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Professional Liability

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PROFESSIONAL LIABILITY

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DURING this Survey period, the landscape for professional liability claims did not change dramatically. The appellate courts did reverse a few summary judgments in legal malpractice cases, but they continued to be vigilant in requiring plaintiffs to prove every element of their claims against their lawyers. At the end of the period, questions still remain concerning the viability of fiduciary duty claims against attorneys based on the attorneys' alleged "misrepresentations" and concerning the enforceability of agreements to arbitrate legal malpractice claims. With regard to claims against health care providers, the courts spent most of their time addressing outstanding questions related to the expert report requirements found in Chapter 74 of the Texas Civil Practice and Remedies Code. There were quite a few cases involving claims against officers and directors during this Survey period. The defendant officers and directors won some and lost some, with the courts addressing issues such as personal jurisdiction over out-of-state directors, derivative claims by the shareholders, and officers' and directors' personal liability for corporate debts.

I. LEGAL MALPRACTICE

A. TEXAS COURTS DELIVER MIXED MESSAGES ON FIDUCIARY DUTY CLAIMS

During this Survey period, the Fourteenth District Court of Appeals in Houston became one of the few courts in recent years to allow a separate claim for breach of fiduciary duty to proceed against law firm defendants[1] and, in doing so, raised questions about the viability of a fiduciary duty claim based on alleged "misrepresentations" by an attorney. In *Trousdale v. Henry*,[2] the appellate court reversed summary judgment on behalf of the defendant lawyers on plaintiff's breach of fiduciary duty claim. Plaintiff alleged that the defendant lawyers were negligent in their handling of two lawsuits filed in Liberty County, Texas, both of which were dismissed for want of prosecution. The trial court granted summary judgment on several grounds, including that plaintiff's claim for breach of fiduciary duty constituted an impermissible fracturing of her legal malpractice claims (which were barred by limitations).

On appeal, the court acknowledged that a malpractice plaintiff cannot transform a claim that sounds only in negligence into other claims. It also noted, however, that attorneys "may also be held liable for a breach of fiduciary duty, but such a claim requires allegations of self-dealing, deception, or misrepresentations that go beyond the mere negligence allegations in a malpractice action."[3] The court explained: "[i]f the gist of a client's complaint is that the attorney did not exercise that degree of care,

1. See our prior Survey article, Kelli M. Hinson et al., *Professional Liability*, 61 SMU L. REV. 1047, 1055 (2008).
2. 261 S.W.3d 221, 224 (Tex. App.—Houston [14th Dist.] 2008, pet. filed).
3. *Id.* at 227.

skill, or diligence as attorneys of ordinary skill and knowledge commonly possess, then that complaint should be pursued as a negligence claim, rather than some other claim."[4] The court then held that the client's allegations that the attorneys misrepresented the status of her case, failed to disclose the dismissal of her claims, continued to bill and collect fees from her, and refused to return her file constituted allegations of deception and misrepresentation that could be separately pursued.[5]

Just a few weeks after issuing the *Trousdale* opinion, the Fourteenth Court of Appeals issued its opinion in *Duerr v. Brown*,[6] in which it affirmed a summary judgment in favor of the lawyer defendants and confirmed that a malpractice plaintiff cannot manufacture a fiduciary duty claim simply by characterizing the lawyers' conduct as "misrepresentations."[7] In *Duerr*, the plaintiff claimed that the lawyer defendants were negligent in failing to obtain the maximum amount of class settlement proceeds for him and that they breached their fiduciary duties in inducing him to rejoin the class settlement by promising him a larger recovery than he actually received. The court held that this claim was an impermissible fracturing of plaintiff's malpractice claim.[8] Plaintiff also alleged that the lawyer defendants had a conflict of interest, which they failed to disclose, because they used him as leverage during the class settlement to obtain larger recoveries for their other clients. The court rejected this claim because plaintiff failed to show he was damaged by any alleged conflict of interest distinct from his alleged malpractice damages and the claim was, therefore, "merely an alternative label for [plaintiff's] underlying legal malpractice complaint about receiving less money than he was promised."[9]

The Eastland Court of Appeals also examined issues related to fiduciary duty claims against lawyers in *Swank v. Cunningham*.[10] That case involved (among many other issues) the appeal of a summary judgment in favor of two defendant law firms arising out of the allegedly inappropriate distribution of settlement proceeds obtained in a prior lawsuit. In the prior lawsuit, Automated Marine Propulsion Systems, Inc. (AMPS) and its founder, Sverdlin, sued several parties, including AMPS's counsel Gardere Wynne. Sverdlin eventually settled the claims against Gardere

4. *Id.*
5. *Id.* at 227-28.
6. 262 S.W.3d 63 (Tex. App.—Houston [14th Dist.] 2008, no pet.).
7. *See also* West v. Hubble, No. 05-06-01683-CV, 2008 WL 2941854, at *1, *3 (Tex. App.—Dallas Aug. 1, 2008, pet. filed) (alleging that attorneys that misrepresented themselves as a partnership and misrepresented that they had timely designated experts was not a fiduciary duty claim); Kimleco Petroleum, Inc. v. Morrison & Shelton, 91 S.W.3d 921, 924 (Tex. App.—Fort Worth 2002, pet. denied) (alleging that attorney that misled clients about readiness for trial was not a fiduciary duty claim).
8. *Duerr*, 262 S.W.3d at 74-75.
9. *Id.* at 75; *see also* Murphy v. Gruber, 241 S.W.3d 689, 699 (Tex. App.—Dallas 2007, pet. denied) (affirming summary judgment in favor of defendant attorneys on grounds that purported fiduciary duty and fraud claims were claims for legal malpractice and were, therefore, barred by limitations).
10. 258 S.W.3d 647, 651 (Tex. App.—Eastland 2008, pet. denied).

Wynne for $20 million, and after a fairness hearing, the court allowed Gardere Wynne to pay that money directly to Sverdlin rather than to AMPS.[11] Plaintiffs in the *Swank* case, Swank and McCoy, claimed to be shareholders in AMPS and complained about their counsel's failure to ensure that AMPS (and consequently they) received a portion of the settlement proceeds. The Eastland Court of Appeals affirmed summary judgment in favor of the defendants on the grounds that (1) the plaintiffs lacked standing to pursue those claims, which belonged to AMPS, and (2) the law firm defendants had represented the plaintiffs individually and were, therefore, never in privity with AMPS.[12]

The *Swank* court also affirmed summary judgment in favor of the law firm defendants on the grounds that plaintiffs' damages theory was "fatally speculative."[13] The court discussed the requirement of proving damages in a legal malpractice case and reiterated that damages "cannot be established by mere conjecture, guess, or speculation."[14] Plaintiffs relied on the affidavit of their expert witness, who opined that the law firm defendants should have objected to the apportionment of the settlement at the fairness hearing and, if they would have objected, "the disbursement of the $20,000,000.00 settlement funds directly to Sverdlin individually would have been stopped and AMPS'[s] and McCoy's and Swank's rights with respect to the settlement funds would have been preserved."[15] The court held that the expert's affidavit failed to raise a fact issue on causation and damages because the expert failed to provide any factual support for his conclusions, and they were, therefore, "mere speculation and conclusory."[16] The court acknowledged that the plaintiffs were not required to prove actual damages in order to obtain disgorgement of fees for the attorneys' alleged breach of fiduciary duty, but still affirmed summary judgment on that claim. First, the court noted that the purported breach of fiduciary duty claims constituted an impermissible fracturing of plaintiffs' legal malpractice claims.[17] More importantly, however, the court held that because the legal fees were paid by third parties (and not Swank and McCoy), allowing Swank and McCoy to recover those fees as a fee forfeiture "would result in a windfall to them" and was not an appropriate remedy.[18]

B. Accidental Creation of a Duty

During the Survey period, the El Paso Court of Appeals dealt with an interesting issue regarding the "duty" or "privity" requirement for bringing a legal malpractice claim. The plaintiff in *Sotelo v. Stewart* sued

11. *Id.* at 653-55.
12. *Id.* at 663-67.
13. *Id.* at 672.
14. *Id.* at 667.
15. *Id.* at 671.
16. *Id.*
17. *Id.* at 656 n.2.
18. *Id.* at 673.

