CASE NO. 18-60552

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

TLS MANAGEMENT & MARKETING SERVICES, L.L.C.,
doing business as Tax Law Solutions, L.L.C.
Plaintiff-Appellee

v.

MARDIS FINANCIAL SERVICES, INCORPORATED; CAPITAL PRESERVATION SERVICES, L.L.C.; J. TODD MARDIS
Defendants-Appellants

Appeal from the United States District Court
for the Southern District of Mississippi, Northern Division;
Case No. 3:14-cv-881-CWR-LRA; Honorable Carlton W. Reeves, Presiding

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BRIEF OF DEFENDANTS-APPELLANTS

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CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record for Defendants-Appellants certifies the following listed persons and entities have an interest in the outcome of this case. These representations are made in order that the judges of the Court may evaluate possible disqualification or recusal.

1. TLS Management & Marketing Services, LLC
   d/b/a Tax Law Solutions, LLC
   Plaintiff-Appellee

2. Mardis Financial Services, Inc.
   Defendant-Appellant

3. Capital Preservation Services, LLC
   Defendant-Appellant

4. J. Todd Mardis
   Defendant-Appellant

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STATEMENT CONCERNING ORAL ARGUMENT

Because this appeal raises serious issues concerning the fundamental unfairness of the proceedings below, Defendants-Appellants respectfully submit the decisional process would be aided by oral argument.

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STATEMENT OF JURISDICTION

This is an appeal of a final default judgment entered by the District Court on August 3, 2018. The District Court determined it had subject matter jurisdiction under 28 U.S.C. §§ 1331 and 1332. Defendants-Appellants timely filed their Notice of Appeal on August 6, 2018. This Court has appellate jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

1. Whether federal subject matter jurisdiction exists?

2. Whether the District Court abused its discretion by granting a default judgment against Defendants-Appellants as a discovery sanction?

3. Whether the District Court should have recused based upon inflammatory and undeserved comments made about Defendants-Appellants to justify the default judgment sanction?

4. Whether the District Court erred in awarding "unjust enrichment" damages under the Mississippi Uniform Trade Secrets Act against Defendants-Appellants as part of its final default judgment?

5. Whether the District Court erred in awarding prejudgment interest against Defendants-Appellants as part of its final default judgment?

6. Whether the District Court erred in granting a permanent injunction against Defendants-Appellants as part of its final default judgment?

STATEMENT OF THE CASE

Plaintiff-Appellee TLS Management & Marketing Services, LLC d/b/a Tax Law Solutions, LLC ("TLS") is a Puerto Rico company that markets and sells tax planning services.[1] Defendant-Appellant J. Todd Mardis ("Mardis") is a citizen of Mississippi. ROA.48, 6757. Mardis, through his company, Mardis Financial Services, Inc. ("MFS"), was affiliated with TLS as an independent contractor for approximately four (4) years from 2010 to 2014.[2]

On June 9, 2010, Mardis entered into a Confidentiality and Non-Competition Agreement with Tax Law Solutions, LLC, a Delaware company. This agreement identifies "Capital Preservation Services" as the "Advisor" but does not provide the status, location or authority of any entity by this name.[3]

On February 28, 2011, Mardis entered into a Subcontractor Agreement with Tax Law Solutions, LLC, a Puerto Rico company. This agreement, which expressly "superseded and cancelled" all prior agreements, identifies the "Subcontractor" as

[1] ROA.48. TLS' Complaint does not plead the identity or citizenship of its members.

[2] ROA.48. Formed in 2005, MFS is a Mississippi company. ROA.6760, 6769-70, 6772-73.

[3] ROA.75, 79. For ease of reference, this agreement is referred to as the "CPS Agreement." The CPS Agreement contains Confidentiality and Non-Competition provisions which survive for a duration of two (2) years following termination. ROA.75-7.

MFS.[4] After relocating to and incorporating in Puerto Rico, Tax Law Solutions, LLC changed its name in 2012 to TLS Management and Marketing Services, LLC. ROA.305-11.

When the business relationship with TLS ended in 2014, Mardis formed a new company called Advanced Tax Planning, LLC, which later changed its name to Capital Preservation Services, LLC ("CPS, LLC").[5] Through CPS, LLC, Mardis continued to offer tax planning services as part of his financial and insurance business.[6] TLS filed its Complaint on November 13, 2014, alleging the following causes of action: (1) Breach of Contract Against CPS, LLC; (2) Breach of Contract Against MFS; (3) Breach of Contract Against Mardis; (4) Violation of Mississippi Uniform Trade Secrets Act ("MUTSA"), Miss. Code Ann. § 75-26-1, *et. seq.*, against all Defendants; (5) Violation of the Lanham Act, 15 U.S.C. § 1125(a)(1)(B), against CPS, LLC; (6) Tortious Interference with Business Relations against all Defendants and (7) Unfair Competition against all Defendants. ROA.64-71.

[4] ROA.80, 87. For ease of reference, this agreement is referred to as the "MFS Agreement." The MFS Agreement contains Confidentiality and Non-Competition provisions which survive for a duration of one (1) year following termination. ROA.82-4.

[5] CPS, LLC was formed in 2014. ROA.6795. TLS' Complaint does not plead the identity or citizenship of the members of CPS, LLC. ROA.48.

[6] ROA.6798. Mardis has been in the financial service and insurance business since 1993. ROA.6759.

On January 29, 2018, the District Court entered an Order granting a default judgment against Mardis, MFS, and CPS, LLC (collectively "Defendants") as a discovery sanction for spoliation of electronically stored information ("ESI"). ROA.6133. This ruling stripped Defendants of their ability to defend on the merits and conclusively established their liability to TLS.

After denying Defendants' Motion for Reconsideration and Motion for Recusal, the District Court convened a bench trial on damages. ROA.6147, 6201. On August 3, 2018, the District Court entered its Findings of Fact and Conclusions of Law and Final Judgment awarding "unjust enrichment" damages against Defendants in the amount of $3,507,718.48, plus exemplary damages in the amount of $100.00, pre-judgment interest in the amount of $516,945.54 and post-judgment interest. The District Court also issued a permanent injunction against Defendants. ROA.6551, 6584. The District Court's rulings are fundamentally unjust and cannot stand.

To frame the issues and place the impact of the District Court's rulings in context, it is necessary to review the history of this case. Since the outset, Defendants have steadfastly challenged TLS' claims as legally invalid and its discovery demands as unreasonable. Despite legitimate requests for relief at various stages of this litigation, the District Court repeatedly deferred consideration of Defendants' challenges and declined to impose reasonable limits on discovery. By granting a

default judgment in TLS' favor, the District Court avoided consideration of the merits altogether.

A. The District Court Stays the Case Pending a Ruling on Defendants' Initial Motion to Dismiss

On December 8, 2014, Defendants filed their Answer and Affirmative Defenses to TLS' Complaint along with a Motion to Dismiss pursuant to Mississippi's "door closing" statute.[7] The District Court entered an Order staying the case pending a ruling on this motion. ROA.228. One year later, on December 17, 2015, the Court entered a text-only Order which denied Defendants' motion without explanation and lifted the stay. ROA.7.

B. After the Stay is Lifted, Defendants File Dispositive Motions and Request Limits on Discovery

The initial Case Management Order was entered on March 9, 2016. ROA.237. Shortly thereafter, on June 6, 2016, Defendants filed a Motion for Summary Judgment as to all of TLS' claims. ROA.301, 318.

Defendants raised several challenges to TLS' breach of contract claims. Specifically, Defendants argued: (1) TLS lacks standing to enforce the contracts at

[7] ROA.125, 138; *see* Miss. Code Ann. §§ 79-4-15.01-15.02 (requiring foreign companies doing business in Mississippi to register with Secretary of State and barring unregistered companies from filing suit in Mississippi courts). Although it claims to be exempt from this requirement, TLS is an unregistered foreign company doing business in Mississippi. ROA.150.

issue;[8] (2) the CPS Agreement was "superseded and cancelled" by the MFS Agreement;[9] (3) the restrictive covenants in the CPS Agreement are unenforceable under Illinois law;[10] and (4) the restrictive covenants in the MFS Agreement are unenforceable under Puerto Rico law.[11]

Defendants also challenged the existence of any "trade secrets" as defined by Miss. Code Ann. § 75-26-3(d). Specifically, Defendants argued TLS' tax planning methods are not unique or secret. ROA.333-35. To the contrary, TLS' methods are based on publicly available information and are commonly utilized in the financial services industry. *See, e.g., Lawfinders Assoc., Inc. v. Legal Research Center, Inc.* 193 F.3d 517 (5th Cir. 1999)(noting business methods based on common knowledge and public information are not entitled to trade secret protection).

[8] The caption of TLS' Complaint is cryptically styled in the name of "TLS Management and Marketing, LLC d/b/a Tax Law Solutions, LLC." This entity is not a party to the CPS Agreement or the MFS Agreement. There are no allegations in TLS' Complaint which explain the relationship between the contracting entities and TLS Management and Marketing Services, LLC. Moreover, both contracts prohibit assignments without the prior written consent of the other party. ROA.78, 87.

[9] CPS, LLC is not a party to either contract.

