IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re:	)	Chapter 11
STRIKE, LLC, *et al.*,	)	Case No. 21-90054 (MI)
DEBTORS[1]	)	(Jointly Administered)

CLEVELAND PARTIES' RESPONSE TO EMERGENCY MOTION TO SHOW CAUSE FILED BY WIND-DOWN DEBTORS' AND LIQUIDATING TRUSTEE AND BRIEF IN SUPPORT OF OWNERSHIP OF CLAIMS

Billy Cleveland and Tammy Cleveland ("the Clevelands") and Circle C Investments, LLC ("Circle C") (the Clevelands and Circle C are collectively referred to herein as the "Cleveland Parties") file their Response to the Emergency Motion to Show Cause Filed by the Wind-Down Debtors and Liquidating Trustee and Brief in Support of Ownership of Claims, and respectfully state as follows:

I. INTRODUCTION

1. The Cleveland Parties, who are residents of Mississippi, are (or were) members of the Debtor, Strike, LLC ("Strike LLC") and are (or were) members of non-Debtor, Strike Capital, LLC ("Strike Capital"). Mr. Cleveland is also the former chief executive of Delta Directional

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtors' federal tax identification number, are: Strike, LLC (2120); Strike HoldCo, LLC (0607); Delta Directional Drilling, LLC (9896); Strike Global Holdings, LLC (4661); Capstone Infrastructure Services, LLC (0161); and Crossfire, LLC (7582). The location of Debtor Strike, LLC's principal place of business and the Debtors' service address is: 1800 Hughes Landing Boulevard, Suite 500, The Woodlands, Texas 77380. Additional information regarding this case may be obtained on the website of the Debtors' proposed claims and noticing agent at https://dm.epiq11.com/StrikeLLC. These requests relate only to the Debtors referenced in the text of the requests.

Drilling, LLC, another of the Debtors. Mr. Cleveland sold a prior iteration of this latter business, including the name, to Strike in 2014.

2. This dispute arises out of the Cleveland Parties' minority membership interests in Strike LLC. The Clevelands obtained their interests when Strike LLC purchased the Clevelands' company for cash consideration and the Strike interests. The Cleveland Parties' membership interests were later converted to membership interests in Strike Capital.

3. There is no dispute that Strike LLC was closely-held – at the time of the Clevelands' acquisition of their interest it had only 19 members.[2] The Clevelands' membership interests were effectively eliminated as a result of a restructure of Strike, LCC and its then parent company, Strike Capital, ten months before the bankruptcy filing by Strike LLC and its affiliate companies.

4. The Cleveland Parties assert that because they were minority members, the majority members owed them fiduciary duties that majority members in larger or publicly-traded companies do not owe to their members. As a result, the Cleveland Parties filed suit against Strike LLC, and non-Debtors, Strike Capital, Mill Point Strike Splitter, LLC ("Mill Point") and other defendants for breach of fiduciary duty and other claims in state court in Mississippi ("Mississippi Suit") in October 2021, prior to the Petition Date (hereinafter defined).

5. On September 22, 2023, the Cleveland Parties intervened in a state court suit filed in Harris County, Texas ("Texas Suit") by the Trustee against members of the Pate Family and James B. Cherry, who are former officers and directors of Strike LLC and Strike Capital. The Cleveland Parties claimed they had an ownership interest in the claims which were the subject of that suit arising from the actions and conduct of the Pates prior to Strike LLC's bankruptcy filing.

[2] There were 10 members holding units, 3 members holding both units and junior units, and 9 members holding junior units. See Fifth Amended and Restated Regulations of Strike, LLC attached as Exhibit "D" to the Clevand's Petition filed in the MS Suit (hereinafter defined).

6. On October 16, 2023, the Liquidating Trustee and "Wind Down Debtors" (jointly referred to herein as the "Movants") filed a Motion to Show Cause ("Show Cause Motion") claiming the Cleveland Parties have violated the Confirmation Order (hereinafter defined) entered on May 17, 2022 by (i) intervening in the Texas Suit, and (ii) seeking to file claims against these third parties in the Mississippi Suit. The Cleveland Parties deny that they have violated any Bankruptcy Court Order as explained more fully below because the claims are against third parties who did not receive a release under Strike's Plan of Liquidation and the Cleveland Parties have an ownership interest in the claims.

II. FACTUAL BACKGROUND.

Sale of Delta Drilling, LLC Business

7. In 2000, Plaintiffs established Delta Drilling, LLC, a company that engaged in horizontal drilling, boring, and related services. It regularly turned a profit, and it ultimately came to the attention of Steve Pate and others, who approached the Clevelands about purchasing the company and folding it into Strike.

