No. _____

In The
Supreme Court of the United States

EDWARD MANDEL,

Petitioner,

v.

STEVEN THRASHER AND JASON COLEMAN,

Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

After a full trial, the bankruptcy court rejected as unreliable the evidence purporting to assert a "lost-asset" model of damages in a trade-secret misappropriation case. After the Fifth Circuit asked it to clarify how it had calculated the $1 million damages given the rejection of the lost-asset model, the bankruptcy court did an about face. It suddenly embraced the lost-asset model, even though it did not receive any additional expert evidence that would have cured the flaws of the model that the bankruptcy court had already identified. The bankruptcy court reaffirmed the $1 million award, and a divided panel of the Fifth Circuit affirmed. Because the panel affirmed the $1 million trade-secret-damages award—an amount that the dissent below called "pie-in-the-sky damages" that were not "grounded…in theory [or] fact," [App. 28]—the majority opinion declined to substantively review the damages on other causes of action that it determined were subsumed in that award, even though substantive review of each damage award will be necessary if any award is deemed non-dischargeable under the Bankruptcy Code.

Accordingly, the questions presented are the following:

1. Where, without an intervening change in the law or the evidentiary record, the trial court subsequently adopted damages models and evidence that it had previously rejected in this

trade-secret case, should this Court summarily vacate the judgment below with directions to require the court to calculate a reasonable royalty instead?

2. Where the court of appeals below did not substantively review all damages awarded, should the Court grant, vacate, and remand with instructions to perform a full review of all damages awarded?

PARTIES TO PROCEEDING

The parties to the judgment under review are the following:

Jason Scott Coleman

Law Offices of Mitchell Madden

Maddensewell L.L.P.

Edward Mandel

Milo H. Segner, Jr. (bankruptcy trustee)

Steven Thrasher

White Nile Software, Inc.

CORPORATE DISCLOSURE STATEMENT

Petitioner Edward Mandel is a natural person.

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OPINIONS BELOW

This Petition involves an affirmance following a prior remand from the Fifth Circuit.

With respect to the judgment under review, the Fifth Circuit's opinion is available at *Mandel v. Thrasher*, 720 Fed. Appx. 186 (5th Cir. 2018). The panel's April 2, 2018 denial of the motion for rehearing is not available online. The district court's opinion is available at *Mandel v. Thrasher*, No. 4:15-cv-715, 2016 U.S. Dist. LEXIS 176096, 2016 WL 7374428 (E.D. Tex. Dec. 20, 2016). And the bankruptcy court's opinion is available at *In re Mandel*, No. 10-bk-40219, 2015 Bankr. LEXIS 3310, 2015 WL 5737173 (E.D. Tex. Sep. 30, 2015), while its opinion on reconsideration is available at *In re Mandel*, No. 10-bk-40219, 2016 Bankr. LEXIS 917, 2016 WL 1178441 (E.D. Tex. Mar. 23, 2016).

With respect to the prior proceedings, the Fifth Circuit's opinion ordering a remand is available at *Mandel v. Thrasher*, 578 Fed. Appx. 376 (5th Cir. 2014). The district court's original opinion is available at *Mandel v. Thrasher*, 4:11-cv-774, 2013 U.S. Dist. LEXIS 93175, 2013 WL 3367297 (E.D. Tex. July 3, 2013). And the bankruptcy court's original opinion is available at *In re Mandel*, No. 10-bk-40219, 2011 Bankr. LEXIS 3829, 2011 WL 4599969 (E.D. Tex. Sep. 30, 2011).

All the foregoing opinions have been reproduced in the appendix to this petition.

JURISDICTION

The bankruptcy court had jurisdiction to consider the bankruptcy petition, including the resulting claim against Mr. Mandel, and the U.S. District Court for the Eastern District of Texas had jurisdiction to review the bankruptcy court's judgment. 28 U.S.C. §§ 151, 158, 1334.

The U.S. Court of Appeals for the Fifth Circuit had jurisdiction to decide the appeal below. 28 U.S.C. § 158.

