United States Court of Appeals for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
October 20, 2023
Lyle W. Cayce
Clerk

No. 22-50945

ARMADILLO HOTEL GROUP, L.L.C.,

Plaintiff—Appellant,

versus

TODD HARRIS; JASON MCDANIEL; SOUTHEASTERN DISASTER RELIEF SERVICES, L.L.C.; BATTLEMENT MESA CONSULTING, L.L.C.; GRAND MAJESTIC LODGE,

Defendants—Appellees.

Appeal from the United States District Court
for the Western District of Texas
USDC No. 1:22-CV-841

Before SMITH, SOUTHWICK, and HIGGINSON, *Circuit Judges*.

LESLIE H. SOUTHWICK, *Circuit Judge*:

The Plaintiff sued for misappropriation of trade secrets under the Defend Trade Secrets Act. The district court granted the Defendants' motion to dismiss because it found that the Plaintiff engaged in impermissible claim splitting between this federal suit and a state suit involving some of the same parties. We conclude that not enough was known from the pleadings about the relation between two of the defendants in the two suits to conclude claim splitting had occurred. REVERSED and REMANDED.

FACTUAL AND PROCEDURAL BACKGROUND

Our factual summary is taken from the Plaintiff's complaint, which is appropriate in the motion-to-dismiss stage of this proceeding. *See Sewell v. Monroe City Sch. Bd.*, 974 F.3d 577, 582 (5th Cir. 2020).

Plaintiff Armadillo Hotel Group, LLC ("Armadillo") is a buyer and operator of modular and mobile structures throughout North America. According to Armadillo, Defendants Todd Harris and Jason McDaniel were hired in May 2019 to oversee Armadillo's construction operations and its hotel, food, and beverage operations, respectively. After a few years, the relationship between Armadillo and Harris and McDaniel deteriorated. McDaniel resigned in January 2021, Harris in July 2021.

In November 2021, Harris and McDaniel sued Armadillo Hotel Group Management, LLC ("AHG Management") in a Travis County, Texas state district court, which is in Austin. The precise relation between the state defendant AHG Management and Armadillo is unclear. Other defendants were AHG Management's principals, Lee Eichen and Michael Maloney, and Centerboard Group, LLC, a Delaware corporation allegedly owned by Eichen and Maloney. Harris and McDaniel contended that AHG Management fraudulently induced them to step back from their own businesses to pursue a joint venture — Armadillo — through promises of profit sharing, salaries, bonuses, financial backing, and assurances of future financial success. Harris and McDaniel asserted that they entered employment agreements with AHG Management as part of the joint venture, but AHG Management breached these agreements by failing to pay the agreed upon salary, bonuses, and profit-sharing interests. They asserted claims of fraudulent inducement, negligent misrepresentation, tortious interference, and unjust enrichment.

In December 2021, AHG Management filed counterclaims against Harris and McDaniel. The company agreed it had hired Harris and McDaniel but claimed they had breached their fiduciary duties by failing to devote their full attention to their responsibilities and diverted business opportunities to their own companies, which allegedly competed with AHG Management. As part of these counterclaims, AHG Management alleged that Harris "knowingly and improperly expropriated numerous proprietary and confidential AHG documents and forwarded AHG documents to former employees (including McDaniel) and to his personal email account for use outside of AHG." AHG Management also alleged that Harris "improperly and without authorization sent AHG's confidential vendor pricing proposals regarding property management systems to Grand Majestic Lodge," a competing company.

The parties conducted some discovery in state court. In August 2022, eight months after filing its counterclaims and with new counsel, AHG Management filed an amended counterclaim in state court, removing its claim against Harris and McDaniel for improper expropriation of proprietary and confidential documents. That same day, the same counsel filed a complaint on behalf of Armadillo — not on behalf of AHG Management — in the United States District Court for the Western District of Texas, in Austin. The complaint was filed against Harris, McDaniel, and the following new parties: Southeastern Disaster Relief Services ("SDRS"), a business affiliated with McDaniel; Battlement Mesa Consulting, LLC ("BMC"), a business affiliated with Harris; and Grand Majestic Lodge ("GML"), a competitor of Armadillo.

