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Professional Liability

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PROFESSIONAL LIABILITY

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DURING this Survey period, Texas courts continued to wrestle with many of the issues that have dominated professional liability cases in recent years, including privity/standing issues, causation, statutes of limitations, jurisdiction over out-of-state defendants, expert report requirements, fiduciary duties, and insurance coverage. The courts also continued to resolve those issues—in most cases—in favor of the defendants.

I. LEGAL MALPRACTICE

A. PLAINTIFFS FACE CONTINUED DIFFICULTIES IN PROVING CAUSATION

As during the last Survey period, Texas courts continued to impose a heavy burden upon malpractice plaintiffs to demonstrate causation. For example, the San Antonio Court of Appeals reversed a $65.5 million judgment against Baker Botts, LLP and Wells Fargo in *Baker Botts, L.L.P. v. Cailloux*.[1] Baker Botts provided estate planning services for Kathleen Cailloux and her husband Floyd. After Floyd's death, Wells Fargo became the independent executor of Floyd's share of the marital estate. Baker Botts continued to represent Kathleen after her husband's death. In addition, Baker Botts represented Wells Fargo in connection with the administration of Floyd's estate as well as one of the foundations that was created as part of the Caillouxes' estate planning process. Baker Botts sought and obtained conflict waivers from Kathleen, Wells Fargo, and the foundation. After Floyd's death, Baker Botts began working with Kathleen to revise the estate plan. As part of that revised plan, Kathleen voluntarily disclaimed her right to her husband's share of the marital estate, and $65.5 million was accordingly transferred to various charitable organizations identified by Floyd in his will, rather than going into a trust for Kathleen's benefit.[2] After Kathleen was diagnosed with Alzheimer's disease, her son Ken obtained a power of attorney and began to manage her affairs. Upon review of Baker Botts' files, he concluded that Baker Botts and Wells Fargo had engaged in "conspiracy and fraud"

1. *See* 224 S.W.3d 723 (Tex. App.—San Antonio 2007, pet. denied).
2. *Id.* at 726, 732.

in convincing Kathleen to disclaim her interest in Floyd's estate, and he brought suit. At trial, the jury concluded that Baker Botts and Wells Fargo had breached their fiduciary duties to Kathleen by failing to "fully and fairly disclose all important information to Kathleen."[3] The jury found that Kathleen could have received $65.5 million in trust if not for the breaches of duty, but that her actual lost income and other economic losses were $0.[4] In light of the jury's findings, the trial court, using its "equitable powers," ordered Baker Botts and Wells Fargo to create an equitable trust for Kathleen's benefit of $65.5 million.[5]

The court of appeals reversed, holding there was no evidence that the conduct complained of caused Kathleen to disclaim her right to Floyd's estate.[6] The court noted that none of the trial witnesses had any knowledge of Kathleen's true wishes or intentions and, therefore, any assumption about what Kathleen would have done had she been fully informed of all material information was speculative and based on conjecture.[7] The court stated that "any attempt to infer or assume what Kathleen would have done in this case had she been adequately advised is improper."[8]

Alternatively, the court held that even if the plaintiff had provided proof of causation, the trial court nevertheless "abused its discretion by imposing an 'equitable trust' upon Baker Botts and Wells Fargo."[9] The court noted that a

> constructive trust is a relationship with respect to property, subjecting the person by whom the title to the property is held to an equitable duty to convey it to another, on the ground that his acquisition or retention of the property is wrongful and that he would be unjustly enriched if he were permitted to retain the property.[10]

Because Baker Botts and Wells Fargo did not hold title to the trust principal, the trial court could not impose a constructive trust.[11] In addition, the court held that the trial court abused its discretion because the creation of the trust "essentially place[d] Kathleen in a better position than she previously occupied" because it allowed her to enjoy the benefits of disclaimer (making a substantial charitable gift during her lifetime, reducing the likelihood of an IRS audit of her estate, and virtually eliminating her estate's tax liability upon her death) while also enjoying the benefits of the Baker Botts/Wells Fargo trust.[12]

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3. *Id.* at 732.
4. *Id.*
5. *Id.* at 726.
6. *Id.* at 734.
7. *Id.*
8. *Id.*
9. *Id.* at 736.
10. *Id.*
11. *See id.*
12. *Id.* at 737-38.

The San Antonio Court of Appeals affirmed summary judgment in another legal malpractice case on the grounds that the plaintiff failed to raise an issue of fact regarding causation. *Collins v. Snow*[13] arose from Mr. Snow's alleged negligent representation of Mr. Collins in a medical malpractice action. The plaintiff alleged that the lawyer failed to adequately plead, prove, and submit a claim for lack of informed consent for a medical procedure that resulted in his wife's death.[14] The court of appeals affirmed the trial court's grant of summary judgment in the medical malpractice action, finding that the plaintiff failed to establish an issue of fact as to one of the elements of the medical malpractice claim—that the patient would have refused the treatment had she been informed of the undisclosed risks.[15] Because the plaintiff could not adequately establish the merits of his underlying claim, he could not prove causation in the malpractice case.[16]

In *McLendon v. Detoto*,[17] the Fourteenth District Houston Court of Appeals followed the rule established in *Peeler v. Hughes & Luce*,[18] that malpractice plaintiffs who have been convicted of a crime cannot establish proximate causation with regard to any alleged legal malpractice in their criminal trial unless they have been exonerated of the crime on direct appeal, through post-conviction relief, or otherwise. Because McLendon presented no evidence that he had been exonerated, the court of appeals granted summary judgment in favor of the defendant lawyer.[19]

B. Personal Jurisdiction Over Out-of-State Lawyers

Another issue faced by the Texas courts during this Survey period is whether and when to allow non-Texas attorneys to be sued in Texas by Texas citizens. The Austin Court of Appeals refused to find personal jurisdiction over two out-of-state attorneys in *Red v. Doherty*,[20] where two California attorneys were sued in Texas state court after their client, a defendant in a wrongful death action in California, moved to Texas and filed bankruptcy. In the Texas bankruptcy proceeding (in which the client was represented by Texas counsel), the bankruptcy court ruled that the wrongful death claims qualified as exceptions to discharge under 11 U.S.C. § 523(a)(6) (2000) because the collision was the result of the defendant's willful and malicious conduct. The California state court then ruled that such decision was *res judicata* as to the wrongful death claims against the defendant in California. The Austin Court of Appeals af-

13. No. 04-05-00903-CV, 2006 WL 2955478, at *1 (Tex. App.—San Antonio Oct. 18, 2006, no pet.) (mem. op.).
14. *See id.*
15. *See id.* at *2.
16. *See id.*
17. *See* No. 14-06-00658-CV, 2007 WL 1892312, at *1 (Tex. App.—Houston [14th Dist.] 2007, pet. denied) (mem. op.).
18. 909 S.W.2d 494, 497-98 (Tex. 1995).
19. *McLendon*, 2007 WL 1892312, at *1-2.
20. *See* No. 03-06-00478-CV, 2007 WL 2066182, at *1 (Tex. App.—Austin July 20, 2007, pet. denied) (mem. op.).

firmed the trial court's ruling that the California lawyers could not be sued for malpractice in Texas.[21] The court reasoned that the California lawyers were hired to represent the defendant before he moved to Texas and that they did not have contact with the defendant or his counsel in Texas except as necessary to coordinate the defense in the California litigation; therefore, the California counsel did not purposefully avail themselves of the privileges and benefits of conducting business in Texas.[22]

The Fourteenth District Houston Court of Appeals also issued two opinions this year on personal jurisdiction over out-of-state attorneys, and in both cases found a lack of minimum contacts to support jurisdiction.[23] In *Markette v. X-Ray X-Press Corp.*,[24] the court held that a non-resident attorney was not subject to jurisdiction in Texas where the attorney represented a client in an Indiana lawsuit but arguably provided advice regarding Texas law. In a letter to the client, the Indiana attorney advised the client of three options, one of which was to allow a default judgment to be taken in the Indiana lawsuit and then "use the Texas court system" to attack personal jurisdiction.[25] The client followed that advice, and ultimately was required to satisfy the default judgment.[26] In the legal malpractice case that followed, the court of appeals held that the lawyer's act of giving legal advice on Texas law directed to a Texas client was insufficient to sustain personal jurisdiction over the attorney in Texas.[27] In *Weldon-Francke v. Fisher*,[28] the Fourteen District Houston Court of Appeals held that merely maintaining a firm website that is accessible to Texas residents is also insufficient to establish personal jurisdiction over a non-resident law firm. The court noted that Internet contacts are evaluated on a "sliding scale":

