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Tenth Circuit Clarifies Ancillary Enforcement Jurisdiction

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In a decision that provides guidance on a previously “ill-defined” and “nebulous aspect of our federal courts' jurisdiction,” the U.S. Court of Appeals for the Tenth Circuit clarified the cases in which federal courts may exercise ancillary enforcement jurisdiction and which law applies—state, federal, or both—when evaluating a plaintiff's standing to bring such a case. *Atlas Biologicals v. Kutrubes*, No. 20-1401, 2022 U.S. App. LEXIS 28203, — F.4th — (10th Cir. Oct. 11, 2022).

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The Principal Action

Kutrubes worked for Atlas as a sales manager, served on its Board of Directors, and owned a 7% stake in Atlas. Id. at *3. Unbeknownst to Atlas, Kutrubes developed a plan to start a competing business, began emailing to himself Atlas's confidential information, and also began contacting Atlas's customers to secure business. Id. at *3-4. A few days after Kutrubes resigned and requested that Atlas buy out his 7% stake, Atlas discovered Kutrubes's plans. Id. at *4. Atlas refused his resignation, terminated his employment for cause, demanded that he cease using the taken information and abandon his plans to form a competing business. Id.

Atlas later sued Kutrubes and his newly formed company in the District of Colorado and asserted various intellectual property, trademark infringements, and misappropriation of trade secret claims. Id. at *5. Apparently “in an attempt to thwart Atlas's ability to collect a likely judgment against him,” Kutrubes sold his 7% stock to Atlas's competitor, Biowest, LLC. Id. at *2, *5.

In response, Atlas filed an emergency ex parte motion for prejudgment attachment, in which it argued that Kutrubes's transfer to Biowest was invalid. Id. at *5-6. The district court granted the motion noting, however, that “it did not know whether the transfer of stock was valid[.]” Id. at *7. Because of this uncertainty, the court issued a “prejudgment attachment as to whatever interest remains” with Kutrubes but ruled that whether Kutrubes still owned the 7% stock would not be “decided by [the court] unless [the parties] file a separate action in this Court for either declaratory judgment or for further undoing the fraudulent conveyance.” Id.

The Ancillary Declaratory Judgment Action

The next day, Atlas sued Kutrubes and Biowest for declaratory relief to void the purported transfer of stock under Article 8 of the Colorado Uniform Commercial Code (CUCC) or, in the alternative, to avoid and recover a fraudulent transfer under Colorado law. Id. at *7-8. Biowest filed a motion to dismiss Atlas's claims on the grounds that the district court lacked subject matter jurisdiction and that Atlas lacked standing to sue Biowest. Id. at *8.

The district court denied the motion, holding that it had “ancillary jurisdiction over [the] collateral proceedings [the declaratory judgment action] … to manage its proceedings, vindicate its authority, and effectuate its decrees.” Id. It also looked to Colorado law to hold that Atlas had standing to sue Biowest “because the declaratory judgment that it seeks—that [the] purported transfer of stock … 'is void and of no effect,' … would effect a change in its present rights or status.” Id. at *9.

Exercising jurisdiction over the action, the district court held on summary judgment that the stock transfer was invalid because it failed to comply with the strict requirements of the CUCC. Id. at *9, *13. The court certified its order as final pursuant to Fed. R. Civ. P. 54(b) and Biowest appealed. Id. at *13.

The Circuit Court Holds the District Court Properly Exercised Ancillary Enforcement Jurisdiction

The Tenth Circuit began its jurisdictional analysis by recognizing that ancillary enforcement jurisdiction has previously been an “ill-defined concept” such that the court should “provide some clarity to an otherwise nebulous aspect of our federal courts' jurisdiction.” Id. at *17.

To that end, the court reiterated that federal courts are courts of limited jurisdiction. “They possess only that power authorized by Constitution and statute … which is not to be expanded by judicial decree.” Id. at *15. “But sometimes the federal courts are permitted to entertain a *claim* or

an *incidental proceeding* that does *not* satisfy requirements of an independent basis of subject matter jurisdiction." Id. at *15-16 (emphasis added). "This 'supplemental jurisdiction' is most commonly used in the context of extending jurisdiction over non-federal question or non-diverse claims asserted in federal court." Id. at *16.

The circuit court acknowledged that this case involves "another species of supplemental jurisdiction—ancillary or ancillary enforcement jurisdiction—that allows federal courts to extend jurisdiction over 'related *proceedings* that are technically separate from the initial case that invoked federal subject matter jurisdiction.'" Id. at *16-17 (emphasis added; citation omitted). "[A] federal court may exercise ancillary jurisdiction (1) to permit disposition by a single court of claims that are, in varying respects and degrees, factually interdependent; and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees." Id. at *17 (internal quotations and citation omitted).