[10] The CPS Agreement provides that Illinois law governs. ROA.79. Defendants argued that, even if the CPS Agreement still existed, the restrictive covenants are facially invalid under Illinois law because they are not limited to a specific geographic area or exiting customers. ROA.320-27.

[11] The MFS Agreement provides that it is governed by the "laws of the jurisdiction in which TLS is domiciled." ROA.87. TLS' business is in Puerto Rico. Defendants argued that the restrictive covenants in the MFS Agreement are facially invalid under Puerto Rico law because they are not limited to a specific geographic area or existing customers. ROA.328-332.

As to TLS' claim under the Lanham Act,[12] Defendants refuted TLS' Complaint allegations concerning the use of testimonials from two (2) clients referred to as "C.H." and "D.H." TLS alleged that neither C.H. nor D.H. had ever utilized Mardis' services but that he and CPS, LLC were falsely advertising otherwise. ROA.68-9. However, through his affidavit (which TLS never rebutted), Mardis established C.H. and D.H. were already his clients prior to his affiliation with TLS.[13]

As to TLS' state law claims for tortious interference with business relations and unfair competition, Defendants argued that, in the absence of a valid non-competition agreement, a former independent contractor is legally entitled to terminate the relationship and compete for business. Accordingly, these claims are not viable as stand-alone theories of recovery against Defendants. ROA.337.

Meanwhile, TLS was seeking onerous discovery from Defendants (including access to their computers and other electronic devices). Because Defendants' Motion for Summary Judgment involved predominantly legal issues, Defendants requested a stay of discovery. Alternatively, Defendants moved for a protective order limiting the scope of discovery to specific factual issues, if any, which TLS identified in

[12] The Lanham Act provides a cause of action for false or misleading advertisements made "in commerce." *See* 15 U.S.C. § 1125(a)(1)(B). The term "commerce," as used in the Act, refers to "all commerce which may lawfully be regulated by Congress." 15 U.S.C. § 1127.

[13] ROA.314, 336-37. Defendants also argued TLS could not prove it suffered any actual damages as a result of these testimonials. ROA.337.

connection with the summary judgment motion. ROA.340, 349. Defendants argued it was improper and premature to allow TLS to conduct wide-open discovery as to their business methods, clients and finances. ROA.514. Contending discovery should have no limits, TLS filed motions to compel. ROA.591, 1105.

The District Court refused to consider the merits of Defendants' Motion for Summary Judgment. On June 17, 2016, a mere eleven (11) days after it was filed, the District Court entered a text-only Order "dismissing" Defendants' motion. ROA.11. The District Court also denied Defendants' request for a stay and referred the parties' disputes concerning the scope of discovery to the Magistrate Judge. *Id.*

Shortly thereafter, on July 1, 2016, Defendants filed a Motion for Judgment on the Pleadings, imploring the District Court to consider the purely legal challenges to the enforceability of the contracts at issue.[14] Meanwhile, Defendants served discovery on TLS requesting a description of the trade secrets which they supposedly misappropriated. TLS' nonresponsive answers resulted in Defendants filing a Motion to Compel and for Protective Order. ROA.1150, 1188. Defendants again urged the District Court to limit the scope of discovery in light of the pending

[14] ROA.524, 527. In its response, TLS argued Illinois law, not Puerto Rico law, governs the MFS Agreement. ROA.550-53. In their Reply Brief, Defendants argued the restrictive covenants in the MFS Agreement are unenforceable regardless of whether Illinois or Puerto Rico law applies. ROA.579.

dispositive motion on TLS' breach of contract claims and TLS' refusal to identify its alleged trade secrets with "reasonable particularity."[15]

C. The District Court Declines to Limit Discovery

Several months later, on November 30, 2016, the Magistrate Judge held a hearing and announced rulings on the pending discovery motions. The rulings were memorialized in an Order entered on December 6, 2016. ROA.1441-44. TLS was ordered to "confirm or supplement" its discovery responses regarding its alleged trade secrets, but the District Court declined to address the applicability of the "reasonable particularity" standard or limit discovery on this basis. *Id.* The District Court also granted TLS' request to inspect the work computers of certain individuals affiliated with CPS, LLC pursuant to an "imaging protocol." ROA.843-50. The imaging protocol established a process for TLS to copy the computer hard drives and search for specific terms that might yield relevant information.[16]

Also, on November 30, 2016, the District Court denied Defendants' Motion for Judgment on the Pleadings. ROA.1420. The District Court believed it would be "more prudent" to defer consideration of Defendant's arguments "until the factual

[15] ROA.1201-06. Defendants' request to limit discovery on this basis was well founded. *See, e.g. DeRubeis v. Witten Technologies, Inc.*, 244 F.R.D. 676 (N.D. Ga. 2007)(holding that a trade secret plaintiff should not be permitted to take general discovery prior to identifying its claimed trade secrets with "reasonable particularity").

[16] ROA.1018-24. TLS proposed 494 search terms, "consisting predominantly of the names of [its] tax consulting clients" and generic phrases such as: "Tax Report." *Id.* The purpose of having search terms was to cull-out irrelevant information archived on the computers.

context surrounding [the restrictive] covenants is fully developed . . ..” ROA.1432. By the time the District Court ruled on the parties’ significant discovery disputes and related motions, this case had been pending for two (2) years.

D. Defendants Comply with the District Court’s Discovery Rulings

After the District Court’s discovery rulings, Defendants timely supplemented their discovery responses and document production. Defendants produced over 50,000 pages of documents, including voluminous ESI, email communications, customer files, marketing materials, tax returns and financial statements. ROA.1446-55, 5681, 6168.

TLS also supplemented its discovery responses and confirmed it had nothing more to add regarding its alleged trade secrets. ROA.6168. Based on its pleadings and discovery responses, the only alleged trade secret identified by TLS is its so-called “Tax Report.” Although TLS describes this document as a “winning playbook,” it is nothing more than a compilation of publicly available information and generic tax planning methods. ROA.1270, 6098, 6105, 6113-18.

In early 2017, counsel for the parties were discussing arrangements for TLS’ vendor to image the email system and computers at CPS, LLC’s office. During this process, Defendants’ counsel learned that Defendants did not have custody, control or possession of the computer utilized by one of CPS, LLC’s independent consultants, David Byrd. Through emails, Defendants’ counsel explained to TLS’

counsel that Byrd is not Defendants' employee and that Defendants did not have access to or maintain his computer. ROA.1484-1502. TLS filed an Emergency Motion to Compel, demanding access to Byrd's computer. ROA.1456. Ultimately, this dispute was resolved by Byrd voluntarily allowing TLS' vendor to image his computer at the same time as the others. ROA.1510-11.

The imaging occurred on February 2, 2017. TLS' vendor, Sean McDermott, imaged the emails on CPS, LLC's cloud-based system and the hard drives of the computers utilized by Todd Mardis, Kim Mardis, Donna Carter, David Byrd and a few others. ROA.1553. McDermott furnished his written report to TLS' counsel on or about April 18, 2017. ROA.1547.

E. TLS' Motion for Default Judgment

On June 2, 2017, TLS filed a Motion for Default Judgment based on McDermott's report. ROA.1542. TLS argued Defendants had "systematically destroyed" ESI by deleting files from certain computers and a default judgment was the only appropriate remedy. Due to the technical nature of TLS' motion and the extreme relief being sought, Defendants requested time to conduct discovery and obtain their own expert analysis. ROA.5309.

In their Response, Defendants argued there was no cause to enter a default because TLS had not shown any ESI was permanently "lost" as required by

Fed.R.Civ.P. 37(e).[17] TLS likewise had not shown any prejudice attributable to the absence of any important data or that Defendants intended to deprive TLS of such information.[18] Alternatively, Defendants urged that a default judgment would be too harsh under the circumstances and also noted that less severe sanctions were available, such as additional discovery at their cost and/or adverse inferences. ROA.5672.

In its Reply, TLS raised new and expanded issues in support of its request for a default.[19] This prompted Defendants to file a Motion to Strike, or in the Alternative, for Leave to File Surreply. Because of the seriousness of the accusations and the unwieldy briefing, Defendants requested that the District Court consider TLS' Motion in an evidentiary hearing or as part of the trial. ROA.6043-44. These and other motions remained pending for several months as the trial date approached. ROA.5333, 5721, 6046.

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[17] ROA.5403, 5670-82. Through their own computer expert, Defendants showed duplicate files were backed-up through various systems including emails and Dropbox. ROA.5567-5581. Defendants also showed many of the deleted files had been retrieved through a recovery program. ROA.5679-80.

[18] ROA.5680-81. Defendants argued that, at most, they had been careless by continuing to use and service their work computers during the protracted pendency of this case. ROA.5681-82. McDermott admitted the vast majority of the deleted files were irrelevant "system" files as opposed to "user created" files. ROA.5675-77. McDermott also admitted he did not know whether any of the deleted files could be recovered. ROA.5676.

[19] ROA.5753, 6042-6045. TLS erroneously claimed Defendants were responsible for preserving a computer which, unbeknownst to them, Byrd had replaced and discarded a few weeks before the imaging process. TLS also submitted a post-deposition affidavit from McDermott which was replete with new opinions, exhibits and argumentative commentary. ROA.5856-5950.

F. Without Conducting an Evidentiary Hearing or Considering the Efficacy of Lesser Sanctions, the District Court Grants TLS' Motion for Default Judgment

The trial was scheduled to begin in February, 2018. ROA.30. Because several motions were still pending, Defendants moved for a continuance on January 3, 2018. ROA.6093. On January 29, 2018, the District Court granted TLS' Motion for Default Judgment. ROA.6133. Without explanation, the District Court also terminated all other pending motions "with prejudice," including Defendants' motion which asked for a hearing or alternatively additional briefing on the spoliation issues. ROA.36, 6140-42.

In its Order, the District Court found the following specific acts of "destruction" had occurred:

1. In early 2017, Todd Mardis deleted hundreds of business documents on his computer.
2. In late 2016, Capital Preservation Services financial advisor David Byrd had his corporate computer thrown away after it "crashed."
3. In August 2016, CPS financial director Kim Mardis deleted the user profile on her corporate computer.
4. In September 2016, CPS tax planning director Donna Carter deleted the user profile on her corporate computer. Later that year, Carter also deleted dozens of business documents from that same computer.

ROA.6135. Despite noting that Defendants utilized multiple back-up systems, the District Court found "this destruction" was intentional and caused ESI to be permanently lost. ROA.6136-37. No specific questions were asked about "this

destruction" during any depositions. Nevertheless, the District Court somehow found Defendants' witnesses "swore under oath that [it] did not happen, and that they did not cause it." ROA.6135-36. The District Court did not attempt to determine how "this destruction" actually prejudiced TLS or explain why anything less than the "death penalty" would be insufficient redress.

The most troubling aspect of this ruling is the extent to which the District Court drew adverse inferences in TLS' favor and vilified Defendants in an attempt to justify this extreme sanction. ROA.6133, 6142. On the basis of a scant record and without conducting an evidentiary hearing, the District Court made alarming and unsupported findings of bad faith intent, even insinuating that Defendants could face criminal charges for deploying a "lethal attack on [its] purpose." ROA.6133 at n.2. To drive home its point, the District Court described Defendants as "egregious wrongdoers" who deserved to be severely punished. The District Court summarized the basis for its ruling, as follows:

> Defendants knew that they had data relevant to this lawsuit, and spent years resisting discovery. Resistance failing, they systematically destroyed places that data was stored. Defendants took extraordinary steps to disguise that destruction, including **lying under oath** and permanently erasing data. This is more than ordinary wrongdoing. It is unacceptable**. It is an assault on this Court's ability to find truth and do justice.**

ROA.6142 (emphasis added).

G. Defendants' Motion for Reconsideration

On February 23, 2018, Defendants filed a Motion for Reconsideration, urging the District Court to vacate the default judgment sanction. ROA.6147. Defendants argued this sanction deprived them of due process because it was unjust and excessive in relation to the alleged discovery violation. ROA.6173-79. Defendants also argued the District Court's predicate findings were clearly erroneous and not supported by the record. Specifically, there was no evidence that Defendants "spent years resisting discovery," "systematically destroyed" data or "lied" under oath about "this destruction." In addition, Defendants argued the District Court erred by failing to conduct an evidentiary hearing and by failing to consider the efficacy of lesser sanctions. ROA.6180-90.

H. Defendants' Motion for Recusal

On February 28, 2018, Defendants filed a Motion for Recusal of the District Court Judge. ROA.6201. Defendants argued the District Court's inflammatory and underserved comments exhibited bias, requiring disqualification under 28 U.S.C. § 455. By describing Defendants as "egregious wrongdoers" who had "assaulted [its] ability to find truth and do justice," the District Court crossed the line and revealed such a high degree of antagonism that a reasonable observer would question its ability to conduct further proceedings in a fair and impartial manner. ROA.6204-10.

I. The District Court's Order Denying Defendants' Motions

On March 22, 2018, the District Court denied Defendants' Motion for Recusal and Motion for Reconsideration. ROA.6261. The District Court declined to recuse because it "was not persuaded its words might reasonably cause an objective observer to question [its] impartiality." ROA.6263-64. The District Court also refused to reconsider the default judgment sanction. Remarkably, the District Court ruled that a due process violation "cannot be used on a motion for reconsideration." ROA.6263.

J. Defendants' Emergency Petition for Writ of Mandamus

In light of these serious issues, which would taint the fairness of a trial and any final judgment, Defendants filed an emergency petition for writ of mandamus seeking relief from this Court. ROA.6317, 6348. This Court denied Defendants' petition on March 23, 2018. ROA.6474.

K. The Bench Trial on Damages

The District Court held a bench trial on damages on March 27, 2018, and May 30, 2018. ROA.6610, 6619, 6733, 8680. TLS called one witness, Brent Bersin, who was tendered as a damages expert. ROA.6622. TLS did not present any proof through Bersin or otherwise to show it sustained any actual loss of income or customers as a result of Defendants' alleged conduct. Lacking such proof, TLS asked

the District Court to award "unjust enrichment" damages by disgorging the profits and/or revenue of CPS, LLC and MFS.[20]

TLS sought to disgorge 100% of the "consideration collected" by CPS, LLC as liquidated damages for breaching the two (2) year restrictive covenants contained in the CPS Agreement.[21] TLS also sought to disgorge 150% of the "fees collected" by MFS as liquidated damages for breaching the one (1) year restrictive covenants contained in the MFS Agreement.[22] In addition, and/or in the alternative, TLS sought to disgorge 100% of the net profits of CPS, LLC and MFS for the period September 2014 to October 2017 as damages for the misappropriation of its alleged trade secrets. After deducting certain "incremental expenses," Bersin calculated this combined amount to be $3,507,718.48. ROA.6657-61, 6671, 7080.

When TLS rested, Defendants moved for a directed verdict. ROA.6718-20. Defendants argued that, because TLS failed to plead "unjust enrichment" as a claim for relief in its Complaint, this was not a proper basis upon which to award damages

[20] ROA.7011, 7029-33. Bersin offered computations for CPS, LLC, MFS and another entity called Capital Preservation Agency, LLC ("CPA"). ROA.7081. CPA is a wholly owned subsidiary of MFS and is the entity through which Mardis conducts his insurance business. ROA.6761. CPA is not a party, and during the trial, TLS withdrew any claim for damages based upon CPA's revenues or profits. ROA.6633-34, 6650.

[21] ROA.6674-75, 7058, 7081. The CPS Agreement contains a liquidated damages provision, stating that, in the event of a breach, TLS shall, "in addition to all other remedies," be entitled to receive any "consideration collected by Advisor..." ROA.78.

[22] ROA.6677-78, 7081. The MFS Agreement contains a liquidated damages provision, stating that, in the event of breach, TLS shall, "in addition to all other remedies," be entitled to receive "150% of all fees collected by Subcontractor . . ." ROA.86.

under the MUTSA stemming from a default judgment. ROA.6718. Defendants also argued the liquidated damages provisions in both contracts were unenforceable penalties. ROA.6719. The District Court denied Defendants' motion. ROA.6722.

L. The District Court's Findings of Fact and Conclusion of Law and Final Judgment

The District Court entered its Findings of Fact and Conclusion of Law and Final Judgment on August 3, 2018. ROA.6551. As a consequence of the default judgment sanction, the District Court deemed TLS' Complaint allegations to be conclusively established. ROA.6552.

Although the District Court deemed Defendants liable on all of TLS' claims, its award was confined to the trade secrets claim.[23] The District Court awarded "unjust enrichment" damages against Defendants, jointly and severally, based on Bersin's computation of the profits of CPS, LLC and MFS, totaling $3,507,718.48.[24] The District Court assessed prejudgment interest in the amount of $516,945.54 based on an interest rate of 8% and a period of 652 days.[25] The District Court also awarded

[23] ROA.6572-75. The District Court noted that, because TLS' claims overlapped, it could not receive a "double recovery." The District Court also ruled the liquidated damages provision in the MFS Agreement was unenforceable as a penalty. ROA.6575-76.

[24] ROA.6568-69, 6576-77, 6583.

[25] ROA.6577-78. The District Court established the "start date" as the date the Complaint was filed, November 13, 2014. A total of 1,379 days elapsed between the filing of TLS' Complaint and the Final Judgment. The District Court excluded 707 days from its prejudgment interest computation which it ascribed to the time it took to rule on pending motions. ROA.6579.

punitive damages of $100.00. ROA.6577. In addition to monetary damages, the District Court permanently enjoined Defendants "from (1) using, disclosing, transmitting or possessing any versions or derivations of TLS' Tax Report and (2) linking their business activities to TLS or otherwise misrepresenting their affiliation with TLS." ROA.6580-81. Finally, the District Court ruled TLS was entitled to recoup its reasonable attorneys' fees.

On July 2, 2018, TLS filed a Motion seeking attorneys' fees and costs in the amount of $2,773,374.16. ROA.6250. Defendants have filed a response in opposition, contending the amount sought is outrageously excessive and unsupported. ROA.6533. The District Court has not yet ruled on this motion.