Gordon Stewart, the attorney who represented her husband as the defendant in a breach of contract action.[19] The malpractice plaintiff, Mrs. Sotelo, was never sued or served as a defendant in the contract action, and was never named in the proceedings until attorney Stewart (apparently mistakenly) added her name to the style of a motion for continuance. Nevertheless, judgment was entered against both Mr. and Mrs. Sotelo in the contract action, and the contract plaintiff obtained a writ of execution against Mrs. Sotelo's real property. Mrs. Sotelo then sued Stewart alleging he committed legal malpractice because, despite the lack of allegations against her, he made her a defendant in the breach of contract case.[20] Stewart obtained a summary judgment against Mrs. Sotelo in the malpractice action on the ground that he was never Mrs. Sotelo's attorney and, therefore, owed her no duty of care.[21] The court of appeals reversed. It noted that an attorney-client relationship generally is created by contract, but it can be implied by the parties' conduct, including the "gratuitous rendition of professional services."[22] Therefore, even though Mrs. Sotelo testified that she never spoke to or hired Stewart and never authorized him to take any legal actions on her behalf, Stewart's actions in adding Mrs. Sotelo's name to the motion for continuance raised a fact issue as to whether an attorney-client relationship existed, and summary judgment was, therefore, inappropriate.[23]

C. Proof of Causation

In *Grider v. Mike O'Brien, P.C.*, the First District Court of Appeals in Houston considered the application of the "suit-within-a-suit" requirement for proving causation in an appellate malpractice case.[24] The client in that case filed suit against her attorneys for failing to perfect an appeal from an adverse judgment in the client's medical malpractice case. In the underlying medical malpractice case, the trial court entered a take-nothing judgment against Grider. The Corpus Christi Court of Appeals reversed and rendered for Grider with regard to the physician's liability and remanded for a new trial on the issue of damages. The physician filed a petition for review, and the Texas Supreme Court reversed the court of appeals's judgment and, because her notice of appeal was untimely, dismissed Grider's appeal for want of jurisdiction.[25]

The trial court granted summary judgment in the legal malpractice case on the grounds that Grider could not prove that the law firm's alleged failure to perfect an appeal caused her any damages.[26] In a legal malpractice case, the plaintiff must prove a "suit-within-a-suit," that is that

19. 281 S.W.3d 76 (Tex. App.—El Paso 2008, pet. denied).
20. *Id.*
21. *Id.* at 78.
22. *Id.* at 80-81.
23. *Id.*
24. 260 S.W.3d 49, 55 (Tex. App.—Houston [1st Dist.] 2008, pet. denied).
25. *Id.* at 53.
26. *Id.* at 54.

she would have prevailed on the underlying action in the absence of the attorneys' negligence.[27] The court of appeals noted in *Grider* that causation is generally a question of fact for the jury, but held that in cases of appellate malpractice, "the determination of causation requires determining whether the appeal in the underlying action would have been successful."[28] Because this inquiry "depends on an analysis of the law and the procedure rules . . . a judge is clearly in a better position to do this than is a jury."[29] The court then held that in cases of appellate malpractice, the issue of causation is a question of law for the court.[30] The court reviewed the entire record and concluded that Grider would not have prevailed on appeal and, therefore, the trial court was correct in granting summary judgment in favor of the defendant law firms.[31]

The Fourteenth District Court of Appeals in Houston reversed a summary judgment that was granted based on the plaintiff's alleged failure to prove her "suit-within-a-suit." In *Grimes v. Reynolds*,[32] the plaintiff filed suit against her former attorneys alleging that they failed to respond to requests for admissions and a motion for summary judgment in her underlying federal sexual harassment case. The federal court had granted summary judgment against her on the sexual harassment claims based, in large part, on the deemed admissions. In the malpractice lawsuit, the defendant attorneys admitted they had breached the duty of care owed to the plaintiff, but argued they were entitled to summary judgment because she could not prove any damages in the underlying suit.[33] The trial court agreed and granted summary judgment in favor of the defendant attorneys. The Fourteenth Court of Appeals in Houston, however, disagreed, holding that defendants had failed to meet their burden to conclusively prove the plaintiff would not have recovered any damages in the federal lawsuit. The defendants relied, in part, on the memorandum opinion of the federal court granting summary judgment on the plaintiff's sexual harassment claims, but the court of appeals pointed out that the federal summary judgment ruling was based on the deemed admissions and the attorneys' failure to file any summary judgment response. The court held that the attorneys could not benefit from their own admitted malpractice by relying on this opinion.[34] The case was thus reversed and remanded.[35]

D. Summary Judgment Granted Based on Judicial Estoppel

In *Jackson v. Hancock & Canada, LLP*,[36] the Amarillo Court of Appeals considered the effect of a malpractice plaintiff's failure to disclose

27. *Id.* at 55.
28. *Id.*
29. *Id.* (citations omitted).
30. *Id.*
31. *Id.* at 58-59.
32. 252 S.W.3d 554, 556 (Tex. App.—Houston [14th Dist.] 2008, no pet.).
33. *Id.* at 560.
34. *Id.* at 561.
35. *Id.*
36. 245 S.W.3d 51 (Tex. App.—Amarillo 2007, pet. denied).

potential malpractice claims in its bankruptcy schedules. In that case, after the alleged claims against the defendant attorneys arose, plaintiffs filed for bankruptcy and failed to include any potential claim against the attorneys in their schedule of assets. When plaintiffs later brought claims against the attorneys, the trial court granted summary judgment on the ground that the plaintiffs were judicially estopped from bringing any unscheduled claims, and the court of appeals affirmed.[37] Because the case involved the effect of statements made in a bankruptcy proceeding, the court applied federal judicial estoppel law in order "to promote the goal of uniformity and predictability in bankruptcy proceedings."[38]

"Under federal law, a party which has assumed one position in its pleadings may be estopped from asserting a contrary position in a subsequent proceeding if: (1) the positions are clearly inconsistent, (2) the court in the prior proceeding accepted the position, and (3) the prior position was asserted intentionally rather than inadvertently."[39] The court noted that debtors in bankruptcy have the duty to report any assets they may have, including any potential causes of action against third parties. Federal courts have held that the omission of potential claims from a party's bankruptcy schedule "is tantamount to a representation that no such claims existed" and is, therefore, inconsistent with the later assertion of a claim.[40] The court also held that even though the bankruptcy was dismissed and the plaintiffs did not get the benefit of a discharge in bankruptcy, the inconsistent statement was nevertheless "accepted" by the bankruptcy court.[41] The court concluded that "the only reasonable inference that may be drawn from the bankruptcy court's dismissal due to a lack of means with which to effectuate a reorganization is that the court accepted the Jacksons' schedules, which omitted their claim for $323,050 in actual damages against H&C."[42] The court also held that the Jacksons clearly had knowledge of their potential claim during the bankruptcy and, thus, their failure to schedule it could not be inadvertent.[43] Because all the elements of judicial estoppel were met, summary judgment was affirmed.[44]

E. Courts Remain Split Regarding Mandatory Arbitration of Legal Malpractice Claims

In *Bennett v. Leas*,[45] the Corpus Christi Court of Appeals revisited the question of whether a legal malpractice claim constitutes a claim for "personal injury" such that any agreement to arbitrate is subject to the height-

37. *Id.* at 54.
38. *Id.* at 55 (citations omitted).
39. *Id.*
40. *Id.* (citing *In re* Superior Crewboats, Inc., 374 F.3d 330, 335 (5th Cir. 2004)).
41. *Id.* at 56.
42. *Id.*
43. *Id.* at 56-57.
44. *Id.*
45. No. 13-06-469-CV, 2008 WL 2525403 (Tex. App.—Corpus Christi June 26, 2008, pet. abated).

ened procedural requirements of the Texas Arbitration Act (TAA).[46] The court had previously held in *In re Godt* that a legal malpractice claim is a claim for personal injury under the statute.[47] Since that time, however, at least three other courts of appeal have disagreed and have criticized the holding in *Godt*.[48] Nevertheless, in the absence of "guidance from the supreme court on this issue," the court declined to overrule its prior holding and concluded that the trial court had not erred in finding that the plaintiff's claim for legal malpractice was a claim for personal injury.[49] A claim for personal injury is not subject to arbitration under the TAA "unless each party to a claim, on the advice of counsel, agrees to arbitrate in writing, and the agreement is signed by each party and each party's attorney."[50] In *Bennett*, the client was not advised to consult an attorney before signing the agreement, nor independently represented when signing the agreement, and the attorney was, therefore, not entitled to arbitrate the malpractice claims.[51]

In *Godt*, the court had suggested that an attorney may violate the state ethics rules by entering into an agreement with a client to arbitrate any future legal malpractice claims.[52] This theory was not discussed in *Bennett*, but the Professional Ethics Committee for the State Bar of Texas issued an ethics opinion in October 2008 concluding that such agreements are permitted under the Texas Disciplinary Rules of Professional Conduct.[53] Disciplinary Rule 1.08(g) prohibits a lawyer from prospectively agreeing with a client to limit the lawyer's malpractice liability unless the client is represented by independent counsel with respect to the agreement.[54] But the committee found that an arbitration provision does not limit the malpractice liability of the attorney, it merely establishes the forum in which such potential liability will be determined.[55] The committee cautioned, however, that the agreement must be carefully drafted so as not to include terms that are clearly unfair to the client or that "shield the lawyer from liability to which the lawyer would otherwise be exposed."[56] The committee also concluded that, in order for an arbitration agreement to be effective, the attorney must advise the client about the differences between arbitration and litigation so that the "client [can] make an informed decision about whether to agree to binding arbitration," acknowledging that the "scope of the explanation will depend on

46. TEX. CIV. PRAC. & REM. CODE ANN. § 171.002(c) (Vernon 2005).
47. 28 S.W.3d 732, 739 (Tex. App.—Corpus Christi 2000, orig. proceeding).
48. *See* Taylor v. Wilson, 180 S.W.3d 627, 631 (Tex. App.—Houston [14th Dist.] 2005, pet. denied); Miller v. Brewer, 118 S.W.3d 896, 898 (Tex. App.—Amarillo 2003, no pet.) (per curium); *In re* Hartigan, 107 S.W.3d 684, 690 (Tex. App.—San Antonio 2003, orig. proceeding).
49. *Bennett*, 2008 WL 2525403, at *7-8.
50. *Id.* at *6.
51. *Id.*
52. *Godt*, 28 S.W.3d at 739 n.7.
53. Op. Tex. Ethics Comm'n No. 586 (2008).
54. *Id.*
55. *Id.*
56. *Id.*

the sophistication, education and experience of the client."[57] The committee recognized the current split of authority regarding whether a legal malpractice claim is a claim for "personal injury," but stated that it was "beyond the authority of [the] Committee to address questions of substantive law."[58]

II. MEDICAL MALPRACTICE

Although Texas law has long required plaintiffs in a health care liability action to provide the defendants they sue with expert reports at an early stage in litigation, changes to the law in 2003[59] and 2005[60] sent many litigants to the courts for clarifications. The statutory changes have been covered in prior Survey articles and will not receive detailed treatment here. The cases involving challenges to late or deficient expert reports, however, dominated the medical malpractice jurisprudence this Survey period and deserve a closer look since these issues have now worked their way up the appellate ladder.

A. CHALLENGES TO INTERLOCUTORY ORDERS ON MOTIONS TO DISMISS

Under Chapter 74 of the Texas Civil Practice and Remedies Code, if a plaintiff in a health care liability action fails to timely serve an expert report, a trial court *shall* grant a defendant's motion to dismiss the case with prejudice.[61] If, however, an expert report is served, but is deficient, the court has discretion to grant the plaintiff one thirty-day extension to cure the deficiency.[62] Since the 2003 legislative amendments, a defendant may immediately appeal the denial of a motion to dismiss, but may not appeal the grant of a thirty-day extension to cure a deficient report.[63] In *Ogletree v. Matthews*, a case decided just outside the last Survey period but mentioned in the last Survey, the Texas Supreme Court determined that when a trial court simultaneously denies a defendant's motion to dismiss and grants the plaintiff a thirty-day extension to cure defects, the two actions are "inseparable," such that a defendant loses the right to immediately appeal the trial court's denial of the motion to dismiss.[64]

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57. *Id.*

58. *Id.*

59. *See* Act of June 2, 2003, 78th Leg., R.S., ch. 204, § 10.01, 2003 Tex. Gen. Laws 847, 864 (amended 2005) (current version at TEX. CIV. PRAC. & REM. CODE ANN. §§ 74.001-.507 (Vernon Supp. 2005)).

60. *See* Act of May 18, 2005, 79th Leg., R.S., ch. 635, § 1, 2005 Tex. Gen. Laws 1590, 1590 (current version at TEX. CIV. PRAC. & REM. CODE ANN. §§ 74.001-.507).

61. TEX. CIV. PRAC. & REM. CODE ANN. § 74.351(b).

62. *Id.* § 74.351(c).

63. "A person may appeal from an interlocutory order of a district court . . . that . . . denies all or part of the relief sought by a motion under Section 74.351(b), except that an appeal may not be taken from an order granting an extension under 74.351." *Id.* § 51.014(a)(9).

64. 262 S.W.3d 316, 321 (Tex. 2007).

In *Badiga v. Lopez*,[65] a case decided outside the Survey period, but important to the topic, the Texas Supreme Court qualified its holding in *Ogletree*. In *Badiga*, the supreme court explained that a defendant *may* seek interlocutory appeal of a trial court's simultaneous denial of its motion to dismiss and grant of a 30-day extension to file an expert report *if* the report was never timely served in the first place.[66] In this case, the plaintiff alleged that Dr. Badiga had negligently perforated her colon during a colonoscopy, but she failed to serve Dr. Badiga with an expert report within 120 days of filing her suit, which would have been February 23, 2004.[67] When Dr. Badiga moved to dismiss the case on these grounds, the plaintiff moved for an extension of time to serve the report.[68] On May 18, 2004, the trial court granted the plaintiff's motion, extending the deadline to file her report to June 18, but did not rule on Dr. Badiga's motion to dismiss.[69] After the plaintiff served Dr. Badiga with her expert report, Dr. Badiga again moved to dismiss, incorporating his first motion, and also challenging the sufficiency of the newly served expert's report.[70] On August 10, 2004, the trial court denied Dr. Badiga's motion.[71] Dr. Badiga sought interlocutory review, but the Corpus Christi Court of Appeals dismissed for want of jurisdiction. The supreme court granted review.[72]

The supreme court distinguished this case from *Ogletree* by noting that the extension granted in *Badiga* was not to cure a timely filed but deficient report. Rather, the extension here was granted for a report that was never filed, an action that is not permitted by the statute.[73] The supreme court explained that, unlike the pre-2003 statute, which *required* the grant of a 30-day extension when the failure to file a conforming report was due to accident or mistake, the 2003 amendments created a "statute-of-limitations-type deadline within which expert reports must be served."[74] The court stated that, because the legislature refused trial courts' discretion to deny motions to dismiss, or to grant extensions when no report is timely served, a trial court's refusal to dismiss under such circumstances may be immediately appealed.[75]

The Texas Supreme Court also made interlocutory review easier for cases filed under the pre-2003 version of the statute, which did not permit defendants to appeal the denial of a motion to dismiss.[76] In *In re McAllen Medical Center*, the supreme court held that, under the right circum-

65. 274 S.W.3d 681, 684-85 (Tex. 2009).
66. *Id.* at 682-83.
67. *Id.* at 682.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.* at 683.
74. *Id.* at 683-84.
75. *Id.*
76. *See In re* McAllen Med. Ctr., Inc., 275 S.W.3d 458, 466-67 (Tex. 2008).

stances, when a court's denial of a motion to dismiss amounts to an abuse of discretion, a defendant may seek immediate mandamus relief.[77] In *McAllen*, some 400 plaintiffs representing 224 former patients sued McAllen Medical Center and a surgeon who practiced at the hospital alleging that the surgeon was unqualified to perform thoracic surgery and that the hospital negligently credentialed the surgeon to practice there.[78] Plaintiffs timely filed expert reports, all of which were signed by one expert.[79] The hospital argued that the reports were deficient, in part, because the expert was not qualified to opine on the claims involved, and it moved to dismiss.[80] The trial court did not rule on the hospital's motion for four years, and eventually denied it.[81] The Corpus Christi Court of Appeals denied the hospital's petition for writ of mandamus, and the Texas Supreme Court granted review.[82]

The supreme court called the trial court's denial of the hospital's motion to dismiss a "clear abuse of discretion," finding that the expert reports were inadequate.[83] The supreme court determined that the expert, who had twenty years of experience as a solo practitioner but no privileges at a hospital, was unqualified to address the issue of negligent credentialing or the specialized standard of care for hospital credentialing.[84] Noting that the statutory requirements for early expert reports were intended to preclude extensive discovery and prolonged litigation in frivolous cases, the supreme court stated this was precisely the kind of case the legislature had in mind when it enacted the expert report requirements.[85] With a critical tone, the court pointed out that this case involved the consolidated claims of 224 separate patients with nothing in common besides their treatment by the defendant doctor, and that in the years the hospital waited for the trial court to rule on its objections to the deficient expert reports its attorneys had to attend numerous docket calls and status conferences and had to prepare summary judgment motions to resolve the claims of 200 additional plaintiffs whose claims were barred by the statute of limitations.[86] Under such circumstances, the supreme court held the hospital had no adequate remedy by appeal when its motion to dismiss was eventually denied. Accordingly, the supreme court held that mandamus relief is available "when the purposes of the health care statutes would otherwise be defeated."[87]

The supreme court acknowledged that in past years it had denied mandamus petitions involving challenges to the adequacy of expert reports

77. *Id.* at 463.
78. *Id.* at 462-63.
79. *Id.* at 462.
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.* at 463.
84. *Id.*
85. *Id.* at 467-69.
86. *Id.* at 467.
87. *Id.* at 462.

under the pre-2003 statute.[88] It also acknowledged that it has no bright-line test for determining when an appeal is inadequate and a mandamus petition appropriate.[89] The court explained that the adequacy of appeal depends on the facts involved in each case, and it endorsed the balancing test it set forth in *In re Prudential Insurance Company of America*.[90] In the context of a health care liability claim, the supreme court suggested that mandamus is appropriate "[i]f (as appears to be the case here) some trial courts are either confused by or simply opposed to the Legislature's requirement for early expert reports."[91]

Notably, the supreme court also held that the plaintiffs in this case were not entitled to a 30-day extension to cure the deficient reports.[92] Under the pre-2003 version of the statute applicable to this case, a court had to grant a thirty-day "grace period" if the inadequacy was the result of an accident or mistake.[93] The current statute gives the courts discretion with regard to whether or not to grant a thirty-day extension.[94] The supreme court held that omission of a necessary element is not an accident or mistake, and that the plaintiffs' attorneys in this case should have known that their solo-practitioner expert, who had no staff privileges at any hospital, was unqualified in hospital credentialing.[95]

In *In re Methodist Health Care System*,[96] the supreme court decided without oral argument and in the wake of its decision in *McAllen*, to reiterate its position that mandamus may be appropriate in pre-2003 cases where interlocutory appeal is not available. On the same day in another case it decided without oral argument, *In re Roberts*,[97] the supreme court held that mandamus is not appropriate to challenge the grant of a 30-day extension to cure deficient reports. The court explained that "[b]ecause a 30-day extension—even if unjustified—does not substantially prolong litigation or allow for extensive discovery," the benefits to mandamus review are outweighed by the detriments.[98]

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88. *Id.* at 461.

89. *Id.* at 468-69.

90. *Id.* (citing *In re* Prudential Ins. Co. of Am., 148 S.W.3d 124, 136 (Tex. 2004)).

91. *Id.* at 466.

92. *Id.* at 469-70.

93. *See* TEX. REV. CIV. STAT. ANN. art. 4590i, § 13.01(g) (Vernon Supp. 1997) (repealed 2003): "[I]f a claimant has failed to comply with a deadline established by Subsection (d) of this section and after hearing the court finds that the failure of the claimant or the claimant's attorney was not intentional or the result of conscious indifference, but was the result of an accident or mistake, the court shall grant a grace period of 30 days to permit the claimant to comply with that subsection."

94. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 74.351(c) (Vernon 2008): "If an expert report has not been served within the period specified by Subsection (a) because elements of the report are found deficient, the court may grant one 30-day extension to the claimant in order to cure the deficiency."

95. *McAllen*, 275 S.W.3d at 469-70.

96. 256 S.W.3d 263, 264 (Tex. 2008).

97. 255 S.W.3d 640, 641-42 (Tex. 2008).

98. *Id.*

B. Curing Deficient Expert Reports

In a pair of related decisions issued on the same day, the Texas Supreme Court held that a plaintiff may cure a deficient expert report by serving a report from a different expert.[99] In *Lewis v. Funderburk*, the primary issue addressed by the court was a defendant's right to interlocutory appeal when the expert report was timely filed but allegedly inadequate.[100] The supreme court noted that, under the statute, a report "has not been served" if it is so deficient that it fails to meet the statutory requirements.[101] Therefore, the court held that an order denying a defendant's motion to dismiss based on the insufficiency of a timely filed report may be immediately appealed under the statute.[102] As to the merits of the defendant doctor's motion to dismiss, however, the supreme court rejected the doctor's argument that a plaintiff may only cure deficiencies with amendments by the original expert.[103] The court reasoned that, because the statute provides that "a claimant may satisfy *any requirement* of this section . . . by serving reports of separate experts . . . the statute does not prohibit [a plaintiff] from changing experts midstream."[104] Citing this analysis, the supreme court similarly decided *Danos v. Rittger*, holding that the statute allows a plaintiff to cure a deficiency by serving a report from a separate expert.[105]

C. Applicability of Chapter 74

A few cases of note during this Survey period examined the applicability of Chapter 74 to claims atypical of standard medical malpractice claims. In a case of first impression for the Dallas Court of Appeals, the court considered whether a non-patient's negligence claim against a hospital constituted a health care liability claim subject to the expert report requirements of Chapter 74.[106] In *Ammons*, Ammons had accompanied her husband to the defendant hospital's emergency department, and while there, she suffered injuries caused by another patient at the hospital.[107] The other patient was a male psychiatric patient who had been placed in a room at the emergency department to await a medical transfer.[108] The hospital had placed a security guard outside the room of the psychiatric patient, but did not otherwise restrain the patient.[109] At some

99. *See* Lewis v. Funderburk, 253 S.W.3d 204, 208 (Tex. 2008); Danos v. Rittger, 253 S.W.3d 215, 215 (Tex. 2008).
100. *Funderburk*, 253 S.W.3d at 207.
101. *Id.* at 207-08.
102. *Id.*
103. *Id.* at 208.
104. *Id.* (citing Tex. Civ. Prac. & Rem. Code Ann. § 74.351(i) (Vernon 2005)).
105. 253 S.W.3d 215, 215 (Tex. 2008). The court again applied this holding in a mandamus proceeding. *In re* Buster, 275 S.W.3d 475, 477 (Tex. 2008).
106. Wilson N. Jones Mem'l Hosp. v. Ammons, 266 S.W.3d 51, 53 (Tex. App.—Dallas 2008, pet. filed).
107. *Id.* at 53-54.
108. *Id.* at 53.
109. *Id.* at 54.

point the psychiatric patient rushed the security guard in the hallway, and as Ammons turned the corner into that hallway, the patient "donkey-kicked" Ammons in the stomach, knocking her to the floor.[110] Ammons subsequently sued the hospital for negligence, couching her suit as an unsafe premises action.[111] Specifically, her petition stated that the hospital failed to keep the common areas of its premises in a reasonably safe condition for its invitees and failed to warn or protect such invitees from dangers it knew or should have known about in the exercise of ordinary care.[112] Her petition alleged that the psychiatric patient who kicked her had been admitted to the hospital fifteen times in the previous five years, and had a documented history of violent and irrational behavior, causing the hospital to restrain and sedate him on at least one prior occasion.[113]

Initially, the hospital filed a no-evidence motion for summary judgment, which was denied.[114] It then filed a motion to dismiss for failure to file an expert report because Ammons never served the hospital with any expert reports related to her claims.[115] After hearing, the trial court granted the hospital's motion "as to any health care liability claims asserted by Plaintiff," but denied the motion "as to Plaintiff's claims for negligence."[116] The hospital filed an interlocutory appeal, arguing that all of Ammons's allegations constituted heath care liability claims for which an expert report is required.[117]

On appeal, Ammons argued that the hospital had waived its right to seek dismissal by not asserting that "defense" in a timely matter.[118] Alternatively, Ammons argued that her case had nothing to do with the hospital's rendition of health care services to her or to her assailant, and therefore was not subject to Chapter 74's requirements for health care liability claims.[119] The court of appeals disagreed on both counts.[120] Concluding that Ammons' claims were health care liability claims governed by Chapter 74, the court of appeals held it was an abuse of discretion for the trial court to deny the hospital's motion to dismiss.[121] In reaching its conclusion, the court of appeals first pointed out that a court looks to the nature and essence of a claim, rather than the way it is pled, in order to determine whether it is a health care liability claim.[122] In this case, the court of appeals reasoned that because the hospital's decision as to how and where to hold the psychiatric patient was a health care deci-

110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.* at 55.
117. *Id.* at 54-55.
118. *Id.* at 59.
119. *Id.* at 59-60.
120. *Id.*
121. *Id.* at 53.
122. *Id.* at 57 (citing Diversicare Gen. Partner, Inc. v. Rubio, 185 S.W.3d 842, 848 (Tex. 2005)).

sion, Ammons's negligence claim was inextricably interwoven with the rendition of health care services, making her claim a health care liability claim subject to the requirements of Chapter 74.[123] The court reasoned that the claims in this case were similar to those considered by the Texas Supreme Court in *Diversicare*,[124] which held that the claims of a nursing home patient sexually assaulted by another nursing home patient at the facility constituted health care liability claims because the supervision of the plaintiff and her assailant were inseparable from the accepted standards of safety applicable to the nursing-home defendant.

Additionally, the court of appeals determined that the requirements of Chapter 74 applied to Ammons, even though she was not a patient of the defendant hospital, because she was a "claimant" under the statute.[125] The court pointed out that the predecessor statute defined a health care liability claim as one arising from the injury or death "*of the patient*," while the current statute defines a health care liability claim as one arising from the injury or death "*of a claimant.*"[126] The court also noted that the statute defines "claimant" as including a decedent's estate, rather than merely a patient's estate, and thus, a claimant may or may not represent the estate of a decedent who may or may not have been a patient.[127] Accordingly, the court concluded, based on the plain and common meaning of the words used in Chapter 74, that a "patient" and "claimant" do not necessarily refer to the same category of persons, and a non-patient such as Ammons could constitute a "claimant" as defined by the statute.[128]

Finally, the court rejected Ammons's argument that the hospital had waived its right to dismissal pursuant to section 74.351 because it had not timely asserted that "defense."[129] The court held that the trial court, by granting the hospital's motion to dismiss as to any health care liability claims, had implicitly ruled against Ammons on such an argument.[130] The court of appeals did not address the hospital's argument that the requirements of Chapter 74 are not an affirmative "defense" that must be timely asserted in a pleading.[131]

In *Parker v. Simmons*, the Texarkana Court of Appeals held that a dental patient's breach of contract and deceptive trade practices claims for ill-fitting dentures also constituted a health care liability claim, subject to

123. *Id.* at 64.
124. Diversicare Gen. Partner, Inc. v. Rubio, 185 S.W.3d at 845.
125. *Ammons*, 266 S.W.3d at 60.
126. *Id.* (citing Act of May 30, 1977, 65th Leg., R.S., ch. 817, § 1.03(a)(4), 1977 Tex. Gen. Laws 2039, 2041 (former TEX. REV. CIV. STAT. ANN. art. 4590i, § 1.03(a)(4) (Vernon Supp. 2003)), *repealed and codified as amended by* Act of June 2, 2003, 78th Leg., R.S., ch. 204, §§ 10.01, 10.09, 2003 Tex. Gen. Laws 847, 864, 884, (current version at TEX. CIV. PRAC. & REM. CODE ANN. § 74.001(a)(13) (Vernon 2008)).
127. *Id.* at 61.
128. *Id.* at 62.
129. *Id.* at 57.
130. *Id.* at 58-59.
131. *Id.* at 59.

the requirements of Chapter 74.[132] Plaintiff Simmons alleged Dr. Parker made false claims and promises about the fit and suitability of "snap-on" dentures.[133] Simmons alleged that Parker induced her into entering into a transaction for ill-fitting dentures that rubbed and gouged her periodontal area, thereby causing her injury, and he subsequently refused to refund her money.[134] Simmons did not serve an expert report on Parker and contended she did not need to because her action was not a health care liability claim.[135] The court of appeals disagreed. Citing *Diversicare*, the court stated that a claimant cannot recast a health care liability claim as another cause of action and thereby avoid the requirements applicable to such claims.[136] In this case, the appellate court held that the conduct Simmons complained of—Parker's failure to provide a better denture or to properly fit the dentures, as promised—are acts "inextricably intertwined with the rendition of health care services."[137] The court noted that "[t]he necessity of expert testimony from a health care professional to prove a claim [is] an important factor in determining whether [that claim] is an inseparable part of the rendition of medical or health care services."[138] In this case, the court held such expert testimony was necessary because the complaint focused on the quality of the doctor's treatment.[139]

The Texarkana Court of Appeals reached a different decision in *Omaha Healthcare Center, L.L.C. v. Johnson*,[140] in which a nursing home resident died as a result of a spider bite suffered while at the defendant's facility. The court of appeals held that the plaintiff's claims in this case were premises liability claims involving a duty of ordinary care, as opposed to a health care liability claim involving a medical standard of care.[141] The court distinguished this case from *Diversicare*, noting that *Diversicare* involved medical decisions about the restraint of nursing-home residents based on medical necessity, whereas this case involved pest-control judgments that do not implicate the medical duty to diagnose and treat.[142] Accordingly, the court held that Johnson had presented "a premises liability claim in a health care setting that may not be properly classified as a health care liability claim" since no medical expert report is required to explain the standard of care or its breach.[143]

132. 248 S.W.3d 860, 862 (Tex. App.—Texarkana 2008, no pet.).
133. *Id.*
134. *Id.*
135. *Id.* at 863.
136. *Id.*
137. *Id.* at 864.
138. *Id.*
139. *Id.*
140. 246 S.W.3d 278, 280 (Tex. App.—Texarkana 2008, pet. filed).
141. *Id.* at 286-87.
142. *Id.* at 285-87.
143. *Id.* at 287.

III. DIRECTOR AND OFFICER LIABILITY

A. TEXAS COURTS EXERCISE JURISDICTION OVER DIRECTORS AND OFFICERS

Several Texas courts addressed jurisdiction over directors and officers during this Survey period. In *Kelly v. General Interior Construction, Inc.*, the Fourteenth Court of Appeals in Houston analyzed specific personal jurisdiction over Arizona resident officers and directors of an Arizona-based construction company named Diva Consulting, Inc.[144] A Texas subcontractor sued the Diva officers for breach of contract, Texas Trust Fund Act violations, and fraud. After the trial court denied the officers' special appearance, they appealed asserting that their actions, including signing a contract and withholding funds paid by the owner, were solely in their corporate capacity and could not, therefore, give rise to personal jurisdiction. The appellate court agreed as to the breach of contract claim, finding that "a corporate officer who signs a contract on behalf of his corporation is not a party to the contract, but acting in his corporate capacity. Such act does not constitute a contact for purposes of personal jurisdiction."[145]

The officers did not fare as well in connection with the trust fund and fraud claims. Chapter 162 of the Texas Property Code imposes fiduciary responsibilities on contractors to ensure that Texas subcontractors are paid for completed work.[146] An officer or director who has control over such funds is personally liable for misappropriating those funds.[147] Because the subcontractor in this case asserted individual claims under the Texas Trust Fund Act, the court of appeals found that personal jurisdiction existed as to those claims.[148] Similarly, because officers may be individually liable for alleged false statements, even if those statements are made in the capacity of a corporate representative, the court held that personal jurisdiction existed as to the fraud claims as well.[149]

Specific and general jurisdiction via an alter-ego theory was addressed by the Corpus Christi Court of Appeals in *Joiner v. Coast Paper & Supply*.[150] In that case, Joiner Food Service, Inc., a Texas corporation, sued a California corporation, its officer, and a Texas limited partnership. The plaintiff alleged that, under an alter-ego theory, specific and general jurisdiction existed over the California corporation's officer by virtue of the partnership's conduct. The court noted that jurisdictional veil-piercing involves different elements of proof than substantive veil-piercing, and the plaintiff must demonstrate that the officer controlled the internal bus-

144. 262 S.W.3d 79, 82 (Tex. App.—Houston [14th Dist.] 2008, pet. granted).
145. *Id.* at 83 (citing Wolf v. Summers-Wood, L.P., 214 S.W.3d 783, 792 (Tex. App.—Dallas 2007, no pet.)).
146. *Id.* at 84-85.
147. *Id.* at 85.
148. *Id.* at 85-86.
149. *Id.* at 86-87.
150. No. 13-07-00623-CV, 2008 WL 2895851, at *2-3 (Tex. App.—Corpus Christi July 29, 2008, no pet.) (mem. op.).

iness operations of the entity "to a degree 'greater than that normally associated with common ownership and directorship.'"[151] Because the plaintiff focused on intentional undercapitalization as its theory to show alter ego by perpetuating a fraud, the court found that the plaintiff may have presented sufficient evidence to pierce the veil substantively but not for jurisdictional purposes.[152] The court further found that the California officer had not purposely availed herself of the jurisdiction of Texas courts because her contacts with the state, including several personal visits, were done in her capacity as an officer of the company.[153] The court further found that the officer had not solicited business in Texas, had never employed residents of Texas, had not committed a tort in Texas, had never done business in Texas in her individual capacity, and had not consented to jurisdiction of Texas courts in her individual capacity.[154]

The nonresident directors in *Glencoe Capital Partners II, L.P. v. Gernsbacher*[155] did not have similar success. In that case, the trial court denied the nonresident directors' special appearance, and the court of appeals agreed, finding that participation in telephonic board meetings constituted purposeful availment because the nonresident directors knew that some directors were Texas residents and that they operated corporate divisions in Texas.[156] Consequently, the nonresident directors sought some benefit and were advantaged by availing themselves of Texas jurisdiction. Significant in this case was that the principal contacts supporting specific jurisdiction were telephonic board meetings during which plaintiffs participated from Texas and during which the defendants allegedly made misrepresentations regarding the company's financial condition and terms for certain notes—the subject matter of the lawsuit. The Fort Worth Court of Appeals acknowledged that the Texas Supreme Court has "disapproved opinions holding that . . . specific jurisdiction is *necessarily* established by allegations or evidence that a nonresident committed a tort in a telephone call from a Texas number," but it noted that the Texas Supreme Court has never "held that telephone calls are *never* sufficient to establish [such] minimum contacts."[157] Unique to this case was that the telephone calls involved multiple telephonic board meetings at regular intervals over a span of years during which time the plaintiffs allege that defendants induced them to enter into certain notes after making alleged misrepresentations. Surprisingly, the appellate court even went a step further stating that its finding of jurisdiction was not dependent on the defendants' knowledge that the plaintiffs were participating in the meetings from Texas because, even in the absence of such knowledge, "it

151. *Id.* at *6 (citing BMC Software Belg., NV v. Marchand, 83 S.W.3d 789, 799 (Tex. 2002)).
152. *Id.* at *7.
153. *Id.* at *7-8.
154. *Id.*
155. 269 S.W.3d 157 (Tex. App.—Fort Worth 2008, no pet.).
156. *Id.* at 163, 165, 167.
157. *Id.* at 165 (citing Michiana Easy Livin' Country, Inc. v. Holdson, 168 S.W.3d 777, 791-92 (Tex. 2005)).

was foreseeable that their activity directed toward Texas residents would subject them to Texas jurisdiction."[158]

B. Officers Acting in an Individual Versus a Corporate Capacity

A cautionary tale is provided by *IMC, Inc. v. Gambulos*, in which an officer signed a personal guaranty and subsequently tried to avoid responsibility.[159] In that case, the president of the corporation, Ceramic & Granite Trading Company, LLC, signed a personal guaranty. After he was sued for breach of contract, the trial court granted his motion for summary judgment, finding that he was not personally responsible for the guaranty because he signed only in his capacity as president of the corporation.[160] The Dallas Court of Appeals disagreed, holding that "[t]he fact that a corporate title follows an individual's signature does not transform a personal guaranty into a corporate guaranty."[161] The court went on to describe the signature as a *descriptio personae*, meaning the use of a word or phrase to identify the person rather than proof that a person is acting in any particular capacity.[162]