Armadillo's complaint alleged that Harris and McDaniel misappropriated trade secrets that they shared with SDRS, BMC, and GML during and after their employment with Armadillo. It also asserted claims under the Defend Trade Secrets Act, 18 U.S.C. § 1836, alleging that the five

defendants conspired together from 2019 through 2021 to misappropriate the trade secrets. Armadillo further sought a temporary restraining order, preliminary injunction, and permanent injunction against these defendants to bar them from destroying or using any of Armadillo's confidential information and to order them to return the information to Armadillo.

Harris, McDaniel, SDRS, and BMC moved to dismiss under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim.[1] These Defendants argued that Armadillo's complaint should be dismissed for impermissible splitting of claims relating to Harris's and McDaniel's employment between the state-court proceedings and this new federal lawsuit. They relied on the fact that the same counsel on the same day filed this federal suit making the misappropriation claims and filed an amended counterclaim in state court removing its misappropriation claims. They argued the federal lawsuit "smacks of harassment" against which the claim splitting doctrine was designed to protect. Alternatively, the Defendants argued that Armadillo's complaint should be dismissed because Harris and McDaniel were never employed by Armadillo but instead were employed by AHG Management. Therefore, they could not have accessed Armadillo's trade secrets. Thus, Armadillo allegedly failed to state a claim upon which relief could be granted.

The district court granted the non-GML defendants' motion to dismiss with prejudice.[2] The district court acknowledged the "apparent

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[1] After being properly served, GML did not enter an appearance or respond to Armadillo's complaint. The district court clerk entered default against GML. Prior to the district court's dismissal of this suit, Armadillo moved for default judgment against GML but the district court never ruled on that motion. GML did not file a notice of appeal and therefore is not a party before us.

[2] As to GML, the district court found that GML had not properly been served. The record, though, contains Armadillo's properly filed proof of service on GML and the

difference between Defendant AHG Management LLC in the state-law action and Plaintiff [Armadillo] in this case," but found that the prohibition against claim splitting applied because the same claims were first removed from AHG Management's counterclaim in the state-court proceedings and then asserted by Armadillo in this federal action. The court found that the similar claims arose out of the same nucleus of operative facts — Harris's and McDaniel's employment — and shared a common factual predicate. This "subject[ed] Defendants to harassment by repetitive litigation" and violated the main purpose of the bar against claim splitting.

Armadillo timely appealed.

DISCUSSION

We have jurisdiction to review final orders granting a party's motion to dismiss for failure to state a claim. 28 U.S.C. § 1291; *ANR Pipeline Co. v. La. Tax Comm'n*, 646 F.3d 940, 946 (5th Cir. 2011). Generally, "[w]e review orders on 12(b)(6) motions to dismiss for failure to state a claim *de novo*." *Petrobras Am., Inc. v. Samsung Heavy Indus. Co.*, 9 F.4th 247, 253 (5th Cir. 2021). In doing so, "[w]e accept all well-pleaded facts as true, viewing them in the light most favorable to the plaintiff." *Id.* We consider "all documents incorporated into the complaint by reference" as well as "matters of which [we] may take judicial notice." *Id.* (quotation marks omitted).

I. Standard of review

The parties dispute whether our review of the district court's grant of a motion to dismiss specifically for claim splitting should be *de novo* or for an

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district court's subsequent entry of default against GML. The district court stated its use of the term "Defendants" did not include GML. What is less clear is whether the dismissal of Armadillo's claims with prejudice also applies to GML or only to the non-GML defendants.

abuse of discretion. In a recent appeal, we agreed to "follow the[] lead" of our sister circuits in applying the abuse-of-discretion standard when reviewing dismissals for claim splitting. *General Land Off. v. Biden*, 71 F.4th 264, 269 n.6 (5th Cir. 2023) (citing *Scholz v. United States*, 18 F.4th 941, 950–51 (7th Cir. 2021)). Thus, no question remains as to the standard to apply.

Under this deferential standard, "[a] district court abuses its discretion if it: (1) relies on clearly erroneous factual findings; (2) relies on erroneous conclusions of law; or (3) misapplies the law to the facts." *In re Volkswagen of Am., Inc.*, 545 F.3d 304, 310 (5th Cir. 2008) (en banc).