This Court has jurisdiction to review the judgment of the U.S. Court of Appeals for the Fifth Circuit. 28 U.S.C. § 1254.

CONSTITUTIONAL AND STATUTORY PROVISIONS

"A person who commits theft is liable for the damages resulting from the theft." Tex. Civ. Prac. & Rem. Code § 134.003(a).

* * *

"[A] person who has sustained damages resulting from theft may recover… from a person who commits theft, the amount of actual damages found by the trier of fact and, in addition to actual damages, damages awarded by the trier of fact in a sum not to exceed $1,000…." Tex. Civ. Prac. & Rem. Code § 134.005(a)(1).

STATEMENT OF THE CASE

This Petition arises out Edward Mandel's bankruptcy in the Eastern District of Texas.

Among the claims presented for allowance was that of Steven Thrasher, who co-founded White Nile Software, Inc., along with Mr. Mandel. They thought that the internet start-up would be a profitable search-engine company, like Google. But the co-founders fell out shortly after they started working together. Mr. Mandel misappropriated White Nile's trade secrets, Mr. Mandel unsuccessfully tried to use them in his newly formed rival company called NeXplore Technologies, Inc., and litigation ensued that was stopped by Mr. Mandel's bankruptcy.

Also included among the claims was that of Jason Coleman, who was brought in as a consultant, and compensated with an equity stake in White Nile and a salary.

After White Nile, Mr. Thrasher, and Mr. Coleman filed claims in the bankruptcy case that mirrored their state-court claims, the bankruptcy court conducted a trial and found Mr. Mandel liable for six Texas-law causes of action: theft of trade secrets, breach of contract, breach of fiduciary duty, fraudulent inducement, oppression of shareholder rights, and conspiracy. Mr. Mandel's liability on those causes of action is not in dispute. What is in dispute is the $1 million in damages that the bankruptcy court found

that Mr. Mandel had caused Mr. Thrasher and the $400,000 awarded to Mr. Coleman.

I. The Bankruptcy Court Rejects as a Matter of Fact Every Damage Model but Still Awards Damages.

Following its trial, the bankruptcy court issued lengthy factual findings.

NeXplore, to whom Mandel gave the misappropriated White Nile trade secrets, never monetized those secrets or made a profit from them. [App. 244 ¶ 96, App. 249 ¶ 108]. Nevertheless, Mr. Thrasher and Mr. Coleman (and White Nile) sought many millions of dollars in damages for misappropriation and lost profits.

As to methods of calculating damages for misappropriation, the bankruptcy court noted that both Mr. Thrasher and Mr. Coleman advocated a lost-asset theory, meaning a recovery equal to what a hypothetical buyer would have paid to purchase the misappropriated intellectual property. [App. 240 ¶ 85]. In support of that model, Mr. Thrasher and Mr. Coleman proffered the expert testimony of Brad Taylor. He calculated the lost-asset to have been worth $56 million, a figure that he derived by comparing valuations for other start-up companies in the relevant period. [App. 241 ¶ 87].

The bankruptcy court was, however, "not persuaded" with Mr. Taylor's analysis. [*Id.*]. His analysis

was flawed because he did not "account for the extremely high failure rate of companies like White Nile." [App. 241 ¶ 87].

The bankruptcy court also found unpersuasive the other damages models that Mr. Thrasher and Mr. Coleman adduced.

Despite its express rejection of every damages model that had been presented, including that of so-called "lost profits," the bankruptcy court awarded $1 million to Mr. Thrasher, $400,000 to Mr. Coleman, $300,000 to White Nile, and more than $1.75 million in attorney's fees.

II. The District Court Affirms the Damages Award.

On appeal, the district court reviewed the bankruptcy court's order. With respect to the damages, the district court agreed with the bankruptcy court that Mr. Taylor's expert testimony was "not a particularly helpful approach in assessing damages under the facts of this case." [App. 175 (quotation omitted)]. Nonetheless, it affirmed the $1 million award to Mr. Thrasher and the $400,000 to Mr. Coleman.

III. The Fifth Circuit Vacates and Remands for the Bankruptcy Court to Explain Its Damage Award.

While the Fifth Circuit affirmed the finding of liability, the Fifth Circuit vacated the award of damages. It did so because "Thrasher and Coleman were required to produce enough credible evidence to show the extent of the damages as a matter of just and reasonable inference, even if the result be only approximate. From the bankruptcy court's opinion we do not see an approximation—only numbers chosen by the court." [App. 142]. It remanded so that the bankruptcy court could either receive new evidence or else better explain its basis for calculating damages on the existing record. [App. 144].

The original appeal also included a cross-appeal from Mr. Thrasher and Coleman, arguing for a greater award of damages on the record. Unlike for Mr. Mandel, the Fifth Circuit expressly denied any relief on that cross-appeal. [App. 144].

IV. Without Receiving any New Evidence, the Bankruptcy Court Accepts as a Matter of Fact the Damage Model and Evidence that It Had Previously Rejected as Unreliable.

On remand, the bankruptcy court elected to better explain its damage award rather than receive any new evidence. It again expressed deep concerns about whether the lost-asset was worth anything. As the bankruptcy court explained, "[a]t the time Mandel

misappropriated White Nile's trade secrets, the search engine had not been developed beyond the alleged 'prototype' stage. Neither White Nile nor NeXplore developed a useable product that could be brought to market." [App. 107]. And while start-up companies "succeed only if their executive team is capable of transforming an idea into a viable business[,] White Nile's executive team did not have this ability." [App. 107]. Further, the bankruptcy court found that "White Nile was having difficulty raising the funds necessary for development costs in sufficient time to beat competitors. White Nile's dysfunctional executive team meant it was never a highly valuable company." [App. 110]

Despite continuing dissatisfaction with Mr. Taylor's analysis, the bankruptcy court explained that Mr. Taylor had found 34 comparable companies (albeit without controlling for risk of failure), valued at between $1 million and $344 million. [App. 108]. The bankruptcy court found that on a lost-asset theory, White Nile's value was "closest" to the low end of Mr. Taylor's range. [App. 110]. It did not explain how low—possibly even approaching zero—that a proper valuation range from Mr. Taylor would have gone.[1] And despite previously noting that more than 80% of companies like White Nile fail, the bankruptcy court nevertheless reverted to Mr. Taylor's range, which

[1] After its decision, the bankruptcy court entered an order on reconsideration addressing damages to White Nile. Those damages are not at issue in this Petition.

had only included successful companies. The bankruptcy court ultimately again awarded damages of $1 million for Mr. Thrasher.

The bankruptcy court used a reasonable royalty method for Mr. Coleman, awarding him $400,000 based largely upon the salary contract from White Nile.

Because it said that the damages on the other theories beside misappropriation were subsumed within the misappropriation award, the bankruptcy court did not separately explain those other damage calculations.

V. The District Court Affirms the Damage Award to Mr. Thrasher and Mr. Coleman.

The district court affirmed the bankruptcy court's re-award of $1 million to Mr. Thrasher and $400,000 to Mr. Coleman. [App. 70].

With respect to the misappropriation award to Mr. Thrasher, the district court held that "[b]y taking into account White Nile's high chance of failure and dysfunctional team in choosing a value within Mr. Taylor's range of values, contrary to Mandel's contentions, the bankruptcy court did not merely pick a number." [App. 60].

Like the bankruptcy court, the district court did not separately evaluate the amount of damages under

other theories that were subsumed within the $1 million misappropriation award to Mr. Thrasher or the $400,000 to Mr. Coleman.

VI. A Sharply Divided Panel of the Fifth Circuit Affirms Without Reviewing All the Claims, Even Though Not All Claims May Be Eligible for a Discharge in Bankruptcy.

In a 2-1 decision, a panel of the Fifth Circuit affirmed, with Judge Elrod in dissent. The majority was not troubled by the bankruptcy court's about face in accepting Mr. Taylor's lost-asset damages model. The majority asserted that because the bankruptcy court's prior order had been vacated, the court was free to change its mind and accept a number at the low end of the previously rejected range. [App. 12]. Accordingly, the majority affirmed the $1 million damage award to Mr. Thrasher on misappropriation grounds. And having affirmed that award, the majority found that there was "no need" to review the damage award to Mr. Thrasher "for fraud, breach of contract, and breach of fiduciary duty," for those damages were subsumed within the misappropriation award. [App. 14].