8. Initially, the Pates and their co-owners agreed that Strike would pay the Clevelands with cash and a promissory note. But they shifted course, representing to the Clevelands that their lenders would not allow them to execute the note. As a result, the Cleveland parties received 4,108.0283 Strike units with a preferred distribution right ("the Preferred Distribution Right").

9. Importantly, the Pates also promised that the Clevelands would be paid distributions in a timely fashion and their interests would be redeemed. To that end, Strike's Bylaws in pertinent part provided that: "the Company shall distribute, at such times and in such amounts as the Board may approve from time to time, to the Members holding Delta Units an

amount equal to the excess, if any, of the Priority Return over aggregate distributions made to the Delta Units under this Section 4.8(b)(i) for all prior periods."

10. At the time of the 2014 transaction, the controlling members of Strike were OEP Strike LLC ("OEP") and Pate Holding Company, LP ("Pate Holding").

11. The Pates represented to the Clevelands that their intent was to redeem the Clevelands' investment in Strike as quickly as possible. Despite these representations, the Clevelands never received a single distribution – declared or undeclared – pursuant to the preferred distribution rights.[3] Meanwhile, the Pates were paying themselves millions of dollars in distributions, and some of those distributions are at issue in this case.

12. In 2016, OEP and Pate Holding merged Strike into Strike Capital without consulting with the Clevelands. As a result of the merger, Strike became a wholly owned subsidiary of Strike Capital and all of the membership interests in Strike, including the Cleveland Parties' interests, were converted to membership interests in Strike Capital.

13. In 2020, Pate Holding and OEP began negotiating another re-structuring, this time with Mill Point Strike Splitter, LP ("Mill Point"). Mill Point was confident enough in Strike's financial strength that it invested nearly $100 million into Strike. Cole Pate – after being confronted with the issue – informed Billy Cleveland that the majority members had engaged in this transaction, and "spent millions of dollars on New York lawyers" in order "to get around" the Clevelands.

14. The transaction included the creation of Strike HoldCo, LLC, which became the owner of all of the membership interests in Strike Capital. Upon information and belief, the value

[3] The Clevelands received tax distributions for a time.

of the Cleveland's membership interests was effectively eliminated when Strike and its affiliated entities entered into the restructuring transaction with Mill Point.

15. The details of these transactions are in the financial records held by Strike.

16. After the restructure with Mill Point, the composition of Strike's board of directors changed. The Board terminated the Pates in the summer of 2021.

17. During this same time, Strike denied Cleveland financial and other information as to the Debtors' businesses. Cleveland received no severance from the Debtors.

18. On October 7, 2021, prior to Strike's chapter 11 bankruptcy filing, the Cleveland Parties filed the Mississippi Suit. Their claims included, inter alia, breach of fiduciary duty, conversion of plaintiffs' priority distribution rights, and fraud.

Strike's Bankruptcy Filing

19. On December 6, 2021 ("Petition Date"), Strike filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code in this District.

20. Strike filed a suggestion of bankruptcy in the Mississippi Case so that action was stayed as to Strike.

21. The Debtors sold their assets shortly after the bankruptcy cases were filed to its DIP and prepetition lender.

22. The Cleveland Parties filed a proof of claim in the amount of $17,449,418.83 against Strike LLC based upon the claims set forth in the Mississippi Suit.

Discovery Requests During Strike's Bankruptcy Cases

23. In the spring/summer of 2021, the Cleveland Parties were notified that they were being allocated substantial taxable income for the tax year 2020, resulting in a tax liability in the approximate amount of $680,000, based on their ownership of 4,108.283 units in Strike. The

Cleveland Parties requested financial information from Strike's CFO regarding the tax liability. They were told that as a result of the restructure with Mill Point, Strike LLC could not provide any information to him and he would need to contact Strike Capital.

24. Cleveland's counsel next made an informal request to the Debtors' counsel for the information. When they refused to provide any tax information, Cleveland's counsel was required to commence formal discovery by issuing a 2004 Examination document request that sought the tax information and other information necessary to prepare his tax return and to pursue the Clevelands' claims against the non-Debtor defendants in the Mississippi Suit. The Debtors' immediate response was to file a Motion to Quash. While Judge Jones granted the Debtors' Motion to Quash, in part, he ordered the Debtors to provide Cleveland with all financial information related to the Debtors' issuance of the K-1. Some of these documents were provided to the Clevelands' accountant, Nathan Cummins.

Debtors' Joint Chapter Plan of Liquidation and Appointment of Liquidating Trustee

25. In April 2022, the Debtors filed their Combined Disclosure Statement and Joint Chapter Plan of Liquidation. The Plan provided for the establishment of a liquidating trust, transfer of any remaining assets to the trust, and dissolution of the Debtors. The Debtors filed a Plan Supplement on May 2, 2022, which named Patrick Bartels ("Bartels" or "Trustee") as the liquidating trustee and attached a copy of the proposed liquidating trust.[4] The Debtors filed an Amended Plan Supplement ("Plan Supplement") on May 16, 2022, the day before the confirmation hearing. Significantly, Steve Pate, the Debtors' former chief executive officer, was added as a potential defendant in litigation that might be prosecuted by the liquidating trust.

[4] Prior to the Debtors' bankruptcy filing, Bartels was appointed as an independent director of Strike Investment.

26. The Court entered an Order (I) Approving the Disclosure Statement, (II) Confirming the Debtors' Joint Chapter 11 Plan of Liquidation, and (III) Granting Related Relief ("Confirmation Order") on May 17, 2022 [Doc. 1111].

Cleveland's Efforts to Conduct Discovery Following Confirmation of the Plan

27. Regrettably, the extraordinary measures necessary to obtain financial documents from Strike, LLC during the pendency of the bankruptcy cases reflected the rule, not the exception. For at least the last year of Strike's operations, Mr. Cummins regularly tried to obtain information from Strike, and he was regularly rebuffed or simply ignored.[5]

28. The Debtors' efforts to stymie the Clevelands' access to information likewise did not stop with their Motion to Quash. In January 2023, undersigned counsel issued a subpoena to Strike for certain records necessary for the Clevelands to pursue their claims against the Pates. Strike's counsel – who were employed by the same law firm currently representing Strike – initially stated that Strike would respond to the subpoena and requested a thirty-day extension of time. The Clevelands readily agreed to the extension, but Strike's counsel changed course and stated that it would only respond to the subpoena after Strike was dismissed from the Mississippi case. After communications that spanned several months,[6] Strike again changed position, stating that it would "review and comply with the subpoena to the extent required. (Not trying to be evasive here, just staying in my lane as the bk attorney.)." (parentheses in original).

29. The end result is that Strike has not responded to the subpoena issued in January 2-2023. But while Strike's bankruptcy team was blocking the Clevelands' access to basic financial

[5] The Clevelands received their ***2021*** K-1s just this month. The purported justification for the delay was that the address for the Clevelands was not correct, but this is no excuse at all, given that all interested parties are aware of the involvement of this law firm and of Mr. Cummins.

[6] There was approximately one month of delay that was at least partially attributable to the Clevelands' counsel being engaged in a nine-week trial. The Clevelands do not contend that portion of the delay is the fault of Strike.

documents to which he was entitled as a member, the Liquidating Trustee was busily pursuing his lawsuit against the Pates without any notice whatsoever to the Clevelands.

Trustee files Texas Suit

30. On January 17, 2023, the Trustee filed suit against Stephen V. Pate, Aaron Cole Pate, Kevin Pate, Richmond Pate, Kyle Pate (collectively referred to herein as the "Pate Defendants"), James B. Cherry and Twin Timbers, LLC in the 151st Judicial District Court of Harris County, Texas docketed under Cause No. 2023-03047 ("Texas Suit").

31. The Clevelands, after discovering the matter by happenstance, attempted to engage with the Trustee about the ownership of claims. During those conversations, the Clevelands asked the Trustee to provide support for his position that a financially healthy company may not make distributions to its owners. To this day, the Trustee has provided no such case.

32. On September 22, 2023, the Cleveland Parties filed a petition in intervention in the Texas Suit seeking a declaratory judgment that the Cleveland Creditors have an ownership interest in the claims brought by the Trustee. The motion was filed shortly before the deadline for intervention in the Texas Case.

33. On October 16, 2023, the Cleveland Parties filed a Motion for Leave to Amend Complaint in the Mississippi Suit seeking to join the Pates as defendants and assert the same claims raised in the Texas Suit.

34. On October 6, 2023, counsel for the Movants sent counsel for the Cleveland Parties a demand letter (which they entitled a "pound sand" letter) claiming the Cleveland Creditors were violating the Confirmation Order, demanding that the Petition in Intervention and the Motion to Amend Claims be withdrawn and threatening sanctions.

35. On October 16, 2023, the Wind-Down Debtors and the Trustee filed their Emergency Motion for Order to Show Cause ("Show Cause Motion"). They purported to need emergency consideration because there was a hearing set in the Mississippi Case. The Cleveland Creditors agreed to cancel the November 2, 2023 hearing to allow sufficient time to respond to the Show Cause Motion and prepare for an evidentiary hearing.

36. Nevertheless, the Court conducted a preliminary hearing on October 24, 2023, and set the Show Cause Motion for an evidentiary hearing on November 14, 2023.