> At one end of the continuum, the website may support a finding of personal jurisdiction when a defendant does business over the internet by entering into contracts and through the repeated transmission of computer files. At the other end of the continuum, personal jurisdiction cannot be based on the passive posting of information on the internet.[29]

Because the website at issue was passive and informational and did not allow for the exchange of information between the user and the law firm or the transaction of business or entry into contracts through the website, the court of appeals found out that the law firm was not subject to per-

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21. *Id.* at *6.
22. *Id.*
23. *See* Markette v. X-Ray X-Press Corp., 240 S.W.3d 464 (Tex. App.—Houston [14th Dist.] 2007, no pet.); Weldon-Francke v. Fisher, 237 S.W.3d 789 (Tex. App.—Houston [14th Dist.] 2007, no pet.).
24. *Markette*, 240 S.W.3d at 464.
25. *Id.* at 466.
26. *Id.*
27. *Id.* at 468–69.
28. *See Weldon-Francke*, 237 S.W.3d at 789 (internal citations omitted).
29. *Id.* at 799.

sonal jurisdiction in Texas.[30]

Although not a Texas case, *Sample v. Morgan*[31] should serve as a cautionary tale to Texas and out-of-state practitioners alike. In that case, a corporate shareholder brought a derivative action in Delaware against, among others, the lawyer and law firm who were acting as the corporation's outside counsel.[32] The lawyer and law firm moved to dismiss for lack of personal jurisdiction.[33] The court denied defendants' motion, holding that in 1) preparing and delivering to Delaware for filing a certificate amendment under challenge in the lawsuit; 2) advertising themselves as being able to provide coast-to-coast legal services and as experts in matters of corporate governance; 3) providing legal advice on a range of Delaware law matters at issue in the lawsuit; and 4) undertaking to direct the defense of the Delaware lawsuit, the defendants had subjected themselves to personal jurisdiction in Delaware. The court noted:

> The United States Supreme Court has held that it is constitutionally permissible to exercise personal jurisdiction over a non-resident defendant when that defendant should have "reasonably anticipated . . . that his . . . actions might result in the forum state exercising personal jurisdiction over him in order to adjudicate disputes arising from those actions." To satisfy this test, the defendant need not have ever entered the forum state physically because the Supreme Court has rightly focused the test on the more relevant question of whether the defendant has engaged in such conduct directed toward the forum state that makes it reasonably foreseeable that that conduct could give rise to claims against the defendant in the forum state's courts.[34]

The court found that for "sophisticated counsel to argue that they did not realize that acting as the de facto outside general counsel to a Delaware corporation and regularly providing advice about Delaware law about matters important to that corporation and its stockholders might expose it to this court's jurisdiction fails the straight-face test."[35] The opinion reflects a good amount of frustration by the Delaware court towards these particular lawyer-defendants, and the court stated that it was a "highly unusual case" that should not cause law firms providing advice to Delaware corporations to fear that they will be regularly hauled into court there.[36] But the court's broad statements of law and policy will inevitably cause some concern.

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30. *Id.* at 799-800.
31. 935 A.2d 1046 (Del. Ch. 2007).
32. *Id.*
33. *Id.*
34. *Id.* at 1062-63 (quoting In re USACafes, L.P. Litig., 600 A.2d 43, 50 (Del. Ch. 1991)).
35. *Id.* at 1065.
36. *See id.*

C. Statute of Limitations in Legal Malpractice Cases

During this Survey period, Texas courts considered two cases interpreting the Hughes Tolling Rule, which tolls the statute of limitations "when an attorney commits malpractice in the prosecution or defense of a claim that results in litigation . . . until all appeals on the underlying claim are exhausted or the litigation is otherwise finally concluded."[37] In *Estate of Whitsett v. Junell*,[38] the First District Houston Court of Appeals held that the phrase "claim that results in litigation" should be construed broadly to include all claims for an indivisible injury that an attorney is hired to pursue on behalf of a client as well as any claim the attorney must assert on behalf of the client in the exercise of reasonable care. Therefore, when an attorney represents a client on multiple claims arising out of the same occurrence or subject matter but negligently fails to file one or more of those claims entirely, the Hughes rule tolls the statute of limitations for a legal malpractice claim against the attorney until all appeals for the filed claims are exhausted.[39]

The Amarillo Court of Appeals also considered the Hughes Tolling Rule in *Brennan v. Manning*,[40] a legal malpractice case arising out of an attorney's representation in a divorce proceeding. The client argued that tolling should be extended for some period after her divorce decree became final since her attorney also performed subsequent legal services to enforce the decree.[41] The court disagreed, holding that the policy concerns underlying the Hughes Tolling Rule did not support an extension of that rule beyond the date that litigation concluded.[42] The court also held that the plaintiff failed to demonstrate sufficient facts to trigger the discovery rule or the fraudulent concealment doctrine to further extend the statute of limitations.[43]

D. Determining Damages Allegedly Resulting from Litigation Malpractice

The Dallas Court of Appeals considered several issues related to litigation malpractice damages in *Akin, Gump, Strauss, Hauer & Feld, L.L.P. v. National Development & Research Corp.*[44] The client, National Development & Research Corp. ("NDR"), brought claims against Akin, Gump, Strauss, Hauer & Feld, L.L.P. ("Akin Gump") alleging that the law firm negligently failed to submit jury questions to support a partial

37. Hughes v. Mahaney & Higgins, 821 S.W.2d 154, 157 (Tex. 1991); *see also* Apex Towing Co. v. Tolin, 41 S.W.3d 118, 119–20 (Tex. 2001).

38. 218 S.W.3d 765, 771-72 (Tex. App.—Houston [1st Dist.] 2007, no pet.) (citing Sanchez v. Hastings, 898 S.W.2d 287, 288 (Tex. 1995)).

39. *Id.*

40. No. 07-06-0041-CV, 2007 WL 1098476, at *1 (Tex. App.—Amarillo Apr. 12, 2007, pet. denied) (mem. op.).

41. *Id.*

42. *See id.* at *2.

43. *Id.* at *3.

44. *See* 232 S.W.3d 883 (Tex. App.—Dallas 2007, pet. filed).

verdict in the client's favor.[45] This alleged negligence resulted in the entry of a judgment notwithstanding the verdict ("JNOV") against the client.[46] In the malpractice case, the jury found the law firm negligent and assessed $922,631.86 in damages. Akin Gump appealed, seeking to reduce the damages awarded.[47]

First, the law firm alleged that NDR did not prove its alleged damages would have been collectible from the defendant in the underlying suit.[48] The court agreed that, in order to prove the law firm's alleged negligence actually caused damages, NDR was required to prove that a damage award in the underlying suit would have been collectible and that NDR was, therefore, required to provide evidence that the defendants in that suit were "solvent 'on the date the case was filed or anytime thereafter.'"[49] But the court of appeals held that NDR had produced sufficient evidence of collectibility.[50] The law firm also argued that the trial court erred in awarding NDR $216,590 for attorneys' fees incurred by NDR in the underlying lawsuit.[51] NDR argued that it was not seeking to recover the attorneys' fees it expended at trial, rather, the appellate "fees it incurred to appeal its loss at trial, only to lose again."[52] The court of appeals acknowledged the debate among Texas appellate courts and commentators concerning whether attorneys' fees and expenses incurred in prior litigation may be included as a measure of damages in a subsequent legal malpractice case, but it relied on the "binding authority" of its own previous decisions and held that NDR's attorneys' fees were not recoverable against Akin Gump.[53]

The court of appeals also considered a damages issue of first impression in Texas: whether damages in a malpractice suit should be reduced by the contingency fee the client would have owed had it prevailed in the underlying litigation.[54] Akin Gump argued that, had NDR prevailed in the underlying trial, it would have owed Akin Gump a ten percent contingency fee and, therefore, the verdict should be reduced by that amount in order to place NDR in the same position it would have occupied absent the alleged negligence.[55] The appellate court considered the divergent opinions on this issue by courts in other jurisdictions and held that Akin Gump was not entitled to the requested offset.[56] It concluded that the law firm would have been entitled to its contingency fee only if NDR prevailed in the underlying lawsuit, which it did not, and that to allow the

45. *Id.* at 888.
46. *Id.*
47. *Id.*
48. *Id.* at 889.
49. *Id.* at 895.
50. *Id.* at 895.
51. *Id.* at 995-96.
52. *Id.* at 896.
53. *Id.* at 896-97 (listing cases).
54. *Id.* at 897.
55. *Id.*
56. *Id.* at 897-98 (listing cases).

firm an offset for the contingency fee would in effect reward the firm for its wrongdoing.[57] Akin Gump has filed a petition for review with the Texas Supreme Court.