II. Claim splitting

"The rule against claim splitting prohibits a party or parties in privity from simultaneously prosecuting multiple suits involving the same subject matter against the same defendants." *General Land Off.*, 71 F.4th at 269–70. The rule is based on principles of *res judicata* and "protect[s] the defendant from being harassed by repetitive actions based on the same claim." *Id.* at 270 (quoting *In re Super Van, Inc.*, 92 F.3d 366, 371 (5th Cir. 1996)). Because the prohibition against claim splitting rests on *res judicata* principles, we rely on *res judicata*'s four-part test: (1) the parties in the current action are the same or "in privity with the parties in the prior action"; (2) "the court that rendered the prior judgment" was a "court of competent jurisdiction"; (3) the prior action "terminated with a final judgment on the merits"; and (4) the "same claim or cause of action" is "involved in both suits." *Gulf Island-IV, Inc. v. Blue Streak-Gulf Is Ops*, 24 F.3d 743, 746 (5th Cir. 1994).

This test is modified when the prior suit is pending because, by definition, no final judgment from the prior suit exists. *See Oliney v. Gardner*, 771 F.2d 856, 859 (5th Cir. 1985); 18 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4406 (3d ed.). Accordingly, in the context of claim splitting when an earlier

suit is pending, the relevant *res judicata* factors are (1) whether the parties are the same or in privity and (4) whether "the same claim or cause of action" is "involved in both suits." *Gulf Island-IV*, 24 F.3d at 746; *Oliney*, 771 F.2d at 859. We discuss both factors, beginning with the similarity of the claim or action.

a. Same claim or cause of action

In determining whether two suits present the same claim or cause of action, we apply the transactional test from the *Restatement (Second) of Judgments* § 24. *Petro-Hunt, LLC v. United States*, 365 F.3d 385, 395–96 (5th Cir. 2004). "[T]he critical issue is whether the two actions were based on the 'same nucleus of operative facts,'" and "we look to the factual predicate of the claims asserted, not the legal theories upon which the plaintiff relies." *Eubanks v. FDIC*, 977 F.2d 166, 171 (5th Cir. 1992) (citation omitted). Under the transactional test, we assess whether the factual predicate of both suits is "related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understanding or usage." *Petro-Hunt*, 365 F.3d at 396 (quoting RESTATEMENT (SECOND) OF JUDGMENTS § 24(2) (1982)).

The district court found that Armadillo brought the "same allegations" that AHG Management asserted in its original counterclaim. Armadillo brought these allegations in federal court only after AHG Management amended its state-court pleadings to remove the misappropriation claim. Thus, the district court concluded that Armadillo's claims of misappropriation of trade secrets "ar[ose] out of the same nucleus of operative facts and share a common factual predicate as [AHG Management's] original counterclaim in the state-court action."

Armadillo argues that the operative facts of the state-court action "relate[] to the employment relationship between Harris/McDaniel and AHG Management." In contrast, according to Armadillo, its federal claims against Harris and McDaniel and their related entities "occurred not only during the employment with AHG Management at issue in the State Case *but also afterward.*" Putting aside for the moment the fact that Armadillo's complaint alleged that Harris and McDaniel worked for Armadillo, not AHG Management, and that the alleged theft of trade secrets arose from *that* employment relationship, the assertion that trade secrets allegedly were misappropriated after this employment relationship ended does not mean Armadillo's claims arise out of separate transactions. Instead, the fact that Harris's and McDaniel's alleged misappropriation began while employed by either Armadillo or AHG Management and continued after they resigned indicates that Armadillo's and AHG Management's claims represent a "*series of connected transactions*, out of which the [original] action arose." *Petro-Hunt*, 365 F.3d at 396 (emphasis added).

Armadillo also argues that Harris and McDaniel "committed separate wrongs against separate parties at separate times and thus they cannot be the same transaction or derive from a common nucleus of operative fact." We will address the "separate parties" issue later, but the assertion that "separate wrongs" were committed at "separate times" is not supported by the record, even when viewing Armadillo's claims in the light most favorable to it. Our approach to claim splitting, like *res judicata*, is a pragmatic one; we also look to the *Restatement*'s commentary for guidance on how to apply the doctrine. *See Petro-Hunt*, 365 F.3d at 395–96; *Ocean Drilling & Expl. Co. v. Mont Boat Rental Servs., Inc.*, 799 F.2d 213, 217 (5th Cir. 1986). Comment (d) to Section 24 of the *Restatement* explains that claim splitting may apply "[w]hen a defendant is accused of . . . acts which though occurring over a

period of time were substantially of the same sort and similarly motivated." RESTATEMENT (SECOND) OF JUDGMENTS § 24 cmt. (d).

Here, Armadillo's federal complaint alleges that Harris and McDaniel "conspired to work together" and with their outside businesses "to compete with [Armadillo] *during their period of employment*." Although Armadillo claimed it discovered such acts after Harris and McDaniel resigned, the discovery was made "[u]pon review of Harris' and McDaniel's [Armadillo] email accounts." Thus, Armadillo contends that Harris, McDaniel, and their related entities "conspired together from 2019-2021 to improperly misappropriate [Armadillo]'s trade secrets for their own benefit and for the purpose of competing with [Armadillo]." From this, Armadillo nearly concedes that, although the alleged acts occurred over a period of time and extended after Harris's and McDaniel's period of employment, they were "substantially of the same sort and similarly motivated." RESTATEMENT (SECOND) OF JUDGMENTS § 24 cmt. (d). To adopt Armadillo's temporal approach to the transactional test would be to replace the pragmatic with the formalistic. Our precedents foreclose this approach.

Finally, Armadillo argues that the state and federal cases do not arise out of a common nucleus of operative fact because Harris's and McDaniel's suit against AHG Management is essentially an employment dispute. Armadillo argues that AHG Management's original counterclaim "say[s] nothing about confidential information" and therefore the operative facts of the state and federal cases are completely separate.

It is irrelevant that Harris and McDaniel brought suit against AHG Management on the basis of fraudulent inducement related to their employment. Although Harris and McDaniel have a different cause of action than Armadillo, our focus is the relevant *claims* that arise out of a common nucleus of operative facts. *See Ocean Drilling*, 799 F.2d at 217 n.5;

RESTATEMENT (SECOND) OF JUDGMENTS § 24 cmt. (c). Moreover, it is not Harris's and McDaniel's claims that are the focus of this inquiry — it is AHG Management's state-court counterclaims that are at issue. Contrary to Armadillo's argument on appeal, AHG Management's original counterclaim did, in fact, assert misappropriation of confidential information. It alleged that Harris "knowingly and improperly expropriated numerous proprietary and confidential AHG [Management] documents," including "AHG financial information, accounts payable information, listings of AHG assets, vendor pricing proposals, and information regarding AHG construction budgets and timelines." In its complaint, Armadillo alleged that its misappropriated trade secrets included proprietary and confidential "vendor pricing and proposals," "construction line-item costs and budgets," "asset listings," and other confidential information.

We cannot ignore the similarity of these claims against Harris and McDaniel even when viewed in the light most favorable to Armadillo. This is because "[i]t is the 'nucleus of operative facts, rather than the type of relief requested, substantive theories advanced, or types of rights asserted' that defines the claim." *Houston Pro. Towing Ass'n v. City of Houston*, 812 F.3d 443, 447 (5th Cir. 2016) (quoting *United States v. Davenport*, 484 F.3d 321, 326 (5th Cir. 2007)).

For these reasons, the district court did not err in concluding that Armadillo's claims against Harris and McDaniel arose out of the same nucleus of operative facts as AHG Management's claims for purposes of claim splitting. We next examine the identity of the parties.

b. Identity of the parties

Under *res judicata* principles, the identity of the parties asserting the claims must be the same or in privity for claim splitting to apply. *Petro-Hunt*, 365 F.3d at 395. All parties agree that Armadillo and AHG Management are

legally separate entities. The district court acknowledged the "apparent difference between Defendant AHG Management LLC in the state-law action and Plaintiff [Armadillo] in this case." A reasonable interpretation of this statement is that the district court found that Armadillo and AHG Management are not legally the same parties. The district court dismissed this apparent lack of identity because of the similarity in the allegations, the fact that the same attorneys filed Armadillo's federal complaint and AHG Management's amended state counterclaim, and that the parties need not be "identical" in order to find claim splitting.