As for the damages to Mr. Coleman, the majority affirmed the $400,000 award for misappropriation of trade secrets, which was calculated using a reasonable-royalty method. [App. 15]. And having affirmed the damages on that basis, the majority likewise found "no need to address" the damages awarded for "fraudulent inducement and conspiracy," which were

subsumed within the misappropriation damages. [App. 15].

Judge Elrod explained the problems with the majority's affirmance of the bankruptcy court's decision to now accept a lost-asset model for damages:

> Simply because the bankruptcy court was not bound by that prior finding does not mean that any evidentiary defects that led the court to reject the lost asset theory were suddenly remedied. The fact that we held that Thrasher and Coleman suffered some damages did not transform a theory for which there was no rational relation to the evidence into a basis for the award of damages. *See Mandel I, 578 F. App'x at 391*. The lost asset theory is not an appropriate damages model here where the technology is not yet functional and the potential profitability of the company is purely speculative. *See Carbo*, 166 F. App'x at 724.
>
> The majority opinion contents itself with the bankruptcy court's about-face by stating there was a "reasonable explanation for choosing a number at the lower end of the expert's testimony" and that the failure rate of comparable companies was accounted for in that analysis. Even assuming, *arguendo*, that the lost asset damages model is appropriate to use here, this

logic fails to account for the inherently speculative nature of selecting a value for White Nile anywhere within Taylor's range. Taylor's valuation range only relied on data for successful companies and did not account for the specific risks of White Nile failing. *See Mandel v. Thrasher*, 2013 WL 3367297 at *10. That risk cannot be factored into the analysis on the back-end simply by picking a number at the low end of the range. These risk factors, as the bankruptcy court recognized, were significant: there was "the dysfunctional executive team, the lack of a functional product, NeXplore's abandonment of its efforts to create its own search engine, and the lack of profits by White Nile and NeXplore." *In re Mandel*, No. 10-40219, 2015 WL 5737173 at *8. Simply because an expert creates a value range of technology companies does not necessitate that the value of the company at issue falls within that range.

White Nile, based on its specific risk factors, could have been valueless. Taylor's model assumes the ability to get a product to market and secure the backing of investors. The evidence presented at trial makes it doubtful that White Nile would do so. Puzzlingly, the bankruptcy court

> seemed to acknowledge this, even on remand, stating that: White Nile's executive team was not "capable of transforming an idea into a viable business" and "even before the misappropriation occurred, White Nile was having difficulty raising the funds necessary for development costs in sufficient time to beat competitors." *Id.* The evidence here did not support an award of damages anywhere within Taylor's value range as a matter of just and reasonable inference. This was speculation all the way down.

[App. 22-24].

REASONS FOR GRANTING THE PETITION

I. This Court Should Summarily Vacate the Judgment Below and Remand with Instructions to Calculate a Reasonable Royalty to Determine the Damages Allowable to Mr. Thrasher.

Although the state-law questions involved in this appeal normally would not merit *certiorari*, this Court will intervene when a court of appeals "has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's supervisory power." U.S. Sup. Ct. R. 10(a). This case presents such a need for this Court's supervisory power. A summary disposition is appropriate. *See, e.g.*, *Maryland v. Dyson*, 527 U.S. 465, 467 n.1 (1999) ("[A] summary reversal does not decide any new or unanswered question of law, but simply corrects a lower court's demonstrably erroneous application of federal law.").