SUMMARY OF THE ARGUMENT

The District Court's rulings should be vacated because its findings as to the existence of federal subject matter jurisdiction are unsupported and otherwise erroneous. Even if it had subject matter jurisdiction, the District Court abused its discretion by failing to place reasonable limits on discovery and by failing to consider Defendants' dispositive motions which raised important threshold issues. After repeatedly deferring consideration of Defendants' challenges, the District Court imposed a default judgment against Defendants as a discovery sanction. This extreme sanction cannot stand because it is based on clearly erroneous findings and fails to comport with due process.

The Final Judgement awarding damages and other relief to TLS must be vacated because it is predicated on an invalid default judgment sanction and tainted by the District Court's demonstrated bias. Even if this Court finds no abuse of discretion regarding the sanction and recusal issues, the Final Judgment must be vacated because it is based on clearly erroneous findings of fact and conclusions of law. The District Court clearly erred in awarding "unjust enrichment" damages, prejudgment interest and a permanent injunction because TLS did not request such relief in its Complaint as required by Fed.R.Civ.P. 54(c). Even if TLS properly raised such claims, the District Court based its award on clearly erroneous assessments of the evidence.

ARGUMENT

A. Subject Matter Jurisdiction Does Not Exist

The District Court's findings as to the existence of federal subject matter jurisdiction are unsupported and otherwise erroneous. Therefore, this Court should vacate the District Court's rulings and dismiss this action.

1. Standard of Review

The question of a federal court's subject matter jurisdiction may be raised at any time, including for the first time on appeal. *Nguyen v. Director,* 400 F.3d 255, 260 (5th Cir. 2005). A district court's determination of subject-matter jurisdiction is generally reviewed *de novo. Williams v. Wynne,* 533 F.3d 360, 364–65 (5th Cir. 2008).

2. Diversity Jurisdiction

The District Court found it had subject matter jurisdiction under 28 U.S.C. § 1332 "as the parties are diverse and the amount in controversy exceeds $75,000." ROA.6553. As to the citizenship of the parties, the District Court found that "TLS is a Puerto Rico business," that Mardis "is a Mississippi resident" and that CPS and MFS "list their principal places of business in Mississippi." *Id.* These findings are inadequate to establish the existence of diversity jurisdiction because two (2) of the parties, TLS and CPS, LLC, are limited liability companies.

The citizenship of a limited liability company is determined by the citizenship of each and every one of its members. *Harvey v. Grey Wolf Drilling Co*, 542 F.3d 1077, 1080 (5th Cir. 2008); *see Bank of America, N.A. v. Fulcrum Enterprises, LLC,* 334, 335 (5th Cir. 2016)(noting the plaintiff must specifically plead the identity and citizenship of the members). Here, TLS' Complaint does not plead the identity or citizenship of its members or the members of CPS, LLC. ROA.48. The failure to affirmatively and distinctly plead this information "mandates dismissal."[26]

3. Federal Question Jurisdiction

In a terse footnote, the District Court stated it also had federal question jurisdiction based on TLS' claim against CPS, LLC under the Lanham Act. ROA.6553 n.8. Under the well-pleaded complaint rule, federal question jurisdiction only exists when "there appears on the face of the complaint some substantial, disputed question of federal law." *Carpenter v. Wichita Falls Indep. School Dist.*, 44 F.3d 362, 366 (5th Cir. 1995). A claim purporting to invoke federal law will not support subject matter jurisdiction "if it is not colorable, *i.e.,* if it is immaterial and made solely for the purpose of obtaining jurisdiction or is wholly insubstantial and frivolous." *Arbaugh v. Y & H Corp*., 546 U.S. 500, 513 n. 10 (2006). The allegations of TLS' Complaint are insufficient as a matter of law to establish a colorable claim

[26] *Stafford v. Mobil Oil, Corp.*, 945 F.2d 803, 804 (5th Cir. 1991). During the course of the proceedings below, TLS had actual notice that its jurisdictional allegations were insufficient and deliberately decided not to plead the required information. ROA.1191-92.

under the Lanham Act. Accordingly, this claim does not support the existence of federal question jurisdiction.

It is nearly impossible to decipher the vague allegations supporting TLS' Lanham Act claim. TLS apparently claims that the use of the client testimonials from C.H. and D.H. violated the Lanham Act, not because they disparaged TLS, but because they lauded the services of CPS, LLC.[27] TLS alleges that these advertisements were potentially misleading and confusing because C.H. and D.H. were TLS' clients and received tax planning services while Mardis was affiliated with TLS.[28] Even if these allegations are presumed to be true, TLS has not presented a colorable claim under the Lanham Act.

TLS failed to plead or prove any facts showing it has Article III standing to pursue relief under the Lanham Act. If a plaintiff lacks Article III standing, then a federal court lacks jurisdiction to hear the complaint.[29] The party invoking federal jurisdiction bears the burden of establishing the three familiar elements of Article III standing: injury in fact, causation, and redressibility. *McConnell v. Fed. Election*

[27] TLS' Complaint does not attach copies of the testimonials or state with specificity the laudatory comments made about CPS, LLC. ROA.68-9.

[28] In their Motion for Summary Judgment on this claim, Defendants presented proof (which TLS never rebutted) that both C.H. and D.H. were Mardis' clients prior to his affiliation with TLS. ROA.314.336-37.

[29] *Grant ex rel. Family Eldercare v. Gilbert,* 324 F.3d 383, 386 (5th Cir. 2003); *Cobb v. Central States,* 461 F.3d 632, 635 (5th Cir. 2006)(noting the issue of standing is one of subject matter jurisdiction).

Comm'n, 540 U.S. 93 (2003). To show injury in fact, the plaintiff must demonstrate an injury that is "concrete, distinct and palpable, and actual or imminent." *Delta Commercial Fisheries Ass'n v. Gulf of Mexico Fishery Management*, 364 F.3d 269, 272-73 (5th Cir. 2004).

TLS' Complaint vaguely alleges in conclusory fashion that as result of these advertisements it has suffered "irreparable harm to its goodwill and customer relationships." ROA.70. TLS provides no details concerning the nature or extent of its alleged injury. Nor does TLS explain how the advertisements, which do not mention TLS or its services, harmed or could cause harm to its business.[30]

The Supreme Court has indicated that Article III standing under the Lanham Act requires substantially more than what TLS alleges. To state a colorable claim, the plaintiff must first plead and then prove "an economic or reputational injury flowing directly from the deception wrought by the defendant's advertising; and that occurs when deception of consumers causes them to withhold trade from the plaintiff." *Lexmark Intern., Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 133 (2014). TLS' Complaint fails to meet this test because it does not allege that any customer actually withheld trade from TLS as a direct result of seeing these

[30] Positive statements made about the defendant's services or products fall into the category of "puffery" and are not actionable under the Lanham Act. *See Lipton v. Nature Co.*, 71 F.3d 464, 474 (2d Cir. 1995).

advertisements.[31] Moreover, because TLS failed to offer any such evidence at trial, the District Court found TLS failed to prove any injury "traceable to [any] deceptive advertising practices."[32] As this finding confirms, TLS never had Article III standing to assert a claim under the Lanham Act.

To state a colorable claim under the Lanham Act, the plaintiff must also plead and prove a specific violation having a substantial effect on interstate commerce. There is no jurisdiction under the Lanham Act unless the interstate commerce requirement is satisfied. 15 USCS § 1125(a); s*ee Highmark, Inc. v. UPMC Health Plan, Inc*. 276 F.3d 160, 165 (3rd Cir. 2001). Here, TLS failed to plead or prove that these advertisements had a substantial effect on interstate commerce.[33] For this additional reason, there is no federal question jurisdiction under the Lanham Act.

B. The Default Judgment Sanction Should Be Vacated

1. Standard of Review

A district court's decision to impose a default judgment as a sanction is reviewed for abuse of discretion. Any factual determinations underlying that

[31] TLS' Complaint falsely suggests that D.H. and C.H. did not authorize CPS, LLC to use their testimonials. Even if true, these allegations are insufficient to confer standing based on any alleged injury to TLS. TLS' Complaint does not allege that D.H. or C.H. withheld trade from TLS.

[32] ROA.6573. At the trial stage, the plaintiff can no longer rest on mere allegations, but must present evidence validating its standing. *Ford v. NYLCare Health Plans, Inc.,* 301 F. 3d 329, 332 (5th Cir. 2002).

[33] TLS' Complaint also alleged a state law claim for unfair competition based upon alleged "false advertising." ROA.71.

decision, including a finding of bad faith, are reviewed for clear error.[34] If a district court's predicate findings are based on "an erroneous view of the law or on a clearly erroneous assessment of the evidence, the imposition of the sanction is necessarily an abuse of discretion." *Crowe v. Smith*, 151 F.3d 217, 236 (5th Cir. 1998). Moreover, a district court necessarily abuses its discretion if it imposes a sanction which does not "comply with the mandates of due process." *Timms v. LZM, LLC*, 657 Fed. Appx. 228, 230 (5th Cir. 2016). Because of the seriousness of a default judgment, "even a slight abuse of discretion may justify reversal." *In re Chinese–Manufactured Drywall Prods. Liab. Litig.*, 742 F.3d 576, 594 (5th Cir. 2014).

2. The Default Judgment Sanction is Based on Clearly Erroneous Findings

a. The Findings that Defendants "refused to open their books" and "spent years resisting discovery" are Clearly Erroneous

The District Court attempted to justify its ruling by suggesting Defendants had engaged in litigation misconduct. Specifically, the District Court stated Defendants "refused to open their books" for the first two (2) years of this litigation "despite many reasonable requests from TLS." ROA.6142. The District Court also

[34] *U.S. for the Use of M—CO Constr., Inc. v. Shipco Gen., Inc.*, 814 F.2d 1011, 1013 (5th Cir.1987). Rule 55(c) provides that a district court "may set aside an entry of default for good cause" and "may set aside a default judgment under Rule 60(b)." Thus, a district court's refusal to set aside a default judgment is also reviewed for abuse of discretion. *Lacy v. Sitel Corp.*, 227 F.3d 290, 291–92 (5th Cir.2000).

stated Defendants' "[spent] years resisting discovery." *Id*. The record provides no support whatsoever for these findings.

This case was stayed during the first year pending a ruling on Defendants' initial Motion to Dismiss. ROA.138-140, 228. After the stay was lifted on December 17, 2015, Defendants filed dispositive motions and sought limits on discovery. ROA.237-24,301-17, 349-51. The District Court did not rule on these issues until late 2016 after nearly another year had elapsed. ROA.1420-33. As acknowledged by the District Court, the parties' "discovery battles… escalated in large part" because of this delay. ROA.1421.

From the outset of this litigation, Defendants contended TLS was pursing meritless claims and engaging in "scorched earth" discovery tactics.[35] Defendants had every right to mount a zealous defense, file dispositive motions and "resist" TLS' unreasonable discovery demands by requesting relief from the District Court. Although the District Court ultimately disagreed with Defendants' positions as to the scope of discovery, it never imposed any sanctions on or issued any warnings to Defendants prior to its default judgment ruling.

The District Court's unfair portrayal of Defendants as vexatious and dilatory is particularly troubling in view of its handling of this case. The discovery issues

[35] In addition to seeking onerous discovery from Defendants, TLS served approximately 140 subpoenas on Defendants' clients and business affiliates. ROA.1404.

which escalated and ultimately culminated in the default judgment sanction could have been avoided had the District Court considered the merits of Defendants' Motion for Summary Judgment rather than "dismissing" it out of hand.[36]

The history of this case is strikingly similar to what transpired in *Chudasama v. Mazda Motor Corp.*, 123 F.3d 1353 (11th Cir. 1997). In that case, the district court also failed to address the defendant's early dispositive motion and related requests for limits on discovery. Meanwhile, discovery battles ensued and escalated into accusations of misconduct. The district court ultimately entered a default judgment as a discovery sanction against the defendant.

Describing this situation with clarity, the Eleventh Circuit observed: "This case illustrates the mischief that results when a district court effectively abdicates its responsibility to manage a case involving contentious litigants and permits . . . discovery tactics to run amok." *Chudasama*, 123 F.3d at 1356. "[M]any, if not most, of the [discovery] problems could have been solved had the district court simply ruled" on the defendant's dispositive motion. *Id.* at 1369. Finding the district court abused its discretion, the Eleventh Circuit vacated the default judgment sanction and remanded the case to a different judge. *Id*. at 1367-68; *see also Hathcock v. Navistar Int'l Trans. Corp*., 53 F.3d 36, 40-1 (4th Cir. 1995)(vacating default judgment

[36] ROA.11. *See In re Sch. Asbestos Litig.*, 977 F.2d 792-93 (3d Cir. 1992)(noting that a district court abuses its discretion in failing to consider the merits of a summary judgment motion).

sanction as a clearly excessive abuse of discretion and reassigning case to another judge on remand).

b. The Finding that Defendants "Systematically Destroyed" Data is Clearly Erroneous

After the District Court ruled on the parties' significant discovery disputes, Defendants supplemented their discovery responses and produced over 50,000 pages of documents in electronic and paper format. Defendants also provided TLS access to CPS, LLC email system and the computers it wanted to inspect. Despite these significant efforts, the District Court found Defendants were at the same time "systematically" destroying data. This finding is clearly erroneous and unsupported by the record.

As the District Court acknowledged, the "vast majority" of the deleted data consisted of irrelevant "system files" which Defendants had no duty to preserve. ROA.6135. n.13. While some "user created" files were also deleted, Defendants showed there was no intent to "destroy" information because multiple back-up systems were in use and recovered files were available for inspection. ROA.5567-81, 5679-80.

Completely discounting this evidence, the District Court stated Defendants had to show by clear and convincing evidence "which deleted files were relevant to the case and that "*all destroyed data* was likely backed up." ROA.6136-37. The District Court pointed out several "unanswered" questions it had about the

sufficiency of Defendants' back-up systems and processes. ROA.6137. However, instead of allowing Defendants an opportunity to "answer," the District Court brushed its own questions aside and erroneously inferred bad faith based on the chance that some, unidentified item of data may not have been backed-up. *Id.*

As Rule 37(e) indicates, the mere fact that a data loss has occurred does not establish a party's intent to deprive its opponent of useful information. *See* Fed.R.Civ.P. 37(e), Committee Notes (noting that ESI often exists in multiple locations and loss from one source may be harmless when substitute information can be found elsewhere). Moreover, a party's failure to preserve information may be the result of carelessness or even gross negligence in the handling or safeguarding of ESI. Unless the record clearly suggests bad faith, the trial court should exercise restraint in imposing sanctions, particularly where, as here, the importance of the information was not demonstrated. *Id.* The District Court abused its discretion by presuming bad faith based on the mere possibility that some data may have been permanently lost.

The District Court also erred because it based this finding in large part on the fact that Byrd did not preserve his old computer for imaging. No evidence was presented that Defendants were responsible for preserving this computer or that they were even aware Byrd had discarded it. Nevertheless, the District Court unfairly inferred Byrd had acted in bad faith and imputed this to Defendants.

c. The Finding that Defendants' Witnesses "Lied" About Destroying Data is Clearly Erroneous

The District Court made a remarkable adverse credibility determination against three (3) of Defendants' key witnesses. Specifically, the District Court found that Todd Mardis, his wife, Kim, and Donna Carter "lied" about destroying business data.

After describing the specific acts of "destruction" which had occurred, the District Court made this finding:

> There is no doubt this destruction happened and that Defendants caused it. Todd Mardis, Kim Mardis and Donna Carter all swore under oath that this destruction did not happen, and that they did not cause it. They lied.

ROA.6136. The only support cited by the District Court for these findings is the McDermott report, which mentions this deletion activity, and scant excerpts from the witnesses' depositions taken by TLS' counsel. ROA.6135 n.14. The complete deposition excerpts are set forth below:

Todd Mardis:

Q: Can you explain how and when CPS and MFS preserved documents and information relating to this litigation?

Mr. McCraney: Object to the form

A: I don't understand the question.

Q: Well, when you receive notice—you, CPS and MFS, receive notice of the lawsuit, what steps did you take to preserve information which might be relevant or responsive to the case?

A: I didn't preserve or destroy documents. Nothing changed. I mean, the documents were where they were.[37]

Kim Mardis:

Q: Are you aware of any reason why information or documents would no longer be available that would be responsive to the discovery served by TLS in this case?

A: No

Mr. McCraney: Let me just object to the form.

A: Sorry, No, I don't . . ..[38]

Donna Carter:

Q: Are you aware of any reason why information which would be responsive to the discovery request that TLS has served in this case would no longer be available?

A: No[39]

Based solely on these snippets of deposition testimony, the District Court found these witnesses lied about specific acts of "destruction" and willfully did so to conceal information. With all due respect, no reasonable fact finder could make such a quantum leap, particularly since the witnesses were not asked any direct

[37] ROA.5272-73.

[38] ROA.5274-77.

[39] ROA.5278-79.

questions about deleting files from their computers, McDermott's report or any specific discovery requests.

Without asking about anything in particular, TLS' counsel asked Mardis a vague question about what steps were taken to preserve information "which might be relevant or responsive to the case." Mardis testified he did not do anything out of the ordinary, and his testimony suggests his belief that whatever information was "relevant and responsive" would still be available. He could not lie about deleting files on his computer because he was not even asked about this. Mardis' largely gratuitous statement that "I didn't preserve or destroy documents" is also uncontradicted by any evidence. There was no showing that Mardis "destroyed documents" or that his deposition testimony was untruthful. Even if files were deleted from his computer, this does not mean documents were permanently destroyed. Because there were multiple back-up systems in use, it is just as likely that duplicates existed in more than one location.

The treatment of Kim Mardis and Donna Carter is even worse. Without laying any foundation, TLS' counsel posed a confusing and objectionable question to Kim Mardis about whether she was "aware of any reason" why some information which might be "relevant or responsive" to "the discovery served by TLS" might no longer be available. TLS' counsel asked essentially the same absurdly vague question of Donna Carter. TLS' counsel did not bother to show these witnesses any discovery

requests. Nor did counsel specifically ask these witnesses whether they had deleted any files or "user profiles" from their computers. Despite obvious gaps and confusion in the testimony, the District Court determined that these witnesses deliberately lied about having done these things.

