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Professional Liability

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PROFESSIONAL LIABILITY

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I. INTRODUCTION

TEXAS courts continue to refine professional negligence law. This Survey period was particularly marked by several Texas Supreme Court opinions regarding medical malpractice issues, including a determination of when a suit involves a "health care liability claim" and when a plaintiff is ultimately time barred from ever bringing a claim. The supreme court also issued an interesting opinion regarding auditors' liability for negligent misrepresentation. The high court remained relatively silent with respect to legal malpractice, but Texas courts of appeals made strides in that area, honing the defined scope of the attorney-client relationship and rejecting attempts to sue lawyers under theories other than professional negligence. Texas courts also addressed several issues concerning director and officer liability including jurisdiction, liability after a corporation's privileges are forfeited, and piercing the corporate veil.

II. LEGAL MALPRACTICE

A. PROOF OF ATTORNEY NEGLIGENCE REQUIRED

The El Paso Court of Appeals affirmed judgment against the plaintiff and in favor of the attorney defendants in *Cunningham v. Hughes & Luce, L.L.P.*[1] In the underlying suit, which formed the basis for the malpractice action, plaintiff Cunningham sued Classic BMW over a dispute regarding repairs to her 2000 Mazda Protégé.[2] The jury in the underlying case awarded Cunningham $1,588,744, and she later settled with Classic BMW for $1.2 million.[3] After the settlement, Cunningham sued the lawyers who represented her in the case against Classic BMW. She claimed among other things, that because of their negligence her attorneys' fees expert was not permitted to testify in the underlying trial, thus depriving her of an additional $300,000 to $500,000 in damages.[4] The trial judge in the underlying case did not allow the attorneys' fees expert to testify because he believed Cunningham's discovery responses had not adequately "disclose[d] [the expert's] opinions, the sources he relied upon, and the amount of fees sought."[5] "During the malpractice lawsuit . . . Judge Stokes (presiding), granted a partial summary judgment, holding that [the judge in the underlying trial] did not abuse his discretion by excluding [the expert's] testimony."[6] The jury rejected all of Cunningham's claims against the attorney defendants, the trial court entered a take nothing judgment, and Cunningham appealed.[7]

1. 312 S.W.3d 62, 65 (Tex. App.—El Paso 2010, no pet.).
2. *Id.*
3. *Id.* at 66.
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.* at 66–67.

On appeal, Cunningham claimed that because Judge Stokes ruled that the trial judge in the underlying case had not abused his discretion in excluding the attorneys' fees evidence, the jury was not free to "ignore or overrule either judge" by concluding that the lawyers were not negligent.[8] But the El Paso Court of Appeals disagreed, concluding that whether the trial judge properly excluded the attorneys' fees evidence and whether the attorneys' negligence, if any, caused that result, are not the same question.[9] The court also noted that Cunningham's malpractice counsel opened the door to this issue by asking the attorneys' expert witness questions (in violation of the order *in limine*) about the propriety of the judges' rulings, which allowed the expert to come back on re-direct and testify that he believed the trial judge "improperly refused" to allow the attorneys' fees evidence.[10] Based on this evidence, the jury was entitled to find that the attorneys were not negligent in connection with the exclusion of the attorneys' fees evidence.[11]

As we have seen in past surveys, