouses who do not reside in this state. The “public policy behind these requirements is to prevent forum shopping by divorce litigants.” Moreover, for this reason, litigating a dispute in Texas over one community asset in a marital estate when the divorce action is pending in another country does not provide particularly convenient and effective relief.

Finally, balancing the relevant international interests—(a) the unique burdens placed on the defendant who must defend itself in a foreign legal system; (b) the procedural and substantive policies of other nations whose interests are affected by the assertion of jurisdiction by a state court; and (c) the federal government’s interest in its foreign-relations policies—does not favor a Texas forum for this action.

Given our disposition, we need not address whether Hellmund’s claims are substantially connected to Castelló’s membership in a Texas LLC.

*Madison Development Group LLC v. Mattress Firm, Inc.*, 608 S.W.3d 376 (Tex. App.—Houston [1st Dist.] 2020, no pet.).

“Most of Mattress Firm’s allegations mention only Quattro, which, as an entity, can act only through its members: Liyeos and Walters. However, Mattress Firm’s live pleading does contain allegations concerning specific actions that Liyeos took with respect to negotiating the Lubbock lease, and the evidence that Mattress Firm attached to its response to Quattro’s and Liyeos’s special appearance also reflects that Liyeos played a significant role in completing that transaction. Mattress Firm’s live pleading, although not a model of clarity with respect to which claims are being asserted against which defendants, also asserts causes of action against Liyeos and seeks relief against him.

All of Liyeos’s contacts with Texas are a result of his position as one of Quattro’s members. We have already held that the Lubbock lease constitutes a purposeful contact of Quattro’s and that there is a substantial connection between this contact and the operative facts of Mattress Firm’s causes of action. The jurisdictional allegations and evidence reflect Liyeos’s significant involvement in the Lubbock transaction. To the extent Liyeos argues that the Lubbock lease should not be considered his contact, individually, because all of his actions with respect to this transaction occurred as an officer of Quattro and were taken on Quattro’s behalf, we note that Texas courts have held that the ‘fiduciary shield doctrine,’ while applicable to protect a corporate officer ‘in some circumstances from being subject to jurisdiction on a general jurisdiction theory, ... does not protect a corporate officer from specific personal jurisdiction as to intentional torts or fraudulent acts for which he may be held individually liable.’ See, e.g., *Nw. Cattle Feeders, LLC v. O’Connell*, 554 S.W.3d 711, 725 (Tex. App.—Fort Worth 2018, pet. denied); *Ennis v. Loiseau*, 164 S.W.3d 698, 707 (Tex. App.—Austin 2005, no pet.) (‘Courts recognize that a corporate officer is not protected from the exercise of specific jurisdiction, even if all of his contacts were performed in a corporate capacity, if the officer engaged in tortious or fraudulent conduct, directed at the forum

state, for which he may be held personally liable.’); *see also Nwokedi v. Unlimited Restoration Specialists, Inc.*, 428 S.W.3d 191, 201 (Tex. App.—Houston [1st Dist.] 2014, pet. denied) (‘A corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though he performed the act as an agent of the corporation.’). Status as a corporate employee ‘does not somehow insulate [the officer] from jurisdiction,’ and an officer ‘may not escape liability where he had direct, personal participation in the wrongdoing, as to be the ‘guiding spirit behind the wrongful conduct’ or the ‘central figure in the challenged corporate activity.’ ‘*See Ennis*, 164 S.W.3d at 707–08 (quoting *Calder v. Jones*, 465 U.S. 783, 790, 104 S.Ct. 1482, 79 L.Ed.2d 804 (1984), and *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 174 (5th Cir. 1985)).

We therefore conclude that the Lubbock lease is also a purposeful contact of Liyeos’s, sufficient to subject him to the exercise of specific jurisdiction in Texas.”

## **W. Service of Process**

*Coleman v. Carrington Mortgage Servs., LLC*, Civ. A. No. 4:19-CV-00231-ALM-CAN, 2020 WL 4723174 (E.D. Tex. July 27, 2020).

“Defendant’s Second Motion to Dismiss specifically asserts ‘Plaintiff failed to send a summons with her Amended Complaint and again failed to serve a person designated or authorized to accept service on CMS’s behalf.’ After the filing of the Second Motion to Dismiss, summons was issued and sent to counsel for Defendant. Plaintiff contends that with such effort service is complete and avers she ‘properly completed the Summons for the clerk to sign, and issue for service’ and that she ‘has not received any notifications of any other failures from the court related to the proper or improper execution of the Summons.’ Defendant’s Reply argues the summons is still not addressed to an agent authorized to accept service, and so service remains deficient (and untimely), justifying dismissal of Plaintiff’s suit.