E. Standard for Establishing Breach of Fiduciary Duty

During this Survey period, Texas courts continued to reject claims for breach of fiduciary duty when those claims were based on allegations that the lawyers failed to meet the standard of care.[58] Such claims are an impermissible attempt to fracture a plaintiff's claim for legal malpractice.[59]

In *Capital City Church of Christ v. Novak*, however, the Austin Court of Appeals considered a stand-alone claim for breach of fiduciary duty brought by the lawyers' and law firm's former client.[60] The law firm defendants had jointly represented two co-owners of a six-story building.[61] Several years later, the defendants represented one of the co-owners, Chen, in litigation against the other, the Capital City Church of Christ (the "Church"). The Church sued the lawyers for breach of fiduciary duty, claiming that they misused confidential information obtained through their prior representation of the Church in order to further their representation of Chen. The trial court granted summary judgment in favor of the lawyer defendants, and the Church appealed.[62] On appeal, the Austin Court of Appeals considered whether the Church had provided evidence of specific confidential information allegedly used or divulged to Chen.[63] The Church argued that such evidence was unnecessary, relying on the standards used in a disqualification setting. In that context, a former client may disqualify its former attorney from later representing the client's adversary against it if it can demonstrate

> a "substantial relationship" between the two representations by proving "the existence of a prior attorney-client relationship in which the factual matters involved were so related to the facts in the pending litigation that it creates a genuine threat that confidences revealed to his former counsel will be divulged to his present adversary.[64]

If the former client meets this burden, it is *presumed* that there are confi-

57. *Id.* at 899.

58. *See, e.g.*, Stromberger v. Law Offices of Windle Turley, P.C., No. 05-06-00841-CV, 2007 WL 2994643, at *4 (Tex. App.—Dallas Oct. 16, 2007, no pet.) (mem. op.) (affirming summary judgment on fiduciary duty and fraud claims on the grounds that such claims "reiterated the facts forming the basis of Stromberger's cause of action for negligence"); O'Donnell v. Smith, 234 S.W.3d 135, 146 (Tex. App.—San Antonio 2007, pet. granted) (finding that alleging that a "firm failed to 'exercise the highest degree of care, good faith, and honest dealing'" did not state claim for breach of fiduciary duty).

59. *Stromberger*, 2007 WL 2994643, at *4.

60. *See* No. 03-04-00750-CV, 2007 WL 1501095, at *1 (Tex. App.—Austin May 23, 2007, no pet.) (mem. op.).

61. *Id.* at *1.

62. *Id.*

63. *Id.* at *3.

64. *Id.* at *3 (quoting NCNB Tex. Nat'l Bank v. Coker, 765 S.W.2d 398, 400 (Tex. 1989)).

dences and secrets at risk of disclosure.[65] The court of appeals held, however, that such a presumption does not arise in a claim for breach of fiduciary duty and cannot substitute for actual evidence of a breach.[66] The court noted:

> Establishing a "substantial relationship" between the prior and subsequent representation for disqualification purposes does not give rise to a presumption that confidences obtained in the prior representation have actually been disclosed to the present adversary. To the contrary, "the former attorney will *not* be presumed to have revealed the confidences to his present client." A "substantial relationship" instead gives rise to an "appearance of impropriety"—a basis for disqualification, not an element of a tort claim—that derives from the perceived *risk* that confidential information will be disclosed.[67]

Accordingly, because, standing alone, a "substantial relationship" between prior and subsequent representations cannot raise a fact issue regarding an actual disclosure of confidences, the trial court properly granted summary judgment in favor of the defendants.[68]

F. The Privity Barrier: Who Can Sue?

Texas courts continued to flesh out the contours of the privity requirement during this Survey period. As we reported in the last Survey, the Texas Supreme Court ruled in 2006 that personal representatives of a deceased client's estate have standing to bring legal malpractice claims on behalf of the estate, reversing two court of appeals opinions that had held to the contrary.[69] The San Antonio Court of Appeals reconsidered one of those cases, *O'Donnell v. Smith*,[70] during the current Survey period.

In that case, Thomas O'Donnell, as executor of the estate of Corwin D. Denney, appealed from a summary judgment in favor of the law firm and attorneys who provided legal advice to Denney during his lifetime in his capacity as executor of his wife's estate. The appeals court affirmed summary judgment, but that decision was vacated and remanded for reconsideration in light of *Belt*.[71] On reconsideration, the defendant attorneys argued that, even in light of *Belt*, the trial court correctly granted summary judgment because *Belt* only "narrowly relaxed the privity barrier to

65. *Id.*

66. *Id.* at *3-4 (discussing City of Garland v. Booth, 895 S.W.2d 766, 773 (Tex. App.—Dallas 1995, writ denied) and Reppert v. Hooks, No. 07-97-0302-CV, 1998 WL 548784, at *28-29 (Tex. App.—Amarillo Aug. 28, 1998, pet. denied)).

67. *Id.* at *4 (emphasis in original) (internal citations omitted).

68. *Id.*

69. Belt v. Oppenheimer, Blend, Harrison & Tate, Inc., 192 S.W.3d 780, 782 (Tex. 2006); O'Donnell v. Smith, 197 S.W.3d 394, 394 (Tex. 2006) (vacating court of appeals' judgment and remanding for reconsideration in light of the Texas Supreme Court's decision in *Belt*).

70. O'Donnell v. Smith, 234 S.W.3d 135, 138 (Tex. App.—San Antonio 2007, pet. granted).

71. *Id.* (discussing Belt v. Oppenheimer, Blend, Harrison & Tate, Inc., 192 S.W.3d 780 (Tex. 2006)).

allow suits by personal representatives for *estate-planning* malpractice."[72] The attorneys maintained that, because the claims against them arose out of advice to Denney with regard to his wife's estate and not his own, it was not an "estate-planning" malpractice case and was not, therefore, governed by *Belt*.[73] The court of appeals disagreed in concluding that the legal malpractice claims in *Belt* survived the death of the client, the supreme court relied on general legal principles and did not limit its holding to the estate-planning context.[74]

The Dallas Court of Appeals addressed claims by a non-client in *Kastner v. Jenkens & Gilchrist, P.C.*[75] In that case, Jenkens & Gilchrist ("Jenkens") and one of its attorneys were sued for negligent misrepresentation by non-clients after a business venture in which the non-clients had invested failed. The plaintiffs appealed from the trial court's grant of summary judgment on all claims against the lawyer and law firm. Jenkens had represented Randy Box, a real estate broker, in connection with the formation of a single-asset Texas limited partnership to purchase an apartment complex.[76] Using information provided by Box, Jenkens prepared a partnership agreement, which it mailed to each of the limited partners, including plaintiffs. Sometime later, the business began experiencing financial difficulties, the limited partnership filed bankruptcy, and the relationship between the general partner and the limited partners deteriorated. Plaintiffs sued Box and related entities, as well as Jenkens and a Jenkens attorney, alleging among other things that the lawyer had made negligent misrepresentations in the partnership agreement that he mailed out to the limited partners. Plaintiffs asserted that their negligent misrepresentation claims fell within the narrow exception to the privity requirement recognized by the Texas Supreme Court in *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*.[77] In *McCamish*, the Court recognized that a non-client can assert a viable negligent misrepresentation claim against a professional and that such potential liability "results from the 'professional's manifest awareness of the non-client's reliance on the misrepresentation and the professional's intention that the non-client so rely.'"[78] Accordingly, this cause of action may, in certain circumstances, "'permit[ ] plaintiffs who are not parties to a contract for professional services to recover from the contracting professionals.'"[79] The court of appeals held that this privity exception did not apply in *Kastner*, where the only communication between the attorney and the plaintiffs was the neutral cover letter accompanying the partnership