The District Court's findings against these witnesses, which are tantamount to findings of perjury, are completely unsupported and undeserved.[40] Because the default judgment sanction is predicated on these and other clearly erroneous findings, it must be vacated.

3. The Default Judgment Sanction Does Not Comport with Due Process

a. The District Court Erred in Refusing to Consider Defendants' Due Process Challenges

Defendants challenged the District Court's Order on due process grounds through their Motion for Reconsideration. ROA.6147. A motion for reconsideration is both a Rule 59(e) motion to alter or amend a judgment and a Rule 60(b) motion for relief from judgment. *Edward H. Brolin Co, Inc. v. Banning Co., Inc.*, 6 F.3d 350, 353 (5th Cir. 1993). Under either rule, a judgment must be vacated "if the district

[40] Precise questioning is imperative when accusing a witness of lying under oath. *See Bronston v. United States*, 409 U.S. 352, 360 (1972)(reversing perjury conviction based on non-responsive, yet literally true, testimony and noting that the examiner failed to probe further with specific follow-up questions). Even though these witnesses were not asked about Byrd's old computer, the District Court apparently determined that they had lied about "this destruction" as well.

court acted in a manner inconsistent with due process."[41] Once again, the District Court refused to consider the merits of an argument presented by Defendants. Erroneously characterizing this as a "new" argument, the District Court decided not to address whether its Order was consistent with due process. ROA.6263. In any event, this issue is properly before this Court for *de novo* review. *See Anwar v. INS*, 116 F.3d 140, 144 (5th Cir.1997)(noting that due process violations are reviewed *de novo*).

b. The Default Judgment Sanction was Imposed Purely for Punishment Without Adequate Procedural Safeguards

The "initial touchstone" for determining the due process rights of a sanctioned defendant lies in whether the sanction is "civil" or "criminal." *Crowe*, 151 F.3d at 226. If the "primary purpose" of the sanction is to punish the violator for a past violation and "vindicate the authority of the court," the order is viewed as criminal. If, on the other hand, the purpose of the sanction is to coerce compliance or compensate another party for the violation, the order is viewed as civil. *In re Collier*, 582 Fed. Appx. 419, 422 (5th Cir. 2014). This distinction is "crucial" because the discretion to impose punitive sanctions is constrained by heightened due process protections. *Collier*, 582 Fed.Appx. at 422. Such protections include: the

[41] *Callon Petroleum Co. v. Frontier Ins. Co.*, 351 F.3d 204, 208 (5th Cir. 2003). A judgment or order that violates due process is void and must be vacated. *See Bass v. Hoagland*, 172 F.2d 205, 209 (5th Cir. 1949).

presumption of innocence, the beyond a reasonable doubt burden of proof, the right to notice, the right to a hearing, the right to call witnesses, the right to an unbiased judge and the right to jury trial. *Crowe*, 151 F.3d at 218. If the district court fails to provide the "proper procedural protections," the sanction must be vacated as an abuse of discretion. *Collier*, 582 Fed.Appx. at 423.

Here, the default judgment sanction is unquestionably criminal in nature. The District Court expressly stated it was imposing this severe punishment to vindicate what it perceived to be an assault on its purpose. To justify this punishment, the District Court made a finding of bad faith which, in large part, was predicated on a finding tantamount to perjury against Defendants. The sanction necessarily implicated heightened due process concerns, yet the District Court deprived Defendants of proper procedural protections.

Most troubling is the fact that the District Court made factual findings and serious credibility determinations without conducting an evidentiary hearing. *See Oprex Surgery (Baytown), L.P. v. Sonic Automotive Employee Benefit Welfare Benefit Plan*, 704 Fed. Appx. 376, 381 (5th Cir. 2017)(noting "we are troubled by the district court's failure to provide any meaningful opportunity . . . to be heard" before dismissing case as a discovery sanction). While not required in every situation, an evidentiary hearing was necessary in this case not only to determine the appropriate

sanction but also to protect Defendants' due process rights. *See Wyle v. R.J. Reynolds Indus., Inc.*, 709 F.2d 585, 591 (9th Cir. 1985).

c. The Default Judgment Sanction is Unjust and Establishes Claims Unrelated to the Discovery Violation

Even in the context of purely civil sanctions imposed for discovery violations, a district court's discretion is constrained "by the most fundamental safeguard of fairness: the Due Process Clause of the Fifth Amendment." *Serra Chevrolet, Inc. v. General Motors Corp.*, 446 F.3d 1137, 1151 (11th Cir. 2006)(*citing Insurance Corp. of Ireland, LTD., v. Compagnie des Bauxistes de Guinee*, 456 U.S. 694, 707 (1982)). The Due Process Clause imposes two (2) limitations on a district court's discretion to impose sanctions for discovery violations: (1) the sanction must be "just," and (2) the sanction must be specifically related to the particular "claim" for which discovery was being sought. *Chilcutt v. U.S.*, 4 F.3d 1313 (5th Cir. 1993)(citing *Ireland*, 456 U.S. at 707). Discovery sanctions which deprive a litigant from asserting a claim or defense "violate due process when imposed merely for punishment of an infraction that did not threaten to interfere with the rightful decision of the case." *Wyle*, 709 F.2d at 591. That is, due process requires a nexus between the discovery abuse and the particular claim or defense that is to be established as consequence of the sanction. *See Serra*, 446 F.3d at 1151-152.

As to the first due process limitation, a sanction is "just" if it fits the circumstances of the case and sufficiently addresses the conduct at issue. In *Ireland* and *Chilcutt*, the courts found that, although harsh, the sanctions at issue were "just" because aggravating circumstances were present. In both cases, there were specific warnings from the trial court followed by intentional discovery abuses.[42] Here, the default judgment is not "just" because no prior warnings or sanctions precipitated this Order.

Relatedly, the default judgment sanction is unjust because the District Court did not consider the efficacy of lesser sanctions. The Fifth Circuit has instructed district courts to use "the least onerous sanction which will address the offensive conduct."[43] Moreover, the record must reflect that the district court actually gave due consideration to lesser sanctions.[44] Because the District Court's focus was on

[42] *See Ireland*, 456 U.S. at 707-08; *Chilcutt*, 4 F.3d at 1321 (noting that the defendant had been previously warned a default judgment would be entered if the requested information was not produced).

[43] *Gonzalez v. Trinity Marine Grp., Inc.*, 117 F.3d 894, 899 (5th Cir.1997)(reversing dismissal sanction because lesser sanctions were available); *see also Topalian v. Ehrman*, 3 F.3d 931, 937 (5th Cir. 1993) (holding district courts must show "sanctions are not vindictive or overly harsh reactions to objectionable conduct").

[44] *See Callip v. Harris County*, 757 F.2d 1513, 1521 (5th Cir. 1985); *see also Roberts v. Storage and Relocation Svc., Inc.*, 34 Fed.Appx. 962 (5th Cir. 2002)(reversing default judgment sanction because the record did not indicate the court considered any lesser alternative); *Oprex Surgery*, 704 Fed. Appx. at 381 (vacating sanction of dismissal because there was "no indication" the district court considered lesser sanctions).

vindicating its authority and severely punishing Defendants, it did not consider any less drastic sanctions in its Order.

As to the second limitation on sanctions, due process requires the district court to consider what specific information the plaintiff was targeting in discovery and whether a substantial nexus exits between the defendant's failure to produce such information and the particular claim at issue. *See Chilcutt*, 4 F.3d at 1320. Where no such nexus exists, a sanction establishing legal consequences from a failure to produce information is purely punitive in nature and violates due process. *See Ireland,* 456 U.S. at 709 (holding the legal consequence of a discovery sanction must follow from the discovery abuse).

Here, the specific discovery abuse at issue is Defendants' failure to preserve potentially relevant ESI. ROA.6134. In assessing whether the default comports with due process, the first question is--what was TLS seeking to establish through discovery of ESI from Defendants? According to the District Court, TLS was seeking "data about Defendants' business strategies, clients and products" in order to prove its claims. ROA.6134. The District Court ruled that because some of this data may have been lost, TLS was entitled to a default judgment conclusively establishing Defendants' liability on all of its claims. This ruling is illogical and unfair because it foreclosed meritorious challenges to TLS' claims which had little or nothing to do with any data in Defendants' possession.

For example, to prevail on its claim under the MUTSA, TLS had the burden of proving the existence of a "trade secret." To warrant trade secret protection, TLS had to prove its tax planning methods were both unique and secret. *See* Miss. Code Ann. § 75-26-3. Defendants challenged both elements in their Motion for Summary Judgment which the District Court improperly "dismissed" before the discovery issue even arose. ROA.11, 333-36.

It is inconceivable that TLS would need to obtain data from Defendants in order to prove the existence of its own trade secrets. The information necessary to establish this threshold liability issue would be entirely within TLS' possession. As such, the loss of data in Defendants' possession could not possibly threaten the rightful determination of this issue. The default judgment sanction does not comport with due process because it conclusively established the existence of trade secrets purely as a punishment for a discovery violation.[45]

C. The District Court Should Have Recused

1. Standard of Review

Denial of recusal is reviewed for abuse of discretion. *Trevino v. Johnson*, 168 F.3d 173, 178 (5th Cir. 1999). If the District Court should have recused, then any

[45]The default judgment sanction also unfairly foreclosed Defendants' ability to challenge the legal enforceability of the restrictive covenants at issue and to pursue other meritorious defenses having no substantial relationship to the discovery abuse. ROA.6177-79. Because the District Court's award was based on the trade secrets claim, Defendants have confined this argument to that particular claim. However, it applies with equal force to TLS' other claims upon which the District Court found Defendants liable by default.

rulings made after the recusal motion must be vacated. *Republic of Panama v. American Tobacco Co.*, 217 F.3d 343, 347 (5th Cir. 2000).