III. LEGAL ARGUMENT ON OWNERSHIP OF CLAIMS

A. INTRODUCTION

37. It is undisputed by the parties that the claims asserted in the Texas Suit are state law claims. They include claims for breach of fiduciary duty against the "Pate Executives" and Cherry, aiding and abetting breach of fiduciary duty against Kyle Pate and Twin Timbers, negligence and gross negligence against all of the defendants, and unjust enrichment against Steve Pate, Kevin Pate, and Richie Pate. It is also undisputed that ownership of the claims asserted in the Texas Suit is determined based upon "whether under applicable state law the debtor could have raised the claim as of the commencement of the case." See *In re Seven Seas Petroleum, Inc.,* 522 F. 3d 575, 584 (5th Cir. 2008). A debtor or trustee "has no right to bring claims that belong solely to the estate's creditors." *Id.* The court must look at the "nature of the injury for which relief is sought and consider the relationship between the debtor and the injury" in order to determine whether the claim is held by the bankruptcy estate or a creditor. *Id.*

38. In the case, the Cleveland Parties were minority members of a closely-held company controlled by the Pates as majority members. While there were other minority members

in Strike, the Cleveland Parties held membership interests with preferred distribution rights that differentiated their interests from the other members.

39. The Trustee alleges in the Texas Suit that (i) excessive compensation was paid by Strike to two members of the Pate family who were officers, but performed no services for the company; (ii) expenses of an accounting group were improperly on the Strike payroll, because this department only provided services to the Pate family businesses; and (iii) various other business expenses of various Pate entities were improperly paid by Strike. The Trustee further alleges these expenses total approximately $7.3 million and were paid by Strike between 2018 and 2022.

40. The Trustee's claims should be recharacterized as undeclared distributions to the Pates. Of equal importance is the timing of the payments – payments made prior to Strike's insolvency did not damage the Company or its creditors. The Cleveland Parties were harmed because they did not receive their preferred distributions. In addition, the Pates orchestrated a series of corporate restructures of the Strike companies eliminating the Cleveland Parties' membership interest altogether while continuing to take distributions for themselves and their other business interests.

41. The Trustee argues that he alone has standing to pursue damages for undeclared distributions that Strike's ultimate members made to themselves and their family members. The Trustee does not argue Strike was insolvent when the distributions were made, or that the payments led to Strike's insolvency. More than that, he has incorrectly argued that solvency is not relevant to the ownership question. [Dkt. No. 1477]. Thus, the Trustee is arguing that an owner of a company breaches his fiduciary duty anytime he pays himself a distribution – even if the company is healthy – because any such distributions necessarily harm the company. That is not the law.

42. By contrast, the Clevelands argue that Strike's majority members paid themselves undeclared distributions so that they were not required to pay equivalent distributions to the Clevelands pursuant to the Clevelands' priority distribution rights. These are individual claims, because the Clevelands were uniquely harmed – no other minority member had a preferred distribution right. *E.g.*, *In re Dexterity Surgical, Inc.,* 365 B.R. 690, 695 (Bankr. S.D. Tex. 2007) (applying Delaware law, and holding that "[f]or a shareholder to bring an individual action, the shareholder must allege either an injury which is separate and distinct from that suffered by other shareholders, or a wrong involving a contractual right which exists independently of any right of the corporation.") (internal punctation and citations omitted).

D. ARGUMENT

Strike was not insolvent when the payments were made, and the payments did not render Strike insolvent.

43. In a failed attempt to establish that he alone can prosecute claims stemming from these distributions, the Trustee argues the distributions harmed Strike. Crucially, however, the Trustee does not argue Strike was having financial problems when the distributions occurred. And as will be established at the hearing of this matter, Strike was financially healthy when at least some of the distributions were made.[7]

44. Given his refusal to address or even engage with the issue of solvency, the Trustee evidently takes the remarkable – and unsupported – position that anytime a company makes distributions, the distributions by definition harm the company. The Trustee's argument is contrary

[7] There can be no question that these payments were distributions, no matter how they may have been classified on Strike's books and records. *See, e.g.,* Fifth Amended and Restated Regulations of Strike, LLC ("the Strike Bylaws") at§ 1.13(aa) (defining Distributions as "any cash and the fair market value of any property distributed to a Member."); *Ireland v. United States*, 621 F.2d 731, 735 (5th Cir. 1980) ("[A]n expenditure made by a corporation for the personal benefit of a stockholder, or the use by the shareholder of corporate-owned facilities for his personal benefit, may result in the taxpayer being found to have received a constructive dividend.").

to applicable law, which recognizes that member distributions "made while the Debtor was financial [sic] healthy" are "perfectly benign" – even if "the Debtor did not receive reasonably equivalent value in exchange." *In re Arabella Petroleum Co., LLC*, 647 B.R. 851, 876 (Bankr. W.D. Tex. 2022); *see also In re Performance Nutrition, Inc.*, 239 B.R. 93, 110 (Bankr. N.D. Tex. 1999) ("[A]n officer or director is not strictly forbidden from profiting from a corporate transaction.").