As noted in the undersigned’s previous report, Defendant CMS is a Limited Liability Company (‘LLC’). Under the federal rules, service of process upon a corporation, partnership or unincorporated association acting under a common name is accomplished by delivering a copy of the summons and of the complaint to ‘an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process[.]’ FED. R. CIV. P. 4(h)(1)(B). Similarly, Texas allows service of process on an LLC’s registered agent, manager, or any member. TEX. BUS. ORGS. CODE §§ 5.201, 5.255(3).

Based on the evidence of record and the affidavit filed by Defendant, Plaintiff has not served or attempted to serve the Amended Complaint on an individual qualified to accept service on behalf of Defendant CMS. Defendant’s counsel in the instant matter is not an officer, managing or general agent, or any other agent authorized or registered to accept service on behalf of CMS. Plaintiff’s attempted service on Defendant’s counsel is therefore ineffective.”

*Hadnot v. Ackerman*, Civ. A. No. 3:19-CV-01949-E, 2020 WL 3491055 (N.D. Tex. June 25, 2020).

“Hollis and Hollis, PLLC, move to quash service and dismiss Hadnot’s claims against them for insufficient service. ... Service on Hollis, PLLC, is properly effected if the plaintiff follows Rule 4(e)(1), which provides for service under the laws of Texas, or ‘by delivering a copy of the summons and of the complaint to the officer, a managing or general agent, or any other agent authorized ... to receive service of process.’ FED. R. CIV. P. 4(h)(1) (governing service on corporations, partnerships, and associations). Texas law authorizes service by (1) delivering a copy of the citation and petition to a defendant in person or (2) mailing a copy of the citation and petition to the defendant by registered or certified mail, return receipt requested. *See* TEX. R. CIV. P. 106(a)(1), (2). In the case of a limited liability company, the citation must be addressed to the company’s manager or registered agent. *See* TEX. BUS. ORG. CODE ANN. §§ 5.201(a)–(b), § 5.255(3). ...

The record contains affidavits of service in which a process server attests that she served Hollis and Hollis, PLLC, at HBH Law Offices, 6988 Lebanon Road, Suite 103, Frisco, Texas 75034, ‘by handing the documents to an individual identified as Barata Hollis, Esq.’ (Doc. Nos. 10, 11). The affidavits, however, include the following ‘additional description:’ ‘Unknown Female, est. age 40, glasses: N, Black hair, 120 lbs to 140 lbs, 5' to 5' 3' (*Id.*).

In an affidavit, Hollis attests that she has not been served personally (Doc. No. 7, pp. 7–8). She leased a small office from Community Development Associates, LLC, at the same Frisco address, but she is employed by the University of Texas Southwestern Medical Center in Dallas and is in the Frisco office rarely during a normal work week. A person named Jean Gard, who worked for Community Development Associations, LLC, was handed

the papers in this lawsuit and placed the papers in Hollis's office. Gard is not, and has not been, an employee or agent for Hollis or Hollis, PLLC. Hollis is the agent for service of process for Hollis, PLLC.

Although the process server attempted to personally serve Hollis and Hollis, PLLC, pursuant to Rule 4(e) and 4(h), respectively, the process server's affidavit contains inconsistent information regarding whether she served Hollis or an '[u]nknown female.' Hollis, on the other hand, attests the papers were not served on her but on another woman employed by a third party who is not an agent for Hollis or Hollis, PLLC. Despite this dispute, Hadnot has not contested Hollis's affidavit or otherwise responded to show either the validity of the service or good cause for failure to properly effect timely service. Under these circumstances, the Court finds Hadnot failed to effectuate service of process on Hollis and Hollis, PLLC, under Rule 4(e), 4(h), and/or Texas Rule of Civil Procedure 106(a). Accordingly, the service should be quashed and these defendants dismissed from the lawsuit."