C. Res Judicata and Parallel Litigation

It is not at all unusual for director and officer liability cases to be brought in parallel federal and state courts. This type of parallel litigation frequently raises the issue of res judicata, as addressed in *Motient Corp. v. Dondero*.[163] In that case, a Delaware corporation, Motient, brought suit against Dondero, a director on the board, in federal court alleging violations of the 1934 Securities Exchange Act based on alleged false, misleading, and incomplete public statements. Motient also brought suit against Dondero in state court alleging breach of fiduciary duties of loyalty and care and the duty of good faith. Dondero successfully moved to dismiss the federal suit due to insufficient pleading under the Private Securities Litigation Reform Act. Dondero then moved for summary judgment in the state court case based on the res judicata effect of the federal court dismissal. Res judicata bars "litigation of claims that either have been litigated or should have been raised in an earlier suit."[164] Prior federal litigation bars a subsequent suit if: (1) the parties are identical in both suits or in privity, (2) the same claim or cause of action is involved in both suits, (3) the prior judgment is rendered by a court of competent jurisdiction, and (4) the prior action was concluded by a final judgment on the

158. *Id.* at 166.
159. No. 05-07-00470-CV, 2008 WL 3867429, at *1. (Tex. App.—Dallas Aug. 21, 2008, no pet.)
160. *Id.*
161. *Id.* at *2.
162. *Id.*
163. 269 S.W.3d 78 (Tex. App.—Dallas 2008, no pet.).
164. *Id.* at 83.

merits.[165] The Dallas Court of Appeals reversed the trial court's order granting summary judgment finding that, although both suits involved the same claim and cause of action, the federal court was not a court of competent jurisdiction over the fiduciary duty claims because there was no diversity jurisdiction.[166] Although supplemental jurisdiction existed, it was clear that the federal court would have declined as a matter of discretion to exercise that jurisdiction because "it was the practice of [that] federal court judge, the Honorable Jorge Solis, to dismiss pendent state law claims when all federal claims had been dismissed."[167] Consequently, the Dallas Court of Appeals found that the Northern District would not have exercised supplemental jurisdiction, and therefore res judicata did not apply.[168]

D. Directors and Officers and the Tax Code

In *In re Trammell*, a Dallas appellate court addressed whether an officer personally liable for corporate debts could enforce an arbitration clause signed by his company.[169] The case dealt with a claim against Cecil Trammell, president and shareholder of C & K Concrete (C & K), a company that had lost its corporate charter. Trammell, who faced liability for C & K's debts pursuant to section 171.255 of the Texas Tax Code, moved to compel arbitration under a contract signed by the company. After the trial court denied Trammell's motion, he filed a petition for a writ of mandamus and an interlocutory appeal, arguing that the trial court's decision constituted an abuse of discretion.[170]

The court affirmed the order denying arbitration and rejected Trammell's petition for a writ of mandamus.[171] It concluded that, because the plaintiffs sought to hold Trammell liable based solely on section 171.255 of the Tax Code, their claims against him did not arise from the contract containing the arbitration provision.[172] In addition, Trammell could not rely on equitable estoppel, which applies when a "signatory to a written agreement containing an arbitration clause must rely on the terms of the written agreement in asserting its claims against the nonsignatory," to enforce the arbitration clause.[173] In a related dispute with the plaintiffs, C & K had not appealed the trial court's denial of its motion to compel arbitration. The court therefore concluded that "Trammell, a nonsignatory, cannot use the principle of equitable estoppel to obtain a greater right to arbitration than the signatories," and held that forcing Trammell to litigate the claims against him would not be unfair or

165. *Id.*
166. *Id.* at 86.
167. *Id.* at 88, 90.
168. *Id.* at 90.
169. 246 S.W.3d 815, 819 (Tex. App.—Dallas 2008, no pet.).
170. *Id.*
171. *Id.* at 825.
172. *Id.*
173. *Id.* at 821.

inequitable.[174]

The Austin Court of Appeals addressed an officer's individual liability for sales tax in *State v. Crawford*.[175] In that case, the State of Texas and the City of Houston sued the CEO and CFO of a construction company seeking to establish individual liability under section 111.016(b) of the Texas Tax Code. The governmental entities alleged that the officers willfully failed to pay or cause to be paid delinquent sales tax amounts owed to the city and the state. Because the evidence was sufficient to establish that the officers did not knowingly fail to remit collected sales taxes to the state, and the evidence was sufficient to establish that the officers did not act with direct disregard of the risk that collected taxes might not be remitted, the court of appeals affirmed the trial court's entry of judgment in favor of the officers.[176]

E. Derivative Actions and Demand Futility

Demand futility was a hot topic for the Dallas and Houston Courts of Appeal during this Survey period. In *Connolly v. Gasmire*, two shareholders of Odyssey Healthcare, Inc., Connolly and Molinari, brought a shareholder derivative action against a Delaware corporation's board of directors and officers.[177] The shareholders alleged that the directors and officers breached their fiduciary duties in connection with Medicare and Medicaid billing and, instead of taking action to halt the wrongdoings, sold more than $60 million of their Odyssey stock. The trial court sustained the directors' and officers' special exceptions, finding that the shareholders had failed to state the necessary factual allegations to show demand futility.[178] After the plaintiffs ignored the court order directing them to amend their petition, the trial court dismissed the case without prejudice.[179]

The appellate court affirmed, first ruling that special exceptions were the proper method to address plaintiffs' failure to plead demand futility.[180] The court then analyzed demand futility under Delaware substantive law,[181] providing detailed analysis as articulated in the two seminal Delaware cases on that issue—*Aronson v. Lewis*[182] and *Rales v. Blasband*.[183] Under those cases, in order to bring a derivative claim, a shareholder must plead with particularity facts that raise a reasonable doubt that a majority of the directors "are disinterested and independent, demonstrating that they are unable to act objectively with respect to a pre-suit

174. *Id.* at 825-26.
175. 262 S.W.3d 532 (Tex. App.—Austin 2008, no pet.).
176. *Id.* at 535.
177. 257 S.W.3d 831 (Tex. App.—Dallas 2008, no pet.).
178. *Id.* at 845-46.
179. *Id.* at 838.
180. *Id.*
181. Del. Ch. Ct. R. 23.1.
182. 473 A.2d 805 (Del. 1984).
183. 634 A.2d 927 (Del. 1993).

demand."[184] The court rejected the shareholders' attempt to show lack of disinterest due to the directors' participation on the compliance, compensation, and audit committees.[185] The court noted that there were no particularized facts showing that the committees had failed to perform their duties, and mere participation on those committees alone was insufficient to show disinterest.[186] The court also ruled that "the mere fact that a director receives compensation for his services as a board member does not demonstrate demand futility."[187] Additionally, merely alleging that the directors had sold stock— absent allegations of insider trading, common trading patterns, or inconsistency in the directors' trading—was not sufficient to show lack of disinterest.[188] Similarly, the shareholders' allegations that the directors had longstanding relationships with each other was not sufficient to show a lack of independence absent something more serious such as financial ties, familial affinity, or a particularly close, intimate personal or business affinity.[189] Finally, allegations concerning the directors' experience and expertise and collective involvement and wrongdoing were not sufficient absent particularized facts detailing the precise duties and each role the directors played, the information that would have come to their attention in those roles, and how they benefited from the alleged wrongdoing.[190]

The court, applying the *Aronson* test, also found insufficient pleaded facts to show lack of business judgment by the directors.[191] In attempting to show lack of business judgment, the shareholders relied on a Seventh Circuit case and a Massachusetts state case.[192] The shareholders asserted that knowledge of alleged defects in internal controls and knowledge of the alleged Medicare and Medicaid violations could be imputed generally to the directors of the corporation. The court rejected those cases, instead noting that under Delaware law a petition must allege facts that suggest or imply the directors "knew they were making a material decision without adequate information and without adequate deliberation, and they did not care if the decision caused the corporation and stockholders to suffer injury or loss."[193] Finding that the plaintiffs had failed to plead sufficient facts under any of the tests, the Dallas Court of Appeals held that the trial court did not err in sustaining the directors' and