Where, as here, a federal court adjudicates a state-law cause of action, "the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court." *Guaranty Trust Co. v. York*, 326 U.S. 99, 109 (1945). The Fifth Circuit normally adheres to that rule. *E.g.*, *Bear Ranch, L.L.C. v. Heartbrand Beef, Inc.*, 885 F.3d 794, 804, (5th Cir. 2018) ("Our effort is an attempt to predict state law, not to create or modify it." (quotation

omitted)); *Mem'l Hermann Healthcare Sys. v. Eurocopter Deutschland*, 524 F.3d 676, 678 (5th Cir. 2008) ("Appellants carry a heavy burden to assure us that we would not be making law because the Texas Supreme Court would likely recognize their proposed exception."). But not so here.

Unlike the panel below, the Texas Supreme Court would not have affirmed an award—on the present record—based on a "lost asset" theory. Under Texas law, "a measure of uncertainty is tolerated [in trade-secret cases], and to an extent, unavoidable. However, when there is objective evidence from which more certainty can be gleaned, it is incumbent on the plaintiff to produce that evidence." *Sw. Energy Prod. Co. v. Berry-Helfand*, 491 S.W.3d 699, 720 (Tex. 2016) (remanding for new trial where plaintiff failed to adduce "readily ascertainable" evidence).

Here, the evidence presented at trial was insufficient to authorize resort to a lost-asset theory. Indeed, as Judge Elrod correctly noted in her dissent below, "[i]f the lost asset theory was viable based on the evidence from the original trial, [the Fifth Circuit] could have affirmed the award of damages on that basis [in *Mandel I*]." [App. 21]. Simply too many gaps existed in the evidence given that Mr. Taylor's valuation model, according to the bankruptcy court's original opinion, "fail[ed] to adequately account for the extremely high failure rate of companies like White Nile," [App. 241 ¶ 87], and the record evidence of NeXplore's value "is, at best, fuzzy," [App. 242 ¶ 90]. Thus,

the bankruptcy court, in its original order, specifically and correctly held that the lost-asset theory "was "not helpful for determining damages based on the facts of this case." [App. 243 ¶ 93].

On remand—without having received any evidence that could have potentially corrected for the gaps in the evidence—the bankruptcy court invoked the lost-asset model to justify the $1 million damage figure that it had originally awarded. While the bankruptcy court was free to re-assess damages, the flaws that the bankruptcy court identified originally remained. Indeed, as Judge Eldrod noted in her dissent, "White Nile, based on its specific risk factors, could have been valueless." [App. 24]. As the bankruptcy court continued to acknowledge on remand, start-up companies succeed "only if their executive team is capable of transforming an idea into a viable business. [But] White Nile's executive team did not have this ability." [App. 109]. Even on remand, the bankruptcy court conceded that the expert testimony that the claimants had submitted in support of their damages claims was flawed: Mr. Taylor needed to, but did not, "adjust for risks specific to White Nile," specifically including "the quality of White Nile's executive team…." [App. 108-09].

A proper expert opinion could have fixed the analytical flaws that are present in Mr. Taylor's valuation. But the bankruptcy court chose not to re-open the evidence—instead resorting to "mere speculation" to seek to justify "pie-in-the-sky damages" not

grounded in "theory [or] fact," [App. 28]. The Texas Supreme Court would not have condoned such speculation. This Court should not either.

Where, as here, a claimant has not proven "a specific injury, the plaintiff can seek damages measured by a reasonable royalty [instead]." *Sw. Energy*, 491 S.W.3d at 711 (quotation omitted). That standard is inherently less speculative. *See id.* ("Because the precise value of a trade secret may be difficult to determine, the proper measure is to calculate what the parties would have agreed to as a fair price for licensing the defendant to put the trade secret to the use the defendant intended at the time the misappropriation took place." (quotation omitted)). This Court should not tolerate a massive award of damages "that cannot be justified by any reasonable inference from the evidence in this case." [App. 28]. Instead, this Court should summarily vacate the judgment below and remand with instructions that the bankruptcy court should determine a reasonable royalty or, if it cannot, award nominal damages plus $1,000 in statutory damages, as provided under Tex. Civ. Prac. & Rem. Code § 134.005(a)(1).

II. This Court Should Exercise Its Supervisory Authority to Direct the Fifth Circuit to Afford Mr. Mandel the Appeal that Congress Statutorily Guaranteed.