***Comako Int'l, Inc. v. Delorme***, Civ. A. No. 7:19-CV-00385, 2020 WL 3525477 (S.D. Tex. Jan. 22, 2020) ("A corporation, partnership, or association, when served within a judicial district in the United States, must be served 'by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process—and if the agent is one authorized by statute and the statute so requires—by also mailing a copy of each to the defendant' or by serving the entity in accordance with state law. FED. R. CIV. P. 4(h)(1). Here, the process server delivered Defendant Grow Fresh's [an LLC's] summons and complaint, in person, to Defendant Luc Delorme. Defendant Luc Delorme is not, and has never been, a 'member, manager, managing member, owner, shareholder, officer, director, registered agent, or other type of agent of [Defendant] Grow Fresh.' Therefore, Defendant Grow Fresh has not been properly served in accordance with the Federal Rules of Civil Procedure, and the Court finds that the Clerk's Entry of Default as to Defendant Grow Fresh should be set aside.").

***Joe Hand Promotions, Inc. v. Citadel Sports Bar & Grill, LLC***, W-18-CV-00285-ADA, 2018 WL 11265408 (W.D. Tex. Dec. 17, 2018) (Although the court issued this opinion in 2018, it is included in this year's update because it did not appear in the Westlaw database until recently.).

The court authorized substituted service on an LLC by serving the Texas Secretary of State based on Section 5.251 of the Texas Business Organizations Code because the process server was unable to serve the registered agent at the registered office (the process server wrote in his affidavit that the office was vacant and the business was no longer there), and multiple attempts to serve the registered agent at his residence address were unsuccessful (the registered agent was not home on the four occasions that the process server attempted service). Section 5.251 of the Texas Business Organizations Code (applicable under Rule 4(h) and 4(e)(1) of the Federal Rules of Civil Procedure) provides that "[t]he secretary of state is an agent of an entity for purposes of service of process, notice, or demand on the entity if: (1) the entity is a filing entity or a foreign filing entity and: ... (B) the registered agent of the entity cannot with reasonable diligence be found at the registered office of the entity ..." The court concluded that the plaintiff had exercised reasonable diligence by attempting to serve the defendant on multiple occasions at its registered office and at the residence of the registered agent. Thus, the court determined that substituted service was appropriate.

## **X. Pro Se Representation**

***JKD Holdings, LLC v. Prison Litigation Reform Act***, No. 3:21-CV-0723-N (BH), 2021 WL 2044316 (N.D. Tex. May 10, 2021), report and recommendation adopted, 2021 WL 2042689 (N.D. Tex. May 21, 2021) ("It is well-established that although individuals have the right to represent themselves or proceed *pro se* under this statute, corporations are fictional legal persons who can only be represented by licensed counsel. ... The rationale for this long-standing rule applies equally to 'all artificial entities', such as partnerships and associations. ... As a cross between a corporation and a partnership, a limited liability company is also an artificial entity that may only appear in federal court through licensed counsel.").

***Huffines Retail Partners v. Atlas Apartments Acquisition, LLC***, No. 3:19-CV-2425-S-BH, 2021 WL 965920 (N.D. Tex. Feb. 17, 2021), report and recommendation adopted, 2021 WL 963755 (N.D. Tex. Mar. 15, 2021) ("It is well-established that although individuals have the right to represent themselves or proceed *pro se*

under this statute, corporations are fictional legal persons who can only be represented by licensed counsel. ... The rationale for this long-standing rule applies equally to ‘all artificial entities’, such as partnerships and associations. ... As a cross between a corporation and a partnership, a limited liability company is also an artificial entity that may only appear in federal court through licensed counsel.”).

**Chaves v. Cogent Medical Laboratory, LLC**, SA-19-CV-00861-ESC, 2020 WL 5096946 (W.D. Tex. Aug. 28, 2020) (“The record in this case establishes that Defendant failed to plead or otherwise defend against Plaintiff’s claims since the withdrawal of its counsel, as an LLC cannot represent itself pro se in this action. *See Memon v. Allied Domecq QSR*, 385 F.3d 871, 873 (5th Cir. 2004) (‘Although 28 U.S.C. § 1654 authorizes individuals to appear in federal courts pro se, the statute is silent regarding corporations. The lack of authorization in § 1654 has been interpreted as barring corporations from appearing in federal court without an attorney.’); *Lattanzio v. COMTA*, 481 F.3d 137, 140 (2d Cir. 2007) (‘Because both a partnership and a corporation must appear through licensed counsel, and because a limited liability company is a hybrid of the partnership and corporate forms, ... a limited liability company also may appear in federal court only through a licensed attorney.’) (internal citations omitted). The undersigned therefore finds that the Clerk properly entered default, and Plaintiff is entitled to default judgment because the facts alleged in Plaintiff’s Complaint state a claim upon which relief can be granted.”).