184. *Connolly*, 257 S.W.3d at 842.
185. *Id.* at 842-45.
186. *Id.*
187. *Id.* at 845.
188. *Id.* at 845-47.
189. *Id.* at 847.
190. *Id.* at 847-49.
191. *Id.* at 852.
192. *Id.* at 850-51 (citing cases that shareholders used as authority: *In re* Abbott Labs Derivative S'holders Litig., 325 F.3d 795, 808-09 (7th Cir. 2003); *In re* Biopure Corp. Derivative Litig., 424 F. Supp. 2d 305, 308 (D. Mass. 2006)).
193. *Id.* (citing Khanna v. McMinn, No. Civ. A. 20545-NC, 2006 WL 1388744, at *12, *25 (Del. Ch. May 9, 2006); *In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 289 (Del. Ch. 2003)).

officers' special exceptions and in ultimately dismissing the case.[194]

Whether or not to stay discovery until the demand futility requirement has been met is a frequent topic of contention. The Fourteenth Court of Appeals in Houston dealt with this issue in *In re Crown Castle International Corp.*[195] In that case, various shareholders brought a derivative action on behalf of a Delaware corporation, Crown Castle, alleging that officers and directors breached their fiduciary duties by backdating stock options grants. Crown Castle filed special exceptions stating that the shareholders had not made demand on the board of directors and had not alleged particularized facts showing demand futility. Soon after the shareholders served discovery, the respective parties filed motions to compel and protective orders. The trial court granted Crown Castle's special exceptions but overruled its objections to discovery, disagreeing that the corporation was not obligated to respond to discovery until demand futility had been adequately pleaded.[196] The corporation filed a writ of mandamus seeking to compel the trial court to stay discovery until the shareholders adequately pleaded demand futility. The Fourteenth Court of Appeals treated both the demand futility pleading requirements and a party's entitlement to discovery as substantive and applied Delaware law, holding that the shareholders could not seek discovery for the purpose of satisfying the demand futility pleading requirements.[197] Consequently, the court of appeals conditionally granted the petition for writ of mandamus and directed the trial court to vacate its order denying the motion for protective order and refusing to stay all discovery pending an adequate pleading of demand futility.[198]

A former CEO's severance compensation and potential breach of fiduciary duties related to his employment agreement were addressed in *Pride International, Inc. v. Bragg.*[199] In that case, Bragg, the CEO of Pride, challenged the severance package provided in the employment agreement he had negotiated after he was hired. While CEO, Bragg made representations to the board regarding the severance benefits, which were contrary to the assertions he made in the lawsuit after he was terminated. Indeed, during the CEO's tenure, he rejected claims brought by other officers urging the very interpretation the CEO made in his lawsuit. In response to the CEO's breach of contract claims, the company alleged breach of fiduciary duty claims against him contending that the CEO had failed to disclose material information about the company, namely his understanding of the employment agreement. The trial court granted summary judgment against both parties and ordered that both

194. *Id.* at 852.

195. 247 S.W.3d 349 (Tex. App.—Houston [14th Dist.] 2008, no pet.).

196. *Id.* at 352.

197. *Id.* at 354 (citing Beam v. Stewart, 845 A.2d 1040, 1056 (Del. 2004)); *see also* Stotland v. GAF Corp., No. 6876, 1983 WL 21371, at *3 (Del. Ch. Sept. 1, 1983) ("the Plaintiffs are not entitled to take discovery in order to prove allegations of futility.").

198. *Id.* at 356.

199. 259 S.W.3d 839, 841 (Tex. App.—Houston [1st Dist.] 2008, no pet.).

parties take nothing by their suits.[200]

The First Court of Appeals in Houston, applying Delaware law, agreed with the trial court finding that Bragg's failure to inform the board of his understanding of the employment agreement did not constitute a failure to disclose because the information was otherwise available to the company.[201] Significantly, the company had consulted with legal counsel and was aware of conflicting views of the interpretation of the agreement. Additionally, Bragg had no duty to disclose his private views as to the interpretation of his employment agreement when negotiating and renewing his own employment.[202] The court specifically held that in such a context, "a corporate officer acts in his individual capacity, as it is evident that the company and the employee are adverse to each other in the context of negotiating that employee's compensation."[203] Consequently, the court of appeals affirmed the granting of Bragg's summary judgment motion.[204] Of course, this victory was of little benefit to Bragg because the court of appeals also affirmed the company's summary judgment as to the breach of contract claims.[205]

F. Fiduciary Duties and Their Limitations

In *Elloway v. Pate*, a Houston appellate court explored the limitations of two sections of the Delaware Code, which exculpate directors from liability in certain circumstances, sections 141(3) and 102(b)(7) of Chapter 8.[206] The plaintiff, Elloway, was a Pennzoil-Quaker State Company shareholder who brought a class action against Pennzoil's directors, alleging that they had breached their fiduciary duties in connection with the company's sale to Shell Oil Company. Elloway argued that the directors agreed to an unfairly low per-share price to ensure that Shell would consummate the merger despite additions to the company's change-in-control benefits. The trial court granted the defendants' motion for a directed verdict on Elloway's duty of care claim, and the jury rejected Elloway's duty of disclosure and duty of loyalty claims.[207]

On appeal, Elloway argued that the court erred in granting directed verdict. In response, the directors relied on a provision in Pennzoil's certificate of incorporation authorized by section 102(b)(7), which insulated the directors from liability for breaches of the duty of care. Elloway argued that the directors did not rely on this provision in the trial court and, therefore, could not raise this defense for the first time on appeal. Since the jury had never considered the issue, it had not concluded that the directors' actions were "in good faith and did not involve intentional mis-

200. *Id.*
201. *Id.* at 850.
202. *Id.*
203. *Id.*
204. *Id.* at 851.
205. *Id.*
206. 238 S.W.3d 882 (Tex. App.—Houston [14th Dist.] 2007, no pet.).
207. *Id.* at 889.

conduct or a knowing violation of the law, which are elements of proof under section 102(b)(7)."[208] But the court held that a jury finding specific to section 102(b)(7) was unnecessary—the jury's response to its breach of loyalty question had necessarily decided that the directors' actions were in good faith.[209]

Elloway also challenged a prefatory jury instruction based on section 141(e), which exculpates board members from liability when they rely in good faith on corporate records, officers, employees, committees of the board, or others "as to matters the [member] reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."[210] Elloway argued that the instruction improperly relieved the directors of the burden of proving their defense, was inappropriate because it only applies to duty of care claims, and was unavailable because the board allegedly was deceived by individuals who would profit from their misconduct.[211] The court rejected each contention, noting first that the relevance of section 141(e) is not limited to duty of care claims.[212] Next, the court rejected the argument that the board could not rely on any individuals who stood to benefit from the transaction at issue: "[s]imply because a director stands to gain financially through change-in-control benefits does not mean the director has a financial interest in the merger so that the board may not delegate negotiating authority to that director."[213] Finally, the court noted that the jury instruction in this case had included a caveat that "a director may not avoid his or her active and direct duty of oversight in connection with the merger.[214] Directors have a duty to inform themselves, prior to making a decision of all material information reasonably available to them."[215] Therefore, the jury was adequately instructed regarding the directors' duties, and there was no harmful error in the jury instruction.

IV. CONCLUSION

As illustrated by the cases in this Survey period, professional liability claims against lawyers, health care providers, and corporate officers and directors all have their own complex procedural and proof requirements. As in past years, the appellate courts in this period required strict compliance with these requirements and rejected those claims where plaintiffs' pleadings or proof fell short.

208. *Id.* at 890.
209. *Id.* at 890-91.
210. *Id.* at 896.
211. *Id.* at 897-98.
212. *Id.* at 898-99.
213. *Id.* at 898.
214. *Id.* at 898-99.
215. *Id.*