Because "this is a court of final review and not first view," *Holland v. Florida*, 560 U.S. 631, 654 (2010) (quotation omitted), this Court will grant *certiorari*,

vacate a judgment of the court of appeals, and remand ("GVR") with instructions where the court of appeals below has not yet reached an issue but should have. *See, e.g.*, *Lawrence v. Chater*, 516 U.S. 163, 167 (1996) (explaining that a GVR order is an important tool that this Court has because it "assists the court below by flagging a particular issue that it does not appear to have fully considered, [and] assists this Court by procuring the benefit of the lower court's insight before we rule on the merits…." (citation omitted)).

With respect to the damage awards for Thrasher and Coleman, the majority below, [App. 14-15], applied the normal rule that an affirmance of the total amount of damages on one claim "moots" the need to consider damages on other claims. *See, e.g.*, *Black v. Pan Am Labs., L.L.C.*, 646 F.3d 254, 260 (5th Cir. 2011). But because this case arises in the bankruptcy context, non-dischargeability considerations of the unreviewed claims mean that the normal rule ought not apply here; the unreviewed damages can still matter.

By statute, Congress has decided that some debts are never dischargeable in bankruptcy. 11 U.S.C. § 523. Included among those non-dischargeable debts are those "for money, property, [or] services…obtained by…false pretenses, a false representation, or actual fraud…..", 11 U.S.C. § 523(a)(2)(A); "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny," *id.* § 523(a)(4); and "for willful and malicious injury," *id.* § 523(a)(6). Thus, as the

bankruptcy court itself recognized on remand, "the amount of compensatory damages may be relevant in the event the Court… finds [Mr. Mandel's] debts to the claimants non-dischargeable in bankruptcy (11 U.S.C. § 523)." [App. 93]. *See also Mandel v. Mastrogiovanni Schorsch & Mersky*, 641 Fed. Appx. 400, 405 (5th Cir. 2016) (holding that Mr. Mandel has standing to appeal claim allowances unless and until the claim is actually discharged because he will be obligated to pay any nondischarged claim).

While the bankruptcy court ultimately denied Mr. Mandel any bankruptcy discharge due to misconduct, *see* 11 U.S.C. § 727, that order is currently the subject of a separate appeal to the district court (and thus not yet before this Court), *see White Nile Software, Inc. v. Mandel*, No. 4:17 cv-262 (E.D. Tex). If Mr. Mandel prevails in establishing that he is entitled to a bankruptcy discharge, the district court (and possibly later this Court) would then have to conduct a claim-by-claim analysis to determine whether the claims are statutorily ineligible for discharge, as the bankruptcy court alternatively found. *See* 11 U.S.C. § 523. Unless this Court directs the Fifth Circuit to substantively review the amount of damages for *each claim* now, however, Mr. Mandel potentially faces non-dischargeable debt on claims in an amount that the Fifth Circuit affirmed without substantive review.

Congress has decided that litigants have an appeal as of right to the courts of appeal from final orders from the bankruptcy court. Here, however, the Fifth

Circuit did not give Mr. Mandel that statutory benefit. This Court should, therefore, vacate the Fifth Circuit's judgment below and remand with instructions to substantively review the damages on each claim.

CONCLUSION

The proceedings below call out for the Court to exercise its supervisory power. Given the rank and unnecessary speculation that underpins the current $1 million "lost-asset" award based on evidences and models that the bankruptcy court itself originally acknowledged were unreliable, the Court should vacate and remand with instructions for the bankruptcy court to calculate a reasonable royalty or, if it cannot, award nominal damages plus $1,000 in statutory damages, as provided under Tex. Civ. Prac. & Rem. Code § 134.005(a)(1).

This Court should also vacate and remand with instructions for the Fifth Circuit to substantively review each damage award for Mr. Thrasher and Mr. Coleman. Non-dischargeability considerations mean the damages on those other causes of action are not moot regardless as to whether they are co-extensive with any award for misappropriation.

Dated this 29th day of June, 2018.

Respectfully submitted,

EDWARD MANDEL

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