**Collins Motor Co., L.L.C. v. FirstCapital Bank of Texas, N.A.**, No. 02-20-00192-CV, 2020 WL 5047510 (Tex. App.—Fort Worth Aug. 27, 2020, no pet.) (mem. op.) (“Wade is not an attorney, and a company may not appear in court through a member who is not an attorney. *See, e.g., Kunstoplast of Am., Inc. v. Formosa Plastics Corp., USA*, 937 S.W.2d 455, 456 (Tex. 1996) (‘Generally a corporation may be represented only by a licensed attorney...’); *Sherman v. Boston*, 486 S.W.3d 88, 95 (Tex. App.—Houston [14th Dist.] 2016, pet. denied) (‘Legal entities, such as ... a limited liability company, generally may appear in a district or county court only through a licensed attorney.’). In our July 14 letter, we also warned that we could dismiss the appeal unless a licensed attorney filed a notice of appearance for Collins Motor Company [an LLC] and Jody Wade Enterprises [an LLC] by July 24, 2020. ... Because Collins Motor Company and Jody Wade Enterprises have failed to obtain counsel as directed by our July 14, 2020 letter, we dismiss their appeal.”).

**Strauss v. Lake City Credit**, Civ. A. No. 4:19-CV-00620-SDJ-CAN, 2020 WL 4589731 (E.D. Tex. July 14, 2020).

“The Motion to Vacate submitted by pro se Defendant Gary S. Williky on behalf of Defendant Lake City Credit should be denied. As stated in the Court’s prior recommendation, Defendant Williky cannot represent the interests of Defendant Lake City Credit in this action. Defendant Lake City Credit is a limited liability company. ‘28 U.S.C. § 1654 states that ‘in all courts of the United States the parties may plead and conduct their own cases personally or by counsel as, by the rules of such courts, respectively, are permitted to manage and conduct causes therein.’ ‘Courts have uniformly interpreted this statute to mean that corporations, partnerships, or associations are not allowed to appear in federal court other than through a licensed attorney.’ ‘Under both Texas and federal law, [t]he rule is well settled that a corporation can appear in a court of record only by an attorney at law.’ ‘Stated differently, a corporation or other artificial entity may not appear pro se or be represented by a non-attorney.

Defendant Lake City Credit—a corporate entity—may not appear in federal court unless represented by licensed counsel. Defendant Gary Williky is not a licensed attorney. Because Defendant Williky is not a licensed attorney, he cannot make an appearance on behalf Defendant Lake City Credit. To permit the filing made by Defendant Williky on behalf of Defendant Lake City Credit to stand as properly filed would functionally permit Defendant Williky to represent Lake City Credit. “The Court cannot permit this action to proceed with a non-lawyer asserting legal positions on behalf of a separate legal entity.” Moreover, Defendant Lake City Credit has had ample time to engage counsel and has engaged counsel to represent it in other similar matters pending in other federal courts.”

**Jyue Hwa Fu v. Yeh Chin Chin**, No. 3:18-CV-2066-N-BN, 2020 WL 4296360 (N.D. Tex. May 6, 2020), report and recommendation adopted, 2020 WL 4287590 (N.D. Tex. July 27, 2020).

“At that time, the undersigned reminded Ling’s Holding that it is not permitted to proceed pro se or through a non-attorney but rather must be represented by a licensed attorney in this litigation in federal court. ...

In a Memorandum Opinion and Order dated August 23, 2019, the Court specifically cautioned Defendant Ling's Holding that, because it is a limited liability company, it must retain counsel to defend itself in this case. At that time, the Court warned Ling's Holding that a failure to do so could result in serious consequences, including the possibility of a default judgment being entered against it. ...

Ling's Holding does not appear to have paid any heed to these warnings. Although Mr. Ling has filed an answer to Plaintiff's amended complaint on behalf of Ling's Holding, Mr. Ling is not an attorney licensed to practice law before this Court.

After careful consideration, the undersigned concludes that the Court should strike Defendant Ling's Holding's answer to Plaintiff's amended complaint from the record.