45. In *Arabella*, Jason Hoisager formed Arabella Petroleum Company, LLC and was its "sole owner and manager." *Id.* at 857. Arabella Petroleum made, *inter alia*, payments to Hoisager in the amount of $822,423 that he used "to buy a property, and build a building on that property, that Mr. Hoisager used personally." *Id.* at 866. The parties referred to these payments as the "Dove Acres" payments. *Id.* Crucially, the parties in *Arabella* stipulated that the company became insolvent on December 31, 2013 – and the last Dove Acres payment was made on April 3, 2013. *Id.* at 866.[8] The Court held the Dove Acres payments did not harm the company because an owner can pay himself so long as the company is solvent. *Id.*

46. *Arabella* is no outlier – there is a long line of cases recognizing that solvency is the key question in determining whether a distribution harms the company. *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575, 585 (5th Cir. 2008)(claims that a "third-party administrator negligently managed [the Debtor] or conspired to make it insolvent" were estate claims but claims that administrators "intentionally misrepresented . . . the [Debtor's financial situation" were direct claims); *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1268 (5th Cir. 1983) (estate held claims that owner of company "deliberately stripped . . . assets in order to benefit himself ***while***

[8] Unlike the Trustee in this case, the Trustee in *Arabella* recognized that insolvency is, in fact, a pertinent inquiry in evaluating whether a distribution was improper.

defrauding the company's creditors[.]") (emphasis added); *In re Soza*, 542 F.3d 1060, 1067 (5th Cir. 2008) ("Taking all the surrounding circumstances in this case into consideration, several of the 'badges of fraud' are evident here . . . They purchased the annuity on the eve of bankruptcy. Assuming the payment came from their non-exempt property, the annuity was in an amount that would have covered all of the debtors' listed debts, and the purchase deprived the creditors of all but $340 in non-exempt assets."); *cf. In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287, 2016 WL 4055044, at *2 (Bankr. S.D. Tex. July 26, 2016) ("If a company is solvent, and the insiders of the company caused a loss for which the insiders are liable, the benefits of any recovery will derive to the owners. If the company refuses to pursue its own insiders, the owners can pursue the claim . . . ***In an insolvent company, the benefits of any recovery would not similarly benefit the owners***.") (emphasis added); *Matter of Life Partners Holdings, Inc.,* 926 F.3d 103, 120 (5th Cir. 2019) ("On the issue of insolvency, Creditors' Trust has plausibly alleged that the LP Entities were insolvent for much of their existence" because "the LP Entities had insufficient funds to cover because they were paying commissions to the Licensees and distributions to insiders.").[9]

47. These cases establish that the members of a financially healthy company – particularly a closely-held company – generally are entitled to pay themselves distributions. And the Trustee has not made any effort to argue that Strike was insolvent when the Pates made the distributions. To the contrary, the Trustee has neither identified the dates of the distributions, nor identified any date by which Strike became insolvent.

The Pates owed the Clevelands applicable legal duties, such that they can pursue the claims directly.

[9] The Clevelands concede that the Trustee alone may recover distributions made while Strike was insolvent.

48. The Trustee also argues that, as a matter of law, the Pates did not owe any fiduciary duty to Cleveland personally – but the argument fails to consider that a limited liability company is not the same as a corporation. It has attributes of both a corporation and a limited partnership which support the existence of fiduciary duties as between members and members and the manager. Texas courts have recognized this distinction and have found in some cases that in a closely-held limited liability company, majority/managing members owe fiduciary duties to minority members. See *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355, 393 (Tex. App. 2012). In this case, Allen, a former member of Chief Holdings, LLC filed suit against the company and Rees-Jones, its president and majority member and manager after he redeemed his membership interests because the officer failed to disclose certain financial information which would have substantially affected his decision to sell his membership interests. The Court explained that: "the relationship between . . . the majority owner and sole manager of Chief, and . . . [the] non-participating minority owner, is substantially similar to the relationship between the general partner and a limited partner in a limited partnership. The nature of this relationship supports recognizing a fiduciary duty between Rees-Jones [the majority owner and sole manager] and Allen and Rees-Jones' operation and management of Chief ."[10]

49. In the case of *B Choice Limited v. Epicentre Development Associates, LLC,* 2017 WL 1160512 (S.D. Tex. 2017), the District Court denied a motion for summary judgment on an individual member's claims against a fellow member recognizing that a fiduciary duty in the context of limited liability companies is typically a question of fact, given that limited liability

[10] *Allen* was settled following an appeal to the Texas Supreme Court, before the Court ruled on the merits.

companies often resemble partnerships. *See also Gadin v. Societe Captrade,* No. 08–CV–3773, 2009 WL 1704049 (S.D. Tex. June 17, 2009)(denying motion to dismiss for similar reasons).