72. *Id.* at 141 (emphasis added).
73. *Id.* at 142 n.9.
74. *Id.* at 142.
75. 231 S.W.3d 571 (Tex. App.—Dallas 2007, no pet.).
76. *Id.* at 574.
77. *See id.* (applying the exceptions recognized in McCamish, Martin, Brown & Loeffler v. F.E. Applying Interests, 991 S.W.2d 787, 791 (Tex. 1991)).
78. *Id.* at 577 (quoting *McCamish*, 991 S.W.2d at 792).
79. *Id.*

agreement.[80] The court found that "[t]he cover letter contained no legal opinions or evaluations; it conveyed neutral information about the mechanics of the revisions he anticipated after the closing."[81] The court rejected any idea that "the mere transmission of a partnership agreement from an attorney to a non-client [could] reasonably be construed as a legal opinion on the validity of the agreement or the propriety of investment in the partnership."[82] The court also held that the Kastners' attempt to characterize the contents of the agreement as representations by the lawyer simply because the lawyer conveyed the partnership agreement via cover letter far exceeded the scope of liability allowed under *McCamish*.[83]

II. ACCOUNTING MALPRACTICE

A. THE PRIVITY BARRIER IN ACCOUNTING MALPRACTICE

In *Ervin v. Mann Frankfort Stein & Lipp CPAS, L.L.P.* ("MFSL"),[84] the San Antonio Court of Appeals relied on *McCamish* in one of the very few summary judgment reversals in this area during the Survey period. In that case, the plaintiffs brought claims against the defendant accounting firm for professional negligence and negligent misrepresentation arising out of the firm's alleged failure to discover an undisclosed $5 million liability with the "buy out" of South Texas Wholesale Records and Tapes, Inc. ("South Texas"). After the trial court granted summary judgment on behalf of the defendant, the plaintiffs appealed. MFSL argued that the plaintiffs lacked standing to pursue a negligent misrepresentation claim because it was unaware of the plaintiffs and therefore could not have intended to provide any information for their reliance. (See discussion of *McCamish* above). The appellate court disagreed and sided with the plaintiffs, holding that there was some evidence to suggest they were part of a limited group of persons for whose benefit the information was supplied or that MFSL knew the initial recipient intended to supply the information to the plaintiffs.[85] The court looked at evidence suggesting that MFSL knew its work was going to be used in connection with the South Texas buy out and that it knew plaintiffs were included in the identified "Buyer Group" for that transaction.[86] The court held that, at a minimum, MFSL knew it was providing information to some members of the Buyer Group who could reasonably be expected to pass the information on to other members of the Buyer Group, including plaintiffs.[87] Interestingly, the court held that "[t]he actions of MFSL in providing multiple copies of [its] report may be construed as some evidence it in-

80. *Id.* at 578.
81. *Id.*
82. *Id.* at 578.
83. *Id.*
84. 234 S.W.3d 172, 177 (Tex. App.—San Antonio 2007, no pet.).
85. *Id.* at 177.
86. *Id.* at 179-80.
87. *Id.* at 180.

tended its work to be shared with the Buyer Group."[88] The court rejected MFSL's argument that, for plaintiffs to have standing to sue, MFSL had to know the specific details of the transaction for which the plaintiffs intended to use the information, noting that "[s]ection 552(2)(b) [of the *Restatement (Second) of Torts*] requires simply that the person or entity providing the information have knowledge about the transaction, or a substantially similar transaction, for which the information is being used."[89] Therefore, the court of appeals reversed the trial court's summary judgment on the negligent misrepresentation claim.[90]

The court also rejected MFSL's claim that it was entitled to summary judgment on the plaintiffs' claim for professional negligence because it held the evidence raised a material fact issue regarding the existence of an accountant-client relationship between MFSL and the plaintiffs.[91] The court acknowledged that a professional negligence claim requires privity of contract and that MFSL had established the absence of any express contractual relationship, but it found that plaintiffs had presented some evidence to suggest an implied agreement to provide accounting services to the entire Buyer Group, including the plaintiffs.[92] In so finding, the court focused on some ambiguous language in the engagement agreement suggesting that the engagement may have included parties other than South Texas. The court also relied on evidence that MFSL sought permission from a member of the Buyer Group before providing information to the President of South Texas, which South Texas were truly the only client.[93] Accordingly, the court of appeals reversed summary judgment on the professional liability claim and remanded the case for trial.[94]

B. Proving Causation in an Accounting Malpractice Case

In *Blitz Holdings Corp. v. Grant Thornton, L.L.P.*,[95] the First District Houston Court of Appeals considered the difficulties of proving causation in an accounting malpractice action. The plaintiffs appealed from a directed verdict rendered in favor of the defendants, Grant Thornton and Deloitte & Touche. The case against the two accounting firms arose out of audit reports prepared by Grant Thornton and business valuations prepared by Deloitte related to IFS Financial Holdings Corporation ("IFS") and Interamericas Financial Holdings Corporation ("Interamericas"), which were both indebted to plaintiff GCM. Plaintiff GCM alleged that it relied on erroneous information prepared by the accounting firms in deciding to restructure the debt of IFS and Interamericas rather than to

88. *Id.* at 178.
89. *Id.* at 180.
90. *Id.* at 185.
91. *Id.* at 182.
92. *Id.* at 183.
93. *Id.* at 184-85.
94. *Id.* at 185.
95. No. 01-04-00627-CV, 2007 WL 1971374, at *1 (Tex. App.—Houston [1st Dist.] May 8, 2008, no pet.) (mem. op.). The court withdrew earlier opinions dated May 24, 2007 and Oct. 25, 2007, and issued this opinion upon rehearing.

foreclose.[96] GCM further alleged that, had it foreclosed on the debt instead of agreeing to a restructure, it would have been able to recover at least some of the debt. In reviewing the trial court's grant of directed verdict, the court of appeals considered whether the plaintiffs provided any evidence that, if GCM had foreclosed instead of restructuring the debt in either October 1999 or March 2000, the foreclosure proceedings would have, in reasonable probability, been successful in recovering any of IFS's assets while they were still available, and it found that GCM had produced no such evidence.[97] When plaintiffs attempted to foreclose on the debt in June 2000, IFS transferred its assets to other entities in violation of a court order and then declared bankruptcy, making the debt uncollectible. GCM failed to produce any evidence that it could have achieved a better result had it initiated the foreclosure in either March 2000 or October 1999.[98] Because there was no evidence that an earlier foreclosure would have been any more successful than the attempted restructuring in recovering the IFS debt, directed verdict was appropriate.[99]

In its motion for rehearing, GCM argued that the court failed to consider Grant Thornton's audits and Deloitte's valuations as "some evidence" of GCM's ability to recover damages from IFS.[100] The court rejected that argument, however, holding that GCM could not rely on the subject audits and valuations because it alleged in the lawsuit that such audits and valuations were "inflated and unreliable."[101] The court noted:

> These allegations of Grant's and Deloitte's wrongful acts were not made in the alternative. Further, the inaccuracy of the audits and valuations forms the basis of GCM's theory of liability. If they are not inaccurate, GCM could not have been harmed by relying on them—as it alleges in its petition.[102]

Because GCM's case relied on its allegations regarding the unreliability of the audits and valuations, it could not rely on those same audits and valuations to establish damages.

III. ARCHITECTURAL AND ENGINEERING MALPRACTICE

A. THE CERTIFICATE OF MERIT REQUIREMENT

During the Survey period, the San Antonio Court of Appeals considered for the first time the effect of recent amendments to section 150.002's requirement of a "certificate of merit" for claims against certain licensed or registered professionals, including architects, surveyors, and engineers. Section 150.002 requires a plaintiff to file an expert affidavit,

96. Plaintiff Blitz sought no independent relief, but sued as a necessary party. *Id.* at *1 n.1.
97. *Id.* at *12.
98. *Id.*
99. *Id.*
100. *Id.* at *9.
101. *Id.* at *9-10.
102. *Id.* at *10.

referred to as a "certificate of merit," to maintain a claim for damages arising from the provision of professional services.[103] The statute was amended in 2005 to apply to any action "arising out of the provision of professional services" rather than to actions "alleging professional negligence," and since then Texas courts have not considered the effect of that amendment.[104] In *Kniestedt v. Southwest Sound and Electronics, Inc.*,[105] the defendant moved to dismiss the claims against it for tortious interference with contract on the ground that the plaintiffs failed to file the required certificate of merit. The trial court denied the motion, and the appellate court affirmed, holding that where the plaintiff alleges an intentional tort rather than an act of negligence, a certificate of merit is not required.[106] The San Antonio Court of Appeals reached the same result in a similar case, *Gomez v. STFG, Inc.*,[107] and further held that the dismissal of a negligence claim under section 150.002 does not require the dismissal of related non-negligence claims, such as tortious interference, conspiracy, breach of contract, wrongful termination, and breach of fiduciary duty.[108]

IV. MEDICAL MALPRACTICE

A. Tolling of Limitations in Medical Malpractice Cases

During this Survey period, the Texas Supreme Court considered the two-year limitations period found in chapter 74 of the Texas Civil Practice and Remedies Code and its predecessor, the Medical Liability and Insurance Improvement Act ("MLIIA"),[109] and suggested that the limitations period may be unconstitutional as applied to some mentally-incapacitated individuals.[110] In *Yancy v. United Surgical Partners International, Inc.*, the mother of a patient who never regained consciousness after surgery argued that the limitations period for filing an action against her daughter's nurse and surgical center should be tolled due to her daughter's vegetative state.[111] The mother claimed that section 10.01 of the MLIIA, which prohibits tolling based on incapacity, violates the Texas Constitution's guarantee that "[a]ll courts shall be open, and every person for an injury done him, in his lands, goods, person or reputation, shall have remedy by

103. Tex. Civ. Prac. & Rem. Code § 150.002 (Vernon Supp. 2008).

104. *Id.*

105. No. 04-07-00190-CV, 2007 WL 1892220 (Tex. App.—San Antonio July 3, 2007, no pet.).

106. *Id.* at *2.

107. No. 04-07-00223-CV, 2007 WL 2846419 (Tex. App.—San Antonio Oct. 3, 2007, no pet.).

108. *Id.* at *3.

109. Act of May 28, 1999, 76th Leg., R.S., ch. 242, § 1, 1999 Tex. Gen. Laws 1104, *repealed by* Act of Sept. 1, 2003, 78th Leg., ch. 204, § 10.09, 2003 Tex. Gen. Laws 884 [hereinafter "MLIIA"].

110. Yancy v. United Surgical Partners Int'l, Inc., 236 S.W.3d 778, 786 (Tex. 2007).

111. *Id.*

due course of law."[112]

The supreme court held in *Yancy* that the statute of limitations was constitutional as applied to the plaintiff in that case.[113] The supreme court noted that the plaintiff had been appointed a guardian, obtained a lawyer, and filed an original petition against other defendants within the two-year limitations period, and that her mother "chose, for unknown reasons, to sue some defendants but not others does not raise due process concerns."[114] It concluded that "[b]ecause [the statute of limitations] is constitutional as applied to [the plaintiff], there is no need to strike it down because it might operate unconstitutionally in another case."[115] Although it declined to rule definitively on the issue, the supreme court suggested that section 10.01 of the MLIIA could be unconstitutional as applied in some circumstances.[116] The supreme court remarked that the plaintiff's "argument is precise: this court has already held that section 10.01 violates the open courts guarantee as applied to minors, and there is no rational basis for allowing a plaintiff's minority but not her mental incapacity to toll limitations for a health care liability claim."[117]

B. Contributory Negligence of Patients in Medical Malpractice Actions

In *Jackson v. Axelrad*,[118] the Texas Supreme Court held that patients have a duty to cooperate with their physicians, and that their failure to do so can constitute contributory negligence. The patient in *Jackson* was a psychiatrist who suffered a perforated colon after his internist misdiagnosed his diverticulitis. At trial, the internist explained that he had not suspected the true nature of the psychiatrist's illness because the psychiatrist had never reported pain consistent with that malady. The psychiatrist, in disputing this contention, designated himself as an expert at trial, presented himself as familiar with his type of complaint, and described his pain as a "classic sign of diverticulitis."[119] The jury found that both the patient and internist had been negligent. Because it assigned 51% of fault to the patient, and only 49% to the internist, the trial court entered a take-nothing judgment.[120] An appellate court reversed and remanded, holding that the plaintiff's negligence should be disregarded because patients usually have no duty to volunteer information to their doctors.[121]

112. *Id.* at 783-84 (quoting Tex. Const. art. I § 13). Although the MLIIA was repealed in 2003, § 74.251(a) includes a two-year statute of limitations with the same wording as that of the MLIIA, subject to an exception for minors under the age of twelve. *See* Tex. Civ. Prac. & Rem. Code Ann. § 74.251 (Vernon 2005).
113. *Yancy*, 236 S.W.3d at 786.
114. *Id.*
115. *Id.*
116. *Id.* at 654-55.
117. *Id.* at 784 (internal citation omitted).
118. 221 S.W.3d 650 (Tex. 2007).
119. *Id.* at 657.
120. *Id.* at 652.
121. *Id.*

The Texas Supreme Court disagreed, holding that patients have a duty to cooperate in their treatment, which requires ordinary care under all the surrounding circumstances. The supreme court described this duty as varying depending on the unique situations and the individuals involved, including "the language skills of [physician and patient], their specialized knowledge, the length of the relationship, the urgency of the situation, the frequency of previous examinations, the patient's current condition, and so on."[122] Rather than assigning physician-patients a higher standard of care, the supreme court stated that determining whether a patient acted with "ordinary prudence" includes consideration of that patient's expertise, quoting Prosser and Keeton that "[i]f a person in fact has knowledge, skill, or even intelligence superior to that of the ordinary person, the law will demand of that person conduct consistent with it."[123] Because there was evidence from which the jury could have concluded that the psychiatrist shared the blame for his injury, the supreme court reversed the appellate court's judgment and remanded for a factual sufficiency review.[124]

C. Deficiency of Expert Reports

Chapter 74's requirement that a medical malpractice petition be accompanied by an expert report was a major source of contention during the Survey period.[125] Notably, several cases addressed when a report is so deficient as to constitute "no report" under section 74.351.[126] This distinction has become important because if an expert report is served within 120 days but fails to meet the subsection's reporting requirements a court has discretion to grant "one 30-day extension to the claimant in order to cure the deficiency."[127] However, the failure to serve a report eliminates the possibility of a grace period and requires that a court "(1) award[ ] to the affected physician or health care provider reasonable attorney's fees and costs of court incurred by the physician or health care provider; and (2) dismiss[ ] the claim with respect to the physician or health care provider, with prejudice to the refiling of the claim."[128]

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122. *Id.* at 655.

123. *Id.* at 656 (quoting W. Keeton et al., Prosser and Keeton on Torts § 32 (5th ed. 1984) (citations omitted)).

124. *Id.* at 658-59.

125. A search found more than forty-five Texas state cases addressing issues related to the medical expert reporting requirement. Federal district courts have held that the expert reporting rules do not apply in federal court because they are preempted by the Federal Rules of Civil Procedure. *See* Mason v. United States, 486 F. Supp. 2d 621, 623-26 (W.D. Tex. 2007).

126. *See, e.g.*, De La Vergne v. Turner, No. 04-06-00722-CV, 2007 WL 1608872 (Tex. App.—San Antonio June 6, 2007, no pet.) (upholding the trial court's denial of a grace period because the plaintiff's expert report had been written by a registered nurse rather than a physician, and the plaintiff needed to file a new report to satisfy statutory requirements); Apodaca v. Russo, 228 S.W.3d 252, 258 (Tex. App.—Austin 2007, no pet.) (holding that an expert report filed by a patient's estate did not represent a "good faith effort" to comply with chapter 74 and, therefore, constituted "no report").

127. Tex. Civ. Prac. & Rem. Code Ann. § 74.351(c) (Vernon Supp. 2008).

128. § 74.351(b).