And the procedural grounds for default—which the Clerk of the Court has already entered—are clearly established: Ling's Holding was warned on multiple occasions that, as a business entity, it may not proceed pro se nor can it be represented by a non-attorney in this action. Ling's Holding was warned on multiple occasions that failure to obtain counsel will result in an entry of default judgment against it. Ling's Holding has failed to take heed to these warnings.”

## **Y. Venue**

*In re Zidan*, No. 05-20-00595-CV, 2020 WL 4001134 (Tex. App.—Dallas July 15, 2020, no pet.) (mem. op.) (“To the extent Alex argues that sections 11.401 and 11.404 of the Texas Business Organizations Code mandate that a dispute between members of an LLC must be brought in the county of the principal place of business or registered office of Prime United, his reliance on these provisions is misplaced. These provisions concern the appointment of a receiver. After amending the pleadings, Ahmed now seeks a receiver only over real property located in Collin County (and not over Prime United) to preserve the property and avoid additional damage during the lawsuit. Thus, Prime United is no longer implicated by these provisions.”).

## **Z. Statutory Fraud**

*Chase v. Hodge*, 1:20-cv-0175-RP, 2021 WL 1948470 (W.D. Tex. May 14, 2021).

The magistrate concluded that the plaintiff's claim for fraud under Section 27.01(a) of the Texas Business and Commerce Code failed because there must be an actual sale of a stock for the provision to apply, and the plaintiff did not allege that the LLC defendant sold him any stock. Rather, the plaintiff complained that he was promised an ownership interest in the LLC by the individual who formed the LLC but named himself as the 100% member.

In this dispute about the ownership of Helping Hands Capital, LLC (“Helping Hands” or the “Company”), a Texas limited liability company that makes non-recourse loans to cover living expenses for parties involved in personal injury claims and suits, Dean Chase, a Florida citizen, asserted claims against Ryan Hodge, an attorney and the sole member of Helping Hands.

Chase alleged that Hodge, Chase, and another individual (Guedri) who was not a party, decided to start a business to provide loans to litigants that would be secured by future recoveries in lawsuits. At the time, the three men were partners in a separate business that provided case expense loans. Chase claimed that Hodge, acting as an attorney for Chase and Guedri, formed the new entity, and that the parties agreed to treat it as an equal partnership in which each owned one third of the company and would share profits in thirds. In 2013, Hodge formed Helping Hands, listing himself on the certificate of formation as the managing member and making no mention of Chase or Guedri in the filing.

From 2013 through 2016, the Company typically reinvested profits into the Company, but funds were occasionally distributed to the three partners on the one-third basis initially agreed upon. In 2016, Guedri tendered his interest back to the Company, and Chase alleged that Hodge acknowledged to Chase in writing that going forward they were “50/50 partners.” In 2016 and 2017, distributions to Hodge and Chase were allegedly made on a 50/50 basis. According to Hodge and Chase, they worked together cooperatively until early 2018, when Chase began to press for more financial information and Hodge eventually sent a communication to Chase advising that Chase's interest in the Company was an “economic benefit only” and not “legal ownership.” Chase contended that Hodge asserted for the first time in 2018 that the Company was “owned 100% by a trust” and that Hodge had no ownership in Helping Hands himself. Chase alleged that Hodge began excluding Chase from the business during



this time frame in the spring of 2018. According to Chase, he tried to resolve the issues with Hodge throughout 2019 until Hodge emailed Chase in September of 2019 and offered to buy Chase’s “interests” in Helping Hands for \$25,000, or otherwise he would “transfer” his money out of Helping Hands and sell the assets and wind down the Company. Chase argued this offer was patently disingenuous, because the Company had made and received millions of dollars in loans over the past two years.

Chase sued Hodge and Helping Hands asserting numerous claims, including a claim for statutory fraud under Section 27.01(a) of the Texas Business and Commerce Code. Chase alleged that Hodge and Helping Hands committed statutory fraud in violation of Chapter 27 of the Texas Business and Commerce Code when Hodge promised Chase that Hodge would: (a) provide ample capital for Helping Hands to operate; (b) use Chase’s contacts—lawyers seeking loans and investors providing capital—to fund litigation loans through Helping Hands; (c) engage in the business of providing litigation financing through Helping Hands; and (d) split the profits from the business with Chase. The court rejected the claim with the following explanation:

[Chase] asserts these actions were made in a stock transaction, and therefore Hodge and Helping Hands’ actions violated Section 27.01(a). However, § 27.01 pertains only to “misrepresentations of material fact made to induce another to enter into a contract for the sale of land or stock.” *Burleson State Bank v. Plunkett*, 27 S.W.3d 605, 611 (Tex. App.—Waco, 2000 pet. denied). As just noted, Chase does not allege that Helping Hands stock was sold. For § 27.01 to apply, there must be an actual conveyance of stock, not merely a breach of contract to convey stock. *U.S. Quest Ltd. v. Kimmons*, 228 F.3d 399, 406 (5th Cir. 2000). “This narrow reading of Section 27.01(a) is consistent with the Supreme Court of Texas’ interpretation that the statute is penal in nature and thus must be strictly construed.” *Id.* The statute is inapplicable and Chase’s statutory fraud claim fails.

#### **AA. Texas Citizens Participation Act**

*Straehla v. AL Global Services, LLC*, 619 S.W.3d 795 (Tex. App.—San Antonio 2020, pet. denied).

The court of appeals held that a Texas LLC alleged its claim for knowing participation in a breach of fiduciary duty with sufficient specificity to survive a motion to dismiss under the Texas Citizens Participation Act.

After Hurricane Maria struck Puerto Rico in September 2017, the Puerto Rico Electric Power Authority hired Cobra Acquisitions LLC (“Cobra”) to rebuild its utility grid. In turn, Cobra hired AL Global Services, LLC (“AL Global”) to provide security and logistics support for the project. AL Global subcontracted a portion of its work to Espada Logistics & Security, LLC (“Espada Logistics”). In August 2018, Cobra ended its contract with AL Global and entered into a contract with Espada Carribean, LLC (“Espada Carribean”) for the work that AL Global had previously performed. AL Global had three members: Jim Jorrie, Craig Charles, and Julian Calderas. The owners of Espada Logistics and Espada Carribean were Jim Jorrie and his ex-wife, Jennifer Jorrie.

AL Global sued Jim Jorrie for breach of fiduciary duty, alleging that he usurped the company’s business opportunity. Additionally, AL Global sued two Cobra executives, Kinsey and Arty Straehla, asserting that they assisted Jim Jorrie in his misdeeds. Kinsey and Straehla moved to dismiss the case under the Texas Citizens Participation Act (TCPA), arguing that the lawsuit was based on their exercise of free speech and right to association. The trial court denied the motions, and Kinsey and Straehla appealed.

A motion to dismiss under the TCPA triggers a three-step burden shifting mechanism. First, the movant has the burden to show—by a preponderance of the evidence—that the legal action is based on, relates to, or is in response to the movant’s exercise of free speech, association, or petition rights. If the movant meets this burden, the nonmovant has the burden of establishing—by clear and specific evidence—a prima facie case for each essential element of its claim. If the nonmovant meets its burden, the burden shifts back to the movant to establish each essential element of a valid defense to the nonmovant’s claim by a preponderance of the evidence.

Consistent with this framework, the court first determined that Kinsey and Straehla could show that the suit was based on their exercise of the right to free speech. Specifically, AL Global alleged that Kinsey and Straehla actively communicated and generated plans with Jim Jorrie to divert work from AL Global to the Espada companies. The court held that these communications were, at least “tangentially,” on “a matter of public concern” because rebuilding Puerto Rico’s utility system was an issue related to the “environmental, economic, or community well-being” of the island and its residents. Thus, the court next turned to whether AL Global could establish a prima

facie case for knowing participation in a breach of fiduciary duty against Kinsey and Straehla by clear and specific evidence (noting that “evidence” for this purpose includes pleadings).

The court outlined the elements of a knowing participation claim as: (1) the existence of a fiduciary duty owed by a third party to the plaintiff; (2) the defendant knew of the fiduciary relationship; and (3) the defendant was aware of his participation in the third party’s breach of its duty. As such, the court recognized that knowing participation in a breach of fiduciary duty is necessarily a derivative claim that requires an underlying breach of fiduciary duty. Thus, AL Global’s claim against Kinsey and Straehla turned on its ability to establish a claim against Jim Jorrie.