50. The District Court for the Eastern District of Texas also recognized a member had a fiduciary duty to other members in the case of *Cardwell v. Gurley,* 2011 WL 6338813 (E.D. Tex. 2011).

51. Other jurisdictions have acknowledged that members of limited liability companies have duties to one another. *See Bluewater Logistics, LLC v. Williford*, 55 So. 3d 148, 161 (Miss. 2011) (recognizing that members of a closely-held limited liability company owe fiduciary duties to one another, including an obligation to ensure that any transaction that the majority members is "intrinsically fair" to the minority members),[11] and that duty arises because, among other reasons, closely-held LLCs: (1) have membership interests that " are not publicly traded"; and (2) are owned by members who are also directors and officers").[12]

52. Stephen Pate was the manager of Strike Capital at the time of the Mill Point Transaction. As such, he owed a fiduciary duty to the Clevelands to protect their membership interest in the limited liability company.

53. The Trustee's reliance on the bankruptcy decision in *In re Chiron Equities, LLC* , 552 B.R.674 (Bankr. S.D. Tex. 2016), is misplaced because the bankruptcy judge assumed, apparently without challenge, that Texas law on the fiduciary duties of officers and directors of a corporation applied equally to a small closely-held limited liability company. Even still, Judge Bohm recognized that: (1) "a fiduciary day may exist in some instances . . ." between members of

[11] *Bluewater* is a Mississippi case, but the Court may consider its reasoning because there is no conflict between Mississippi law and Texas on this point. [cite].

[12] *Bluewater* is a Mississippi case, but the Court may consider its reasoning because there is no conflict between Mississippi law and Texas on this point.

a closely-held company, and; (2) "a minority shareholder could have a direct claim against a majority shareholder . . . for 'malicious suppression of dividends.'" 552 B.R. 674, 688-89 (Bankr. S.D. Tex. 2016).

54. Again, the Clevelands' claims are in essence claims that the Pates maliciously suppressed dividends – that they disguised the distributions at issue to ensure that the Clevelands would not receive distributions pursuant to their priority rights. By contrast, in *Chiron*, the "majority shareholder" was the plaintiff, "so it could hardly have a claim against Krasoff for malicious suppression of dividends . . ." *Id.*[13]

55. Further, the governing corporate document in *Chiron* stated that the owner could not make ***any*** payments without written approval of the Board of Directors. By contrast, the Strike Operating Agreement expressly provided for distributions to the Pates. Strike Bylaws at § 4.8(a). Here again, *Chiron* supports the Clevelands' position.

56. In summary, while *Chiron* emphatically stated that existing case law "slam[med] the door on" the right of KRD to bring a direct claim against its fellow member, KRD was a majority member – not a minority member – and the governing documents did not allow the minority member to make any distributions, regardless of the company's financial condition.[14] The facts here are quite different, and as this Court has held, "[t]he characterization of the claim" as direct or derivative "depends on the facts of each particular case." *In re Dexterity Surgical, Inc*., 365 B.R. at 696–97.

[13] *Chiron* decided the ownership issue in an adversary proceeding, which supports the Clevelands' position that the issues should be decided in an adversary proceeding and not in an emergency, two-hour hearing.

[14] *Chiron* did not directly address the company's financial condition, but clearly stated that distributions harmed the company, referring to them as "embezzlement", and "skullduggery".

57. And, regardless of whether the Court determines that the Pates owed the Clevelands a fiduciary duty under Texas law, the Trustee's argument is one of semantics. Even if the Trustee alone had the exclusive right to pursue breach of fiduciary claims, "the existence of common parties and shared facts between the bankruptcy and the bondholders' suit does not necessarily mean that the claims asserted by the bondholders are property of the estate . . . it is entirely possible for a bankruptcy estate and a creditor to own separate claims against a third party arising out of the same general series of events and broad course of conduct." *In re Seven Seas Petroleum, Inc*., 522 F.3d 575, 585 (5th Cir. 2008); *see also Great Am. Food Chain, Inc. v. Andreottola*, No. 3:14-CV-1727-BK, 2016 WL 852962, at *3 (N.D. Tex. Mar. 4, 2016) (individual plaintiff could pursue direct action stemming from his "personally guaranteeing a loan, even though it was for the benefit of GAMC, is personal to him rather than to GAFC.") There is no question that the Clevelands have claims arising out of the Pates' wrongful conduct, whether classified as breach of fiduciary duty, breach of contract, corporate freeze-out, minority shareholder oppression, negligence, or fraud. When the Pates took distributions in a manner meant to avoid the Clevelands' preferred distribution rights, they committed a tort against the Clevelands.