The San Antonio and Houston appellate courts have held that the absence of a physician's opinion on causation renders an expert report the equivalent of "no report," requiring the court to dismiss the plaintiff's suit.[129] The courts have interpreted the statute as "vest[ing] the trial court with the discretion to grant an extension, but only to cure deficiencies in the existing reports," not to file a new report with the required opinion on causation.[130]

In November 2007, the Texas Supreme Court addressed a similar issue. In *Ogletree v. Matthews*, the supreme court considered both whether a defendant may file an interlocutory appeal from a court's grant of a thirty-day extension, and when a report is so deficient as to constitute "no report."[131] The plaintiffs in *Ogletree* brought claims against an urologist and hospital based on the urologist's care of an eighty-four-year-old patient who died, allegedly due to a bladder perforation and kidney failure caused by the urologist's negligent insertion of a catheter.[132] The plaintiffs filed three expert reports, one from a radiologist, which dealt with the urologist's standard of care, and the remainder from nurses, which dealt primarily with the behavior of hospital nurses.[133] The urologist timely objected to the reports, arguing they did not comply with statutory requirements. The hospital, however, failed to object within twenty-one days as mandated by chapter 74. To avoid dismissal of its objections, the hospital argued that no objection to the nurses' reports was necessary because the reports were so deficient as to be nonexistent due to the absence of a physician's opinion on causation.[134] The trial court found that the radiologist's report was deficient, but granted a thirty-day extension to remedy the deficiencies. The trial court rejected the "no report" argument, holding that the hospital had waived its objections.

Both the urologist and hospital appealed the decision. The appellate court found that it was without jurisdiction to consider the urologist's appeal because of chapter 74's prohibition against the interlocutory appeal of orders granting an extension to cure reporting deficiencies. The appellate court affirmed the trial court's dismissal of the hospital's objection.[135] The Texas Supreme Court agreed that it was without jurisdiction to consider the urologist's arguments and it rejected the urologist's attempt to sever the trial court's denial of his motion to dismiss from its grant of the thirty-day extension.[136] It described "the actions denying the motion to

129. *See* Cuellar v. Warm Springs Rehab. Found., No. 04-06-00698-CV, 2007 WL 3355611, at *4 (Tex. App.—San Antonio Nov. 14, 2007, no pet.) (mem. op.); *De La Vergne*, 2007 WL 1608872, at *1; Methodist Health Ctr. v. Thomas, No. 14-07-00085-CV, 2007 WL 2367619, at *4 (Tex. App.—Houston [1st Dist.] Mar. 1, 2007, no pet.).

130. *Cuellar*, 2007 WL 3355611, at *4; *see also De La Vergne*, 2007 WL 1608872, at *1; *Methodist Health Ctr.*, 2007 WL 2367619, at *4.

131. No. 06-0502, 2007 WL 4216606 (Tex. Nov. 30, 2007). Although outside the Survey period, this case is important for a correct understanding of the current law in this area.

132. *Id.* at *1.

133. *Id.*

134. *Id.* at *2.

135. *Id.*

136. *Id.* at *3.

dismiss and granting an extension" as inseperable and remarked that "[i]f a defendant could immediately (and prematurely) appeal, the court of appeals would address the report's sufficiency while its deficiencies were presumably being cured at the trial court level, an illogical and wasteful result."[137] Although the supreme court spent almost two pages discussing the urologist's arguments, it disposed of the hospital's contentions in only two paragraphs. The supreme court noted that the reports clearly implicated the hospital's conduct, and described the hospital's motion to dismiss as being directed at the reports' "sufficiency." Because the hospital's arguments "could have been urged within the statutory twenty-one day period, as the statute clearly requires," the supreme court held that the hospital had waived its objections and that the trial court had correctly denied its motion.[138]

D. The Scope of Health Care Liability Claims under the MLIIA and Chapter 74

Texas courts have generally taken a broad view of the definition of "health care liability" claims under both chapter 74[139] and the MLIIA.[140] While some courts have interpreted the language of chapter 74 as narrower than that of the MLIIA, other courts have treated the two statutes as indistinguishable.

In *Valley Baptist Medical Center v. Stradley*,[141] the Corpus Christi Court of Appeals found that the definition of "health care liability" did not include negligence and premises liability claims brought by a patient who fell on a medical center's treadmill.[142] The court rejected the medical center's argument that the causes of action should be characterized as "health care liability" claims based on the Texas Supreme Court's holding in *Diversicare General Partner, Inc. v. Rubio*.[143] The Corpus Christi Court of Appeals described *Diversicare* as holding that "the legislature meant to include all safety claims against health care providers or physi-

137. *Id.* at *4. A Tyler appellate court recently avoided this prohibition by dismissing an interlocutory appeal for lack of jurisdiction, and then conditionally granting the defendant mandamus relief. Nexion Health at Oak Manor, Inc. v. Brewer, Nos. 12-06-00307-CV, 12-06-00349-CV, 2008 WL 151287, at *4 (Tex. App.—Tyler Jan. 16, 2008, no pet.).

138. *Ogletree*, 2007 WL 42116606, at *5.

139. Section 74.001 of the chapter, which defines health care liability claims, applies to claims filed after September 1, 2003. Clark v. TIRR Rehab. Ctr., 227 S.W.3d 256, 258 n.2 (Tex. App.—Houston [1st Dist] 2007, no pet.).

140. *See, e.g.*, Lee v. Boothe, 235 S.W.3d 448 (Tex. App.—Dallas 2007, pet. denied) (applying the requirements of chapter 74 to an eye surgery patient's claims that his physician violated the Texas Deceptive Trade Practices Act, and committed fraud and assault); Marks v. St. Luke's Episcopal Hosp., 229 S.W.3d 396, 402 (Tex. App.—Houston [1st Dist] 2007, pet. granted) (applying MLIIA requirements to the negligence claims of a patient who fell while getting out of bed because the claims were "relate[d] to departures from accepted standards of medical care, health care, or safety").

141. 210 S.W.3d 770 (Tex. App.—Corpus Christi 2006, pet. denied).

142. *Id.* at 775.

143. *Id.* (following the holding in Diversicare Gen. Partner, Inc. v. Rubio, 185 S.W.3d 842 (Tex. 2005)).

cians within the scope of the MLIIA."[144] However, the court found that chapter 74, unlike the MLIIA, included within the definition of "health care liability" only those safety violations "*directly related to health care.*"[145] The court found that the plaintiff's claims were not "directly related to health care," despite the fact that her physician had recommended she exercise regularly.[146] The court commented that "[w]hile exercise has a salutary effect on one's health, in most situations a doctor's recommendation of regular exercise is no more related to the rendition of health care than the automobile ride one makes for a doctor's appointment."[147]

The First District Houston Court of Appeals agreed with *Stradley's* interpretation of chapter 74 in *Christus Health v. Beal.*[148] The *Christus Health* court held that a drug and alcohol treatment center resident who was injured when his bed collapsed was not required to comply with chapter 74's requirement that he file an expert report.[149] The court determined that "a safety claim under Chapter 74 can be categorized as a health care liability claim 'only when it is . . . for a claimed departure from accepted standards of safety *directly related to health care.*'"[150] It concluded that a complaint about a faulty bed did not directly relate to drug and alcohol rehabilitation and could not, therefore, be characterized as a health care liability claim.[151]

Other courts have failed to note any difference between chapter 74 and its predecessor.[152] For example, in *Clark v. TIRR Rehabilitation Center*, the First District Houston Court of Appeals relied on the Texas Supreme Court's construction of the repealed MLIIA in *Diversicare* to justify dismissing the negligence claims of a plaintiff who failed to comply with the requirements of chapter 74.[153] The plaintiff in *Clark* was a sixty-four-year-old woman who died allegedly due to complications from injuries she suffered after falling off of a "balance board" while undergoing physical therapy. The court concluded that the claim was one for health-care liability because "an integral part of the services rendered by TIRR is the supervision of patients during therapy-exercises" and because expert testimony would be necessary to show the physical therapist's alleged negligence.[154]

144. *Valley Baptist Med. Ctr.*, 210 S.W.3d at 773-74.

145. *Id.* at 774 (quoting TEX. CIV. PRAC. & REM. CODE ANN. § 74.001(13) (Vernon 2005)) (emphasis in original).

146. *Id.*

147. *Id.* at 776.

148. 240 S.W.3d 282 (Tex. App.—Houston [1st Dist.] 2007, no pet. h.).

149. *Id.* at 290.

150. *Id.* at 289 (emphasis in original).

151. *Id.* at 290.