2. Analysis

The right to trial by an impartial judge is a basic requirement of due process. *In re Murchison*, 349 U.S. 133 (1955). A litigant "is entitled to a trial before a judge who is not biased against him at any point" during the proceedings. *United States v. Holland*, 655 F.2d 44 (5th Cir. 1981).

Under 28 U.S.C. § 455, a district court judge "should disqualify himself if a reasonable person, knowing all the relevant circumstances, would harbor doubts about the judge's impartiality." *See Liteky v. United States*, 510 U.S. 540 (1994). Opinions formed and comments made during the course of judicial proceedings constitute a basis for recusal where "they display a deep-seated favoritism or antagonism that would make fair judgment impossible." *United States v. Landerman*, 109 F.3d 1053, 1066 (5th Cir. 1997) (quoting *Liteky*, 510 U.S at 554). A judge's comments cross this line when they reveal a predisposition that is "wrongful or inappropriate" either because they are "undeserved" or "excessive in degree." *Liteky*, 510 U.S. at 550.

At issue is the District Court's inflammatory characterization of Defendants as "egregious wrongdoers" and liars who assaulted its ability to find truth and do justice. This pre-trial vilification crosses the line into the "deplorable range" because

it reveals such a high degree of antagonism that fair judgment is impossible. *See Andrade v. Chojnacki,*, 338 F.3d 448, 463 (5th Cir. 2003)(noting that judge's derisive comment about character of a witness arguably "[fell] within that deplorable range" established by *Liteky*). The District Court's comments are particularly troubling because they reflect opinions formed outside of the context of a hearing and without live testimony of witnesses.

In his concurring opinion in *Liteky*, Justice Kennedy cited this Court's decision in *Holland*, 655 F.2d at 44 and a Sixth Circuit case, *Nicodemus v. Chrysler Corp.*, 596 F.2d 152 (6th Cir. 1979), as examples of cases where recusal was required. *Liteky*, 510 U.S. at 561 (Kennedy, J., concurring). In *Holland*, a criminal defendant successfully overturned his conviction based on an interaction the trial judge had with the jury during deliberations. When the defendant returned before the same trial judge for a retrial, the trial judge commented that the defendant had "broken faith" with the court by raising his jury interaction as an error on appeal. After a second conviction, the Court reversed and ordered a new trial before a different judge. The Court found that the judge's comment, although made during the course of a judicial proceeding, reflected a bias against the defendant that would cause a reasonable person to question his impartiality. *Holland*, 655 F.2d at 47.

Nicodemus was an employment discrimination case. *Nicodemus*, 596 F.2d at 155-56. The trial judge presided over a preliminary injunction hearing concerning

Chrysler's decision to terminate the plaintiff. During the hearing, the trial judge made disparaging comments about Chrysler—that it was not "worthy of credence by anybody" and was comprised by "a bunch of villains." *Id.* On appeal, the Sixth Circuit found that the remarks were unsupported by the record and that the judge had "overstepped." *Id.* at 156. Because his comments "place[d] into doubt his ability to conduct unbiased future proceedings," the Court reversed the injunction ruling and reassigned the case to a different judge. *Id*. at 157.

The District Court likewise overstepped in this case. The derisive comments about Defendants cannot be described as mere expressions of aggravation or indignation. Rather, they reflect a deep-seated antagonism based on a perception that Defendants launched a "lethal attack on the Court's purpose." ROA.6142. These comments are arguably more serious than the judge's "broken faith" comment in *Holland*. Likewise, the District Court's characterization of Defendants as "egregious wrongdoers" is no different than the vilification of Chrysler in *Nicodemus*. As in those cases, the District Court's comments were "undeserved" and "excessive in degree." *See Liteky*, 510 U.S. at 550.

Based on these comments and the surrounding context, an objective person would reasonably question whether the District Court could fairly reconsider its default judgment sanction and/or conduct a bench trial on damages. An objective person would likewise reasonably question whether the District Court was

predisposed to mete out additional punishment as part of its final default judgment.[46] Even if this were a "close call," any doubts are resolved in favor of disqualification. *Republic of Panama*, 217 F.3d at 347(citing *In re Chevron*, 121 F.3d 163, 165 (5th Cir. 1997)). Accordingly, under *Liteky* and § 455(a), the District Court should have recused.

D. The Final Default Judgment Should be Vacated

1. Standard of Review

Following a bench trial, findings of fact are reviewed for clear error and legal issues are reviewed *de novo*. *Coe v. Chesapeake Exploration, L.L.C.*, 695 F.3d 311, 316 (5th Cir. 2012); *see also* Fed. R. Civ. P. 52(a)(6). A finding "is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Guzman v. Hacienda Records & Recording Studio, Inc.*, 808 F.3d 1031, 1036 (5th Cir. 2015). Even if this Court finds no error regarding the default judgment and recusal issues, the Final Judgment must be vacated.

[46] *See Holland*, 655 F.2d at 46 n. 2 (5th Cir. 1981)(recusal required because district court's negative comments about the defendant displayed a prejudice likely to taint future proceedings). This concern became reality when the District Court awarded a judgment against Defendants which can only be described as additional punishment.

2. The District Court Erred in Awarding Damages Based on an Unpled "Unjust Enrichment" Theory

The MUTSA provides that damages may be based upon the plaintiff's actual losses, the defendant's "unjust enrichment" or a reasonable royalty. *See* Miss. Code Ann. § 75-26-7(1). TLS did not present any proof to show it sustained any actual losses as a result of Defendants' alleged use or disclosure of its Tax Report. The District Court granted TLS' request for "unjust enrichment" damages of $3,507,718.48 based on 100% of the combined profits of CPS, LLC and MFS earned between September 2014 and October 2017. ROA.6567, 7059.

The District Court erred in awarding unjust enrichment damages because TLS did not request this relief in its Complaint. ROA.48. Nowhere in TLS' Complaint does it mention the term "unjust enrichment" or that it is seeking to disgorge profits as damages under the MUTSA. To the contrary, TLS' request for relief on this claim is expressly limited to damages "TLS has suffered" as a result of the alleged misappropriation of its trade secrets. ROA.68. Under Rule 54(c), the District Court was required to confine its award to the specific relief requested in TLS' Complaint.

Rule 54(c) provides that a final judgment by default "must not differ in kind from, or exceed in amount, what is demanded in the pleadings."[47] This Court

[47] Fed.R.Civ.P. 54(c). Importantly, "Rule 54(c) does not differentiate between a default based on a total failure of defendant to appear and a default following an appearance." 10 Charles A. Wright *et al.*, Federal Practice and Procedure § 2663, at 171 (3d ed.1998). In this case, the relevant "pleadings" are the Complaint and the Answer. *See* Fed.R.Civ.P. 7.

recently addressed the appropriate standard for determining the relief which may be awarded upon a default in *Ditech Financial, LLC v. Naumann*, 2018 WL 3492001 at *1 (5th Cir. July 19, 2018). According to *Ditech*, the question is whether the defendant had "meaningful notice, based on the complaint alone, of [their] exposure in the event of default."[48] Based on TLS' Complaint alone, Defendants had no meaningful notice that upon default they might be "jointly and severally" exposed to damages under the MUTSA based on an unjust enrichment theory.[49]

Although the District Court considered TLS' claim for unjust enrichment damages during the trial, this is irrelevant for purposes of Rule 54(c).[50] In *Ditech*, 2018 WL 3492001 at *4, this Court cited with approval the First Circuit's decision in *Hooper-Haas v. Ziegler Holdings, LLC*, 690 F.3d 34 (1st Cir. 2012). As in the instant case, in *Hooper-Haas*, the district court entered a default against the defendant as a sanction and then held a hearing to determine what relief should be

[48] *Ditech*, 2018 WL 3492001 at *3. As this Court noted, based on the relief sought in the complaint, a defendant may decide it is not worth the effort to defend against a particular claim. *Id.* The District Court cited *Ditech* in a footnote but apparently did not appreciate its broader significance. ROA.6578 n.89.

[49] *See Ditech*, 2018 WL 3492001 at *3 (noting it is fundamentally unfair for a court upon default to award relief that is of a different "type and dimension" than what is demanded in the complaint). Damages measured by the actual loss or harm to the plaintiff is an entirely different concept from disgorgement of profits which measures the defendant's gain. *See. e.g. George Basch Co., Inc. v. Blue Coral, Inc.*, 968 F.2d 1532, 1540 (2d Cir. 1992). Moreover, even though TLS' Complaint did not include such a request, the District Court assessed disgorgement damages against Defendants on a joint and several basis. ROA.6576-77.

[50] The unjust enrichment issue was not tried by consent. Defendants objected to this unpled theory of recovery in the pre-trial order and in their directed verdict motion. ROA.8676, 6718.

awarded to the plaintiff. *Hooper-Haas, 690 F.3d at 37.* Following the hearing, in which the defendant participated, the district court granted the plaintiff's request for declaratory relief and monetary damages based on the evidence and arguments presented. *Id.* However, applying Rule 54(c), the First Circuit reversed the damages award because the plaintiff failed to plead such a request in its Complaint. *Id.* at 41. This Court should reach the same conclusion as to the monetary damages awarded by the District Court based upon an unpled unjust enrichment theory.

Even if TLS' claim for unjust enrichment damages is not barred by Rule 54(c), the District Court's award is clearly erroneous. Although the default relieved TLS of its burden to prove a violation of the MUTSA, it did not relieve TLS of its burden to establish the amount of its recovery with reasonable certainty. TLS failed to plead or offer any proof at trial as to the nature and extent of any alleged misappropriation. That is, TLS did not establish how long or frequently Defendants' used its trade secrets. Nor did TLS establish the extent to which the profits of MFS and/or CPS, LLC were connected to the use of its trade secrets.[51] The District Court's award erroneously assumes, without any pleading or proof offered by TLS, that 100% of

[51] Bersin did not analyze this and simply assumed that, but for TLS' trade secrets, MFS and CPS, LLC would have no profits. ROA. 6689-90. The evidence is uncontroverted that MFS did not derive any revenue from tax planning services. ROA.6828.

the profits of CPS, LLC and MFS from 2014 to 2017 were derived solely from TLS' trade secrets.[52]

As a result of these errors, the District Court's award is grossly excessive and unreasonable.[53] This Court should vacate the award and enter a judgment as matter of law assessing TLS' compensatory and exemplary damages at zero. Alternatively, the issue of TLS' recoverable damages under the MUTSA should be vacated and remanded for a new trial.[54]

3. The District Court Erred in Awarding Prejudgment Interest

The District Court awarded prejudgment interest based on Mississippi law.[55] Under Mississippi law, prejudgment interest must be specifically raised in the pleadings or the claim is waived. *See Upchurch Plumbing, Inc. v. Greenwood Utilities Com'n*, 964 So.2d 1100, 1116-117 (Miss. 2007). TLS did not demand

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[52] The District Court did not provide any rationale for assessing unjust enrichment damages based on this three (3) year time period. TLS did not plead or offer any proof as to the basis or reasonableness of this duration.

[53] Indeed, the award constitutes a windfall to TLS in that it nearly equals the fair market value of TLS' entire tax planning business, including the value of its alleged trade secrets. ROA.8181.

[54] If a new trial is ordered on compensatory damages, the question of punitive damages should also be retried. *Pollard v. Turner*, 298 F.3d 421, 424 (5th Cir. 2002). The same goes for the issues of prejudgment interest, attorney's fees and Defendants' joint and several liability which derive from the compensatory damages award.

[55] ROA.6577. *See* Miss. Code Ann. § 75-17-7. An award of prejudgment interest is reviewed under the abuse of discretion standard. *See Liberty Mut. Fire Ins. v. Canal Ins. Co.*, 177 F.3d 326, 338 (5th Cir. 1999).

prejudgment interest in its Complaint. ROA.48, 71-2. Nevertheless, the District Court found TLS' Complaint included a prayer for general relief, and "according to the Fifth Circuit, this "suffices to plead a claim for prejudgment interest." ROA.6578-79 (*citing Fed. Sav. & Loan Ins. Corp. v. Texas Real Estate Counselors, Inc.*, 955 F.2d 261, 270 (5th Cir. 1992)). While this is an accurate statement of the law for non-default judgments, it is not in this context.

In *Silge v. Merz*, 510 F.3d 157 (2d Cir. 2007), the Second Circuit expressly rejected the plaintiff's argument that a general demand for relief was sufficient to plead prejudgment interest in the context of a default judgment. *Silge*, 510 F.3d at 160. The Court reasoned that whatever import such boilerplate had in other contexts, it did not provide meaningful notice of a claim for prejudgment interest as required for a default judgment by Rule 54(c). *Id.* The Fifth Circuit cited *Silge* with approval in *Ditech*, 2018 WL 3492001 at * 4, noting that the failure to request prejudgment interest will "cut-off" any right to obtain such relief upon default. TLS' Complaint did not provide meaningful notice that a default might expose Defendants to an award of prejudgment interest.[56] Thus, under *Ditech* and Rule 54(c), the prejudgment interest award is clearly erroneous and must be vacated.

[56] TLS likewise failed to include prejudgment interest as an issue in the pretrial order. ROA.8676. This Court has previously ruled that a claim for prejudgment interest is waived if omitted from the pre-trial order. *See Lindy Investments, L.P. v. Shakertown Corp.*, 209 F.3d 802, 804 n.1 (5th Cir. 2000).

Even if prejudgment interest was sufficiently pled, TLS is not entitled to such an award. Under Mississippi law, the plaintiff is entitled to prejudgment interest "only if the money due was liquidated and there was no legitimate dispute that the money was owed." *Tupelo Redevelopment Agency v. Abernathy*, 913 So.2d 278, (Miss. 2005). Moreover, "no award of prejudgment interest may rationally be made where the principal amount [due] has not been fixed prior to judgment."[57] Here, TLS' Complaint did not seek a fixed sum as damages, and its right to any recovery was legitimately contested. Because the amount of TLS' recovery was not fixed prior to the final default judgment, the District Court's award of prejudgment interest lacks any rational basis.

The District Court also erred by assessing prejudgment interest on profits which were earned unevenly over a three (3) year period. ROA.6578-79. Though the District Court deducted 770 days from its computation, its award erroneously assumes that all of the profits of CPS, LLC and MFS were fixed and owed to TLS as of November 13, 2014, when the Complaint was filed. *Id.* That is, the District Court applied a compound interest formula to a fixed sum of $3,507,718.48 based on a rate of 8% interest over a time period of 652 days. *Id*. at n.96. Because this

[57] *See Stockstill v. Gammill*, 943 So.2d 35, 50 (Miss. 2006); *Coho Res. v. McCarthy*, 829 So. 2d 1, 19-20 (Miss. 2002); *Warwick v. Matheny*, 603 So.2d 330, 342 (Miss. 1992).

computation is fundamentally flawed, the prejudgment interest award must be vacated.

4. The District Court Erred in Granting a Permanent Injunction

Once again, this aspect of the District Court's judgment violates Rule 54(c) because TLS' Complaint does not request a permanent injunction under the MUTSA. The allegations contained in this section of TLS' Complaint simply note that "injunctive relief" is available under the MUTSA. ROA. 67-8. Nowhere in its Complaint does TLS specifically ask the District Court to enter any form of injunctive relief under the MUTSA or to enjoin the use or disclosure of any alleged trade secrets.

Under the "Prayer for Relief" section of its Complaint, TLS asked the District Court to permanently enjoin Defendants from engaging in certain business activities allegedly prohibited by the contracts at issue. ROA.71-2. Apparently referring to this prayer, the District Court found that TLS' "current request for injunctive relief is overbroad." ROA.6581. This finding should have ended the inquiry and resulted in the denial of any injunctive relief. Nevertheless, the District Court took it upon itself to craft a permanent injunction which TLS did not specifically request and was not supported by any evidence. Because this ruling violates Rule 54(c), it must be vacated.

Even if TLS' Complaint properly requested a permanent injunction under the MUTSA, TLS failed to preserve this issue in the pretrial order. The Pre-Trial Order states only that TLS is seeking compensatory damages, exemplary damages, attorney's fees and costs. ROA.8676. Once entered, the pretrial order controls the course and scope of the proceedings, and "if a claim or issue is omitted from the order, it is waived even if it appeared in the complaint." *Elvis Presley Enterprises, Inc. v. Capece,* 141 F.3d 188, 206 (5th Cir. 1998). Defendants rightly assumed TLS had abandoned any claim for injunctive relief and was pursuing only monetary damages after the default judgment sanction.

Consistent with the pretrial order, the District Court conducted a bench trial on damages only. ROA.6142. There was no notice provided to Defendants that a permanent injunction would also be determined by the District Court. During the trial, nothing was mentioned about injunctive relief. Because Defendants had no meaningful notice of or opportunity to defend against this claim, the permanent injunction must be vacated.

CONCLUSION

For these reasons, the District Court's rulings should be vacated. This case should be dismissed for lack of subject matter jurisdiction, or in the alternative, remanded to a different District Court judge for further consideration and findings.

RESPECTFULLY SUBMITTED this the 6th day of November, 2018.

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CERTIFICATE OF SERVICE

I certify that this Brief of Defendants-Appellants was filed electronically on November 6, 2018, causing an electronic copy of the brief to be served on each of the individuals or entities below via electronic mail on November 6, 2018.

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CERTIFICATE OF COMPLIANCE

Counsel for Defendants-Appellants certify that this document complies with the word limit of Fed. R. App. P. 21(d)(1) because, excluding the parts of the document exempted by Fed. R. App. P. 32(1) and Fed. R. App. P. 21(d) this document contains 12,352 words.

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