The court first observed that the Texas Business Organizations Code does not directly address the duties that a manager or member owes the LLC but contemplates that duties may exist by providing that “[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.” Tex. Bus. Orgs. Code § 101.401. The court noted that it did not have the AL Global LLC agreement in the record, but the court stated that it presumed, “based on the assumption inherent in section 101.401 of the Business Organizations Code that, Jorrie owed the same fiduciary duties that a corporate executive or partner would owe a corporation or partnership, unless the LLC agreement shows otherwise.” Thus, the court concluded that Jorrie “owed a duty of loyalty to [AL Global] and a duty not to usurp corporate opportunities.”

The court then determined that there was sufficient evidence to establish a prima facie case of breach of a fiduciary duty against Jim Jorrie, describing a sequence of events from the fall of 2017, when AL Global pursued and secured its contract with Cobra, until August 2018, when Cobra entered into a contract with Espada Carribean for the security and logistics work that AL Global had been performing.

As described by the court, the record showed that Jennifer Jorrie began an intimate relationship with Ken Kinsey, a senior Vice President at Cobra, shortly after work on the contract began, and Jim Jorrie appointed Jennifer Jorrie as the project manager for Espada Logistics, a role in which she would work closely with Kinsey. After becoming project manager, Jennifer was assigned to work from Cobra’s headquarters in Puerto Rico at Kinsey’s request. About this time, Jennifer formed Espada Carribean as a Puerto Rican LLC. Jennifer installed Jim Jorrie as CEO of Espada Carribean and assigned him a 67% interest in the company. Although AL Global tasked Jim Jorrie with securing a Puerto Rican security services license for AL Global, Jorrie instead secured the license for Espada Carribean, which enabled Espada Carribean to legally provide security services in Puerto Rico. In March of 2018, Jorrie attempted to renegotiate AL Global’s subcontract with Espada Logistics in order to increase Espada Logistics’ payment. Charles and Calderas refused, and Jorrie sought to use Jennifer Jorrie’s relationship with Kinsey as leverage, stating in an email to the other AL Global members that Jennifer’s relationship with Kinsey was “immensely valuable” and that, “[w]hether we like the origin or nature of that relationship, it remains undisputed that he is protective of her interests.” Two days later, Jim Jorrie—acting on AL Global’s behalf—executed an amendment to the Cobra contract that provided the agreement would continue after August 15, 2018, only if certain conditions were met. In April, Jorrie continued to press the issue of changing the profit-sharing arrangement between AL Global and Espada Logistics, and Jorrie also informed the other members of AL Global that Jennifer’s relationship with Kinsey had changed and that Kinsey had raped her. After the April meeting of the members, there was evidence that Espada Carribean was negotiating a new contract directly with Cobra. Several communications in July reflected Espada Carribean’s pursuit of a contract directly with Cobra, and AL Global alleged that Jorrie threatened Cobra that if it did not contract directly with the Espada companies, Jennifer Jorrie would publicly allege that Kinsey raped her. When AL Global contacted Cobra in July 2018 to inquire about an extension of the contract, Cobra responded that it was engaged in a Request for Proposal process to evaluate bids, but no process actually occurred, and Cobra never assessed whether contracting directly with Espada Carribean would actually save money. On August 16, 2018, Cobra signed a contract with Espada Carribean to perform the work previously performed by AL Global.

Viewed in a light most favorable to AL Global, the court concluded that this evidence showed that Jorrie placed his own interests ahead of AL Global in order to secure a direct contract between Cobra and Espada Carribean, thus breaching his fiduciary duty of loyalty and usurping AL Global’s business opportunity.

Next, the court turned to whether Kinsey and Straehla were knowing participants in Jorrie’s alleged fiduciary duty breach. The court determined that they were. The court observed that evidence in the record—including two signed contracts—identified Jim Jorrie as an AL Global “Manager.” The court determined that Kinsey and Straehla’s extensive business experience was sufficient to support an inference that they were aware

that Jorrie owed AL Global fiduciary duties. As to whether Kinsey and Straehla were knowing participants in Jorrie's breach of fiduciary duty, the court noted the suspicious circumstances surrounding Cobra's abrupt pivot from contracting with AL Global to directly dealing with Espada Carribean. The court determined that a reasonable factfinder could infer that this suspicious change was executed to favor Jorrie. As a result, the court determined that AL Global could establish a prima facie case of knowing participation in a breach of fiduciary duty against Kinsey and Straehla.

Finally, the court determined that neither Kinsey nor Straehla had established a defense to AL Global's prima facie knowing participation case. Thus, the court affirmed the trial court's decision to deny Kinsey and Straehla's TCPA motions to dismiss.