152. *See, e.g.*, Sloan v. Farmer, 217 S.W.3d 763 (Tex. App.—Dallas 2007, pet. denied); Clark v. TIRR Rehab. Ctr., 227 S.W.3d 256 (Tex. App.—Houston [1st Dist.] 2007, no pet.).

153. *Clark*, 227 S.W.3d at 262-63.

154. *Id.* at 263-64.

E. Oral Depositions During a Chapter 74 Stay

During the Survey period, several courts explored the limits of a provision of chapter 74 that stays discovery until the filing of an expert report. Section 74.351(s) states that, until a report is filed, all discovery must cease, with certain exceptions for written discovery, depositions on written questions, and discovery from nonparties.[155] The statute leaves unresolved whether a plaintiff may take oral depositions in order to investigate a possible claim, and this ambiguity has generated several appellate court opinions.

The Dallas and Fourteenth District Houston Courts of Appeals recently rejected arguments that the restriction does not bar oral depositions of potential defendants who have not yet been named in a lawsuit.[156] The courts described this contention as ignoring the legislature's purpose in enacting chapter 74 of reducing systemic costs due to health care liability claims, which the legislature characterized as having had "a material adverse effect on the delivery of medical and health care in Texas."[157]

However, the Texarkana Court of Appeals found an exception to the general rule when a plaintiff has theories of recovery other than health care liability claims.[158] In *In re Temple*, the court found that limited pre-suit oral depositions are permissible when the plaintiff seeks to determine what type of claim to file.[159] The plaintiff in *Temple* alleged that the replacement implanted in his right knee was designed for a left knee joint. He sought permission to take oral depositions to help him decide whether to sue his physician or the manufacturer of the incorrect knee. The trial court granted the request but limited the subject-matter of the depositions.[160]

The Texarkana court described the plaintiff as having "two divergent theories of potential liability."[161] Under the first theory, which involved "a health care liability suit against doctors or possibly other health care personnel," pre-suit depositions would be barred by chapter 74.[162] Under the second theory, which involved "a negligence or products liability cause of action against the knee joint manufacturer or provider," pre-suit depositions would be allowed.[163] To resolve this conflict, the court determined that the trial court should "limit the subject matter to exclude the health care questions prohibited by Section 74.351, and allow questions as

155. *See* Tex. Civ. Prac. & Rem. Code Ann. § 74.351(s) (Vernon Supp. 2008).
156. *In re* Clapp, 241 S.W.3d 913 (Tex. App.—Dallas 2007, no pet.); *see also In re* Mem'l Hermann Hosp. Sys., 209 S.W.3d 835 (Tex. App.—Houston [14th Dist.] 2006, no pet.).
157. *Clapp*, 241 S.W.3d at 918 n.5; *Mem'l Hermann Hosp. Sys.*, 209 S.W.3d at 840.
158. *In re* Temple, 239 S.W.3d 885 (Tex. App.—Texarkana 2007, no pet.).
159. *Id.*
160. *Id.* at 886.
161. *Id.* at 890.
162. *Id.*
163. *Id.*

to the source and handling of the device implanted in [the plaintiff.]"[164] Because the court found the trial court's order permitting the depositions overly broad, it conditionally granted a petition for a writ of mandamus to forestall them.[165] The court resolved to grant mandamus relief only if the trial court failed to rescind or modify its order.[166]

V. DIRECTOR AND OFFICER LIABILITY

A. IDENTITY AND RELEASES UNDER THE TEXAS TAX CODE

Last year's Texas Survey included three cases addressing personal jurisdiction under section 171.255 of the Texas Tax Code.[167] During this Survey period, courts analyzed the substance of that statute, described by some courts as a "Draconian" provision designed to encourage payment of the corporate franchise tax.[168]

In *Martin v. State*, Martin, an officer of defunct corporation Pathfinder Capital, L.C. ("Pathfinder"), challenged the admissibility and sufficiency of evidence used to prove that, pursuant to section 171.255 of the Tax Code, he was an officer or director of the corporation, and therefore severally liable for expenses and administrative fees incurred by the State of Texas in cleaning up an abandoned salt water disposal facility previously owned by the corporation.[169] Pathfinder failed to pay its franchise taxes and forfeited its corporate privileges and charter on May 16, 2002. The defendant Martin was listed as an officer of Pathfinder on the corporation's 1996 and 2002 "Transporter's Transportation Authority and Certificate of Compliance" (Form P-4) and the corporation's "Organizational Report" (Form P-5). Martin signed both documents, and an affidavit by the custodian of the Commission's records stated that the corporation had never amended its filings. After the corporation forfeited its privileges, the Commission spent over $151,000 in state funds to clean up its salt water disposal site. The State filed suit against Pathfinder as the responsible company and against Martin individually. The district court ruled in favor of the State against both Pathfinder and Martin, awarding $151,641.83 in costs, fees, prejudgment interest, and attorney's fees. The trial court found Martin jointly and severally liable under section 171.255(a) of the Tax Code.

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164. *Id.*
165. *Id.*
166. *Id.*
167. Kelli M. Hinson, Jennifer Evans Morris & Elizabeth A. Snyder, *Professional Liability*, 60 SMU L. REV. 1233, 1253-57 (2007).
168. Martin v. State, No. 03-05-00810-CV, 2007 WL 2214502, at *2 (Tex. App.—Austin, Aug. 3, 2007, no pet.) (mem. op.) (citing Williams v. Adams, 74 S.W.3d 437, 440 (Tex. App.—Corpus Christi 2002, pet. denied)).
169. Section 171.255(a) provides that if the corporate privileges of the corporation are forfeited due to the corporation's failure to file a report or pay tax or penalty, the directors and officers of the corporation are individually liable for each debt of the corporation that is created or incurred after the date on which the report, tax, or penalty is due but before the corporate privileges are revived. *See* TEX. TAX CODE ANN. § 171.255(a) (Vernon 2008).

Martin argued that there was no evidence that he was an officer or director when the corporation's debt was created or incurred because the only evidence of him being an officer or director was Form P-4 and Form P-5, which merely listed him as an officer or director at the time the forms were filed. In viewing the evidence in the light most favorable to the verdict, the Austin Court of Appeals found that the evidence at trial was "both legally and factually sufficient to support the court's implicit finding that Martin was a director or officer of Pathfinder when the cleanup expenses were incurred and when the administrative penalties were assessed."[170] Significant to the court's ruling was section 3.1 of the Texas Administrative Code, which requires corporations to provide the identities of officers in a Form P-5 and requires organizations to amend those reports within fifteen days after a change in any information. The court of appeals noted that section 3.1 creates a presumption that the officers are unchanged until the Form P-5 is amended or all duties owed by the corporation are fulfilled. Because Pathfinder's Form P-5 listed Martin as the sole primary officer, was signed by Martin, and had never been amended, the court of appeals found that "the unrebutted and dispositive presumption [was] that Martin continued as an officer of Pathfinder at all relevant times."[171] Consequently, the court of appeals affirmed the trial court's ruling that Martin was jointly and severally liable for the expenses and administrative fees incurred by the State of Texas.[172]

An unsecured creditor used section 171.255(a) in a creative way in *In re Wool Growers Central Storage Co.* to convince a bankruptcy court to reject a plan of reorganization because the plan included a release of directors for claims, including unsecured creditor claims, brought against the directors pursuant to the Texas Tax Code.[173] *Wool Growers* arose out of a mediation settlement between the debtor, Wool Growers Central Storage Co. ("Wool Growers"), the members of its board, and the official unsecured creditor's committee by which the directors agreed to pay approximately $2.5 million in the form of loans to the debtor, which would be distributed to creditors. Under the plan, the creditors were to receive sixty to seventy cents on the dollar and the remaining unsecured debt would be discharged. The settlement included a release of the board of directors from any claims and causes of action that might be brought against them by any creditor of the corporation. One unsecured creditor, Wardlaw Group, who provided mohair to Wool Growers for sale claimed that the corporation owed it over $250,000. Wardlaw sought payment from the directors under section 171.255(a) because while it was conducting business Wool Growers forfeited its corporate privileges for failure to pay its franchise taxes. The corporate privileges were forfeited on July 9, 2004, and were not reinstated until April 10, 2006. The Wardlaw

170. *Martin*, 2007 WL 2214502, at *3.
171. *Id.*
172. *Id.* at *3-4.
173. 371 B.R. 768 (N.D. Tex. 2007).