Thus, "if a federal court had jurisdiction [over] the principal action, it may hear an ancillary proceeding, regardless of the citizenship of the parties, the amount in controversy, or any other factor that normally would determine subject matter jurisdiction" to ensure it is able to "decide collateral matters necessary to render complete justice" and "to protect and give effect to its judgments[.]" Id. at *18-19.

Applying these principles, the Tenth Circuit held that "the district court had ancillary subject matter jurisdiction over Atlas's declaratory judgment claim to void the stock transfer to Biowest." Id. at *24. The court reasoned that "deciding this question through a declaratory judgment is essential to the district court deciding the entire case before it." Id. at *26. "That is, whether the transfer to Biowest was effective under Colorado law determines whether the district court's writ of attachment attached to anything at all." Id. As a result, the ancillary declaratory judgment action was "the very sort of proceeding that would allow the district court to decide the entire case and assure that its judgments are followed" and "fit[] nicely and properly within the compass of ancillary enforcement jurisdiction." Id. at *27.

Standing Had To Be Evaluated Under Both Federal and State Law

The next step was to determine whether Atlas had standing to sue Biowest for declaratory relief. Id. at *34. Article III standing "assures that federal courts only hear cases consistent with the jurisdictional limits articulated in the Constitution" by "identify[ing] those disputes which are appropriately resolved through the judicial process[.]" Id. at *35.

"To establish Article III standing, a plaintiff must show (1) an injury in fact, (2) a sufficient causal connection between the injury and the conduct complained of, and (3) a likelihood that the injury will be redressed by a favorable decision." Id. (internal brackets, quotations, and citations omitted). As a general rule, determining Article III standing "is a matter of federal law." Id. at *36. However, that rule is "not absolute and does not comprehensively answer the question regarding the source of law concerning standing in at least two circumstances where federal courts typically apply state substantive law: that is, under diversity jurisdiction, 28

U.S.C. §1332; and, as most relevant here, under supplemental jurisdiction." Id. at *37. In particular, a "state's law of standing should be applied—in addition to federal standing law—in considering claims in such settings that are derived from state law." Id.

Under both federal and Colorado law, "standing must be assessed in the context of the claim the plaintiff seeks to bring." Id. at *41. Here, Atlas's sole claim was for declaratory judgment, but neither the Federal nor the Colorado Declaratory Judgment Acts provided jurisdiction. Id. Thus, the circuit court relied on a Colorado Supreme Court test, indicating that to establish standing, "the plaintiff demonstrate that there is an existing legal controversy that can be effectively resolved by a declaratory judgment, and not a mere possibility of a future legal dispute over some issue." Id. at *42 (citing *Bd. of Cnty. Comm'rs, La Plata Cnty. v. Bowen/Edwards Assocs.*, 830 P.2d 1045, 1053 (Colo. 1992)).

Notably, Biowest only contested one element of standing—injury-in-fact—arguing that Atlas was not a party to the Stock Sales Agreement and Assignment between Kutrubes and Biowest. Id. at *51. The court rejected this argument, reasoning that, if the stock transfer between Kutrubes and Biowest was declared valid, this would threaten to injure Atlas by hindering Atlas's ability as a judgment creditor to collect on its judgment in the principal action. Id. at *43, *48-49. The circuit court thus concluded that Atlas had standing to bring its declaratory judgment claim and have the district court determine the respective legal rights of both parties in relation to the share transfer. Id. at *53.

The Tenth Circuit Holds the Stock Transfer Invalid Under Colorado Law

Applying the strict requirements of the CUCC, the circuit court held that Kutrubes's attempted transfer of his stock to Biowest was invalid. Id. at *55-56. The court also rejected Biowest's argument that the district court erred in concluding that the doctrine of equitable transfer of corporate stock, which would have made the transfer valid despite the technical defects, did not apply to Kutrubes's attempted transfer. Id. at *63-64. It reasoned that "equitable title claims are recognized in Colorado only where the rights of third parties would not be affected," which was not the case here. Id.

Lastly, in a related unpublished decision by a separate panel, the Tenth Circuit affirmed the approximately $2 million judgment entered in Atlas's favor on its claims against Kutrubes in the principal case. Id. at *13-14; see also *Atlas Biologicals v. Kutrubes*, No. 19-1404, 2022 U.S. App. LEXIS 20097 (10th Cir. July 21, 2022).

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