58. Based upon the foregoing, the Cleveland Parties have an ownership interest in the claims and should be allowed to pursue those claims whether in the Texas Suit or the Mississippi Suit.

IV. THE CLEVELAND PARTIES HAVE NOT VIOLATED ANY COURT ORDER

Trustee's Standing to Bring Claims

59. The Trustee claims the Cleveland Parties have violated the Confirmation Order based on the language contained in Article VIII.E of the Plan. This section is entitled "Preservation of Preserved Estate Claims" and states "the Liquidating Trust will retain and may

enforce any Preserved Estate Claims in accordance with this Plan and the Liquidating Trust Agreement." This provision does not preclude other creditors from bringing claims against the same parties the Liquidating Trustee may pursue. There is clearly a dispute between the Trustee and the Cleveland Parties regarding the ownership of certain litigation claims against the Debtors' former officers and directors.

60. The Trustee's standing to bring the claims against the Pate Defendants and other parties in the Texas Suit is derived from the Debtors' confirmed plan of reorganization. As stated above, the Debtors' assets were sold shortly after the bankruptcy cases were filed. As a result, the Debtors filed a liquidating plan of reorganization. Under the terms of the Plan, the remaining asserts were transferred to a trust. The Plan provided as follows:

> Additionally, on the Effective Date, the Debtors shall irrevocably transfer and shall be deemed to have irrevocably transferred to the Liquidating Trust all of the Debtors' and Estates' rights, title and interest in and to all of the **Liquidating Trust Assets** . . . . Plan at Article VIII, (D). The **Liquidating Trust Assets** are defined as "the **Preserved Estate Claims**, the Liquidating Trust Reserve, the Insurance Coverage Rights, and all other property, interests, and rights of the Debtors and the Estates as of the Effective Date (excluding, for the avoidance of doubt, any Purchased Assets (as defined in the Asset Purchase Agreement . . ."

Plan at Article I, (A)(85).

61. "**Preserved Estate Claims**" are defined under the Plan as "all Causes of action of the Debtors that are not waived, relinquished, released, compromised, or settled in the Plan or any Final Order, including, but not limited to, Causes of Action identified on the **Preserved Estate Claims Schedule**."

62. The **Preserved Estate Claims Schedules** were attached as Schedules to the Plan Supplement. Schedule D provided the Trustee may bring "any Preserved Estate Claim . . . (d) based upon any other legal or equitable theory of liability or recovery arising under federal, state or other statutory or common law or otherwise, including, without limitation, breach of fiduciary

duty, breach of the duty of care, breach of the duty of good faith and fair dealing, breach of the duty of loyalty, breach of the duty of candor, breach of the duty of oversight, or breach of any other duty, or aiding and abetting any such breaches of duty; . . . [and] (h) arising from or relating to the failure to properly oversee and govern the Debtors' operations and finances, operational mismanagement, expenditures of company funds for personal use (e.g., self-dealing, kickbacks, embezzlement), improper and excessive compensation, improper and excessive benefits, improper dealings with companies owned or controlled by the Debtors' former equity holders (direct or indirect), officers, directors, members, managers, employees or agents. . . . "

63. It is of note that the Plan Supplement appears to differentiate the claims listed in paragraph (h) from the breach of fiduciary claims listed in paragraph (d). More importantly, what property constituted property of the Debtors' bankruptcy estate was determined on the Petition Date under state law. *See Butner v. United States,* 440 U.S. 48, 55 (1979). Neither the Bankruptcy Code nor the Plan can create rights in the Trust which do not exist under either state or federal law. In this case, and as stated above, multiple claims can stem from the same set of facts. The Clevelands hold claims against Strike Capital and the other named defendants in the Mississippi Suit which existed on the Petition Date. The claims asserted by the Trustee in the Texas Suit are based upon transactions which should be recharacterized as distributions. These distributions were made without similar distributions being made to the Cleveland Parties. The Cleveland Parties have the right to pursue claims against Steve Pate as the manager and the other

The Claims against the Pates were Not Released by the Plan

64. Although several third parties received releases under the Plan, including Mill Point, significantly, the Pate family members were excluded as release parties. In fact, the Pates,

several of their companies, and James Cherry were listed as potential defendants on Schedule D, Preserved Estate Claims.[15]

The Post-Confirmation Injunction Does Not Bar Claims against Third Parties

65. The Plan provides for a post-confirmation injunction against certain actions by creditors as follows:

> Except as otherwise expressly provided in the Plan or for obligations issued or re quired to be paid pursuant to the Plan or the Confirmation Order, all Entities who have held, hold, or may hold Claims, Interests, or Causes of Action that have been released or are subject to exculpation are permanently enjoined, from and after the Effective Date, from taking any of the following actions against, as applicable, the Debtors, the Wind-Down Debtors, the Liquidating Trust, the Released Parties, or the Exculpated Parties: (a) commencing or continuing in any manner any action or other proceeding of any kind on account of or in connection with or with respect to any such Claims, Interests, or Causes of Action; (b) enforcing, attaching, collecting, or recovering by any manner or means any judgment, award, decree, or order against such Entities or the property or the estates of such Entities on account of or in connection with or with respect to any such Claims , Interests, or Causes of Action; (c) creating, perfecting, or enforcing any encumbrance of any kind against such Entities or the property or the estates of such Entities on account of or in connection with or with respect to any such Claims, Interests, or Causes of Action; (d) asserting any right of setoff or subrogation of any kind against any obligation due from such Entities or against the property of such Entities on account of or in connection with or with respect to any such Claims, Interests, or Causes of Action unless such Holder has filed a motion requesting the right to perform such setoff on or before the Confirmation Date, and notwithstanding an indication of a claim or interest or otherwise that such Holder asserts, has, or intends to preserve any right of setoff pursuant to applicable law or otherwise; and (e) commencing or continuing in any manner any action or other proceeding of any kind on account of or in connection with or with respect to any such Claims, Interests, or Causes of Action released or settled pursuant to the Plan.

Plan, Article XII (F) (attached to Confirmation Order as Exhibit "A").

66. By its terms, the plan injunction applies to Claims, Interests, or Causes of Action that have ben released or are subject to exculpation. It is undisputed that the claims against the

[15] Schedule D also identified the following individuals and/or entities as potential defendants: Cole Pate; Adam Pate; Kevin Pate; Megan Pate; Steve Pate; Pate Brother Land & Cattle LLC; Pate Lodge LLC; Twin Timbers LLC ; and James Cherry.

Pates, their companies, and Cherry were not released and were expressly reserved as "Preserved Estate Claims."

67. "A party commits contempt when he violates a definite and specific order of the court requiring him to perform or refrain from performing a particular act or acts with knowledge of the court's order." *Travelhost, Inc. v. Blandford*, 68 F.3d 958, 961 (5th Cir. 1995); *Martin v. Trinity Industries, Inc.*, 959 F.2d 45, 47 (5th Cir. 1992) ("Contempt is committed only if a person violates a court order requiring in specific and definite language that a person do or refrain from doing an act."). "For civil contempt, this must be established by clear and convincing evidence." *Hornbeck Offshore Servs., L.L.C. v. Salazar*, 713 F.3d 787, 792 (5th Cir. 2013). Specifically, "the party seeking an order of contempt need only establish (1) that a court order was in effect, and (2) that the order required certain conduct by the respondent, and (3) that the respondent failed to comply with the court's order." *F.D.I.C. v. LeGrand*, 43 F.3d 163, 170 (5th Cir. 1995). An effective court order places the party of whom it "require[s] certain conduct," *id.*, "under a duty to make in good faith all reasonable efforts to comply," *Smith v. Smith*, 194 F.3d 1309, 1309 (5th Cir. 1999). "The contemptuous actions need not be willful so long as the contemnor actually failed to comply with the court's order." *Waste Mgmt. of Washington, Inc. v. Kattler*, 776 F.3d 336, 341 (5th Cir. 2015) (internal quotations and citations omitted).

68. Based upon the foregoing, the Cleveland Parties submit there is no evidence they have violated any Court Order. As such, there is no basis for finding them to be in contempt. In the alternative, the Cleveland Parties request that they be allowed to amend their Petition in Intervention to clarify that they do not seek relief for claims which are held by the Trustee.

WHEREFORE, Billy Cleveland, Tammy Cleveland and Circle C Investments, LLC respectfully request that this Court determine that they have an ownership interest in the claims

which are subject to the Texas Suit, deny the Motion to Show Cause, and grant Billy Cleveland, Tammy Cleveland and Circle C Investments, LLC such other and further relief to which they may be justly entitled.

Dated: November 12, 2023

Respectfully submitted,

BAKER, DONELSON, BEARMAN, CALDWELL & BERKOWITZ
A Professional Corporation

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CERTIFICATE OF SERVICE

I hereby certify that on November 12, 2023, this Response was served on the Movants and all parties entitled to receive electronic service through the Court's Electronic Case Filing System.

/s/ Susan C. Mathews
Susan C. Mathews