In the absence of total identity of the parties for claim splitting, privity is required. *General Land Off.*, 71 F.4th at 270. We have "held that privity exists [for res judicata purposes] in just three, narrowly-defined circumstances: (1) where the non-party is the successor in interest to a party's interest in property; (2) where the non-party controlled the prior litigation; and (3) where the non-party's interests were adequately represented by a party to the original suit. *Meza v. Gen. Battery Corp.*, 908 F.2d 1262, 1266 (5th Cir. 1990). That list demonstrates that we look to whether "the relationship between the one who is a party on the record and the non-party is sufficiently close to afford application of the principle of preclusion." *Id.* "Privity 'is not established by the mere fact that persons may be interested in the same question or in proving the same set of facts.' And it 'requires more than a showing of parallel interests or, even, a use of the same attorney in both suits.'" *General Land Off.*, 71 F.4th at 270 (quoting *Freeman v. Lester Coggins Trucking, Inc.*, 771 F.2d 860, 864–65 (5th Cir. 1985)). It is therefore the relationship of the *parties*, not their claims or their attorneys, that governs this part of the claim-splitting analysis.

We cannot find sufficient information in the record to decide if Armadillo and AHG Management were in privity with each other. The fact that the same attorneys filed AHG Management's amended state

counterclaim and Armadillo's federal complaint is insufficient to show privity. *General Land Off.*, 71 F.4th at 270–71. As to the apparent differences between AHG Management and Armadillo, the district court held that the "same transaction test" does not require the parties to be identical and that the allegations made in the state and federal suits satisfied the test. That may be correct on the face of Armadillo's complaint, but the district court needed to determine factually the relationship of the two parties in order to apply our claim splitting test.[3] *See id.* We conclude that the district court erred in granting the Defendants' motion to dismiss without more about the legal relationship of AHG Management and Armadillo.

The Defendants argue that the district court was correct because the pleadings in the state and federal actions provide sufficient support for its finding of privity. The Defendants rely on the similarities in Armadillo's and AHG Management's descriptions of themselves, in the shorthand names they use in their respective cases, in their services and customers, and in their descriptions of the confidential information at issue. The Defendants contend that these similarities support a conclusion that either Armadillo or AHG Management could exercise "actual control" over the other such that they were in privity.

Perhaps an inference is reasonable that Armadillo and AHG Management are in privity based on the similarities the Defendants highlight. At the motion to dismiss stage, however, such inferences are inappropriate. *See In re Katrina Canal Breaches Litig.*, 495 F.3d 191, 205 (5th Cir. 2007).

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[3] The cases cited by the district court focus on the identity of the claims under the transactional test for the simple reason that the total identity of the parties was not disputed. *See FDIC v. Nelson*, 19 F.3d 15 (5th Cir. 1994) (unpublished); *Test Masters Educ. Servs., Inc. v. Singh*, 428 F.3d 559 (5th Cir. 2005); *New York Life Ins. Co. v. Gillispie*, 203 F.3d 384 (5th Cir. 2000); *Verde v. Stoneridge, Inc.*, 137 F. Supp. 3d 963 (E.D. Tex. 2015); *Katz v. Gerardi*, 655 F.3d 1212 (10th Cir. 2011). These cases are thus inapposite.

Rather, the district court must accept "all well-pleaded facts as true" and view "them in the light most favorable to the plaintiff." *Id.* (citation omitted). Therefore, the district court in this case was required to assess whether assertions about the relationship between Armadillo and AHG Management, if accepted as true and construed in the light most favorable to Armadillo, support that the two entities are in privity. The district court did not have sufficient information or even assertions about the relationship of Armadillo and AHG Management to perform such an assessment.

REVERSED and REMANDED for further proceedings consistent with this opinion.