Group claimed, and the bankruptcy court agreed, that the directors were individually responsible for contract breaches that occurred after the corporate privileges were forfeited and before they were reinstated. The court found that those claims belonged entirely to the Wardlaw Group and not to the estate, and therefore, ruled that they could not be the subject of any release in connection with the reorganization plan.[174] The court consequently denied confirmation of the plan.[175]

B. The Ever Expanding and Contracting Fiduciary Duties in the Zone of Insolvency

Texas courts contended with director liability in the zone of insolvency this Survey period with differing results and little clarity. The viability of a claim by a creditor for knowing participation in breach of fiduciary duties against investors took an interesting twist in *In re I.G. Services, Ltd.*[176] In that case, an arbitration panel found in favor of Wells Fargo Bank in an action brought by the Chapter 11 trustee alleging knowing participation in breach of fiduciary duty and breach of trust claims. By court order, the arbitration only applied to the action brought by the estate itself and not to separate claims asserted by individual investors. Subsequently, the individual investors, through an investor claim trustee, pursued claims against Wells Fargo Bank again for the very same claims—knowing participation in breach of fiduciary duties and breach of trust. Wells Fargo Bank, alleging that the investor's claims against it were derivative in nature and therefore only properly brought on behalf of the debtor, sought a ruling that *res judicata* barred the investor trustee from proceeding. After providing a thorough background describing the line of cases addressing zone of insolvency claims by creditors, including a discussion of the seminal Delaware case on that topic, *North American Catholic Education Programming Foundation, Inc. v. Gheewalla*,[177] the bankruptcy court acknowledged that creditors could not maintain direct breach of fiduciary duty claims against directors even when the corporation is in the zone of insolvency because those claims are exclusively derivative in nature.[178] The damages sought belonged to the corporate entity because a knowing breach of fiduciary duty claim hinges on a finding of breach of fiduciary duty, and a breach of fiduciary duty claim cannot be brought directly by creditors. The court held that because the

174. *Id.* at 780-81.
175. *Id.* at 781.
176. No. 04-5041, 2007 WL 2229650 (Bankr. W.D. Tex. July 31, 2007).
177. 930 A.2d 92 (Del. 2007).
178. *In re I.G.*, 2007 WL 2229650, at *3-4. As illustrated in *JetPay Merchant Servs., LLC v. Miller*, No. 3:07-CV-0950-G, 2007 WL 2701636, at *7 (N.D. Tex. Sept. 17, 2007), this issue continues to be treated by courts across the country in various ways. *Id.* In that case, the Northern District of Texas denied the defendant's motion to dismiss against its creditors, acknowledging that although under Delaware law officers and directors do not owe creditors fiduciary duties when a company is insolvent, they do owe such duties under Colorado law. *Id.* (citing N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 97, 99 (Del. 2007); Alexander v. Anstine, 152 P.3d 497, 497 (Colo. 2007)).

claim for knowing breach of fiduciary duty could only be brought on behalf of the corporation, and the corporation had already done so in the unsuccessful arbitration, the investor claims trust action was barred by *res judicata*.[179]

Whether fiduciary duties are owed to creditors when a corporation is in the zone of insolvency was also explored in *In re VarTec Telecom, Inc.*[180] In that case, certain officers and directors moved to dismiss the trustee's claims for breach of fiduciary duties allegedly owed to creditors while the debtor was in the zone of insolvency. The officers and directors relied on *Floyd v. Hefner*,[181] which the bankruptcy court dismissed as a distinguishable, an unpublished decision from another jurisdiction. The directors argued that *Floyd* clearly held that officers and directors do not owe a corporation's creditors fiduciary duties when the corporation enters the vicinity of insolvency. Like the Western District of Texas in *In re I.G.*, the Texas Northern District Bankruptcy Court reviewed the zone of insolvency law from Delaware, including *Gheewalla*.[182] The Northern District even acknowledged that *Gheewalla* held that creditors of an insolvent corporation have standing to maintain derivative claims *on behalf of* the *corporation*.[183] Unlike the Western District, however, the Northern District held, without analysis, that a Chapter 7 trustee may bring a derivative action for breach of fiduciary duty against directors and officers *on behalf of* the corporation's *creditors*.[184] Arguably, this holding is inconsistent with *Gheewalla*, the very case cited by the court. It is unclear whether the court's language is merely imprecise or if the court intended to recognize a new fiduciary duty owed to creditors. The court's concluding discussion, however, certainly indicates an acknowledgement that the holding extends officers' and directors' duties.[185] Regardless, the language found at the end of this case further muddies the legal waters that both *I.G. Services* and, ironically, *In re VarTec Telecom*, indicate *Gheewalla* cleared.

C. To Cover or Not to Cover

A discussion of director and officer liability would not be complete without consideration of insurance coverage. Two cases in particular touched on coverage issues during this Survey period. The Texas Insur-

179. *In re I.G.*, 2007 WL 2229650, at *3-4.

180. No. 04-81694-HDH-7, 2007 WL 2872283 (Bankr. N.D. Tex. Sept. 24, 2007).

181. No. H-03-5693, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006). Although *Floyd* was decided just outside of this Survey period, it is important to note that the Southern District of Texas in that case ruled that Texas law does not impose a general fiduciary duty on directors and officers in favor of creditors when the company is in the zone of insolvency. *Id.*, at *19-20.

182. *Gheewalla*, 930 A.2d 92.

183. *In re VarTec Telecom, Inc.*, 2007 WL 2872283, at *3.

184. *Id.* at *4.

185. *Id.* (stating that "[t]his Court recognizes that extending officers' and directors' duties to creditors when a corporation nears insolvency creates many issues for such officers and directors and the professionals providing them advice").

ance Code section 705.005, which requires an insurer in a rescission action to give a ninety-one day notice of its intention to seek rescission to the insurer, was addressed in another VarTec case, *In re VarTec Telecom, Inc.*[186] In that case, the insurer, Federal Insurance Company ("FIC"), filed a declaratory judgment against the defendants, former officers and directors, seeking rescission of the policy that provided director and officer coverage. FIC argued that the policy was void *ab initio* due to alleged misrepresentations made by the defendants when applying for coverage. The defendants filed a motion to dismiss arguing that section 705.005 of the Texas Insurance Code required FIC to provide a ninety-one day notice of rescission. Conducting a conflicts-of-law analysis, the district court held that the Texas statute was not applicable because the insurance policy was created, negotiated, and had a place of performance in the State of Mississippi, and therefore, in the absence of a choice-of-law clause, Mississippi law governed. The fact that the defendants were all citizens of Texas was not sufficient to trigger application of Texas law. The defendants' motion to dismiss was denied because Mississippi did not have a similar statute requiring notice.

In the second insurance coverage case, directors and officers of Specialty Piping Components, Inc., now known as Westcott Holdings, Inc. ("Westcott"), sued the company's insurer for coverage based on the insurer's refusal to indemnify the plaintiffs, pursuant to the company's policy, for the cost of defense incurred in two underlying lawsuits.[187] The insurer removed the case to federal court, asserting improper joinder of one of the plaintiffs, and the plaintiffs filed a motion for remand. The court acknowledged the heavy burden of demonstrating improper joinder, particularly when, as in this case, the challenge is that a plaintiff has improperly joined *himself* in the case as a plaintiff. The insurer based its improper-joinder theory on the plaintiffs' alternative assertions that either the insurance company owed coverage to Westcott because Westcott indemnified the officers and directors in the underlying cases, or alternatively, that the insurance company was obligated to pay the officers and directors directly for the loss they suffered in the underlying litigation. Through this alternative pleading, the insurer argued that the plaintiffs had admitted that any proceeds were owed to Westcott, and therefore, the petition foreclosed any potential recovery for the directors and officers. The district court disagreed, granting the motion for remand and finding that plaintiffs may plead inconsistent claims and facts in support of alternative theories of recovery.[188] The district court reasoned that such alternative pleading does not result in an admission that its claims are unsupportable.[189]

186. No. 07-03056, 2007 WL 2142499 (Bankr. N.D. Tex. July 23, 2007).
187. Westcott Holdings, Inc. v. Monitor Liab. Managers, Inc., No. 8-06-1746, 2006 WL 3041606, at *3-4 (S.D. Tex. Oct. 24, 2006).
188. *Id.*
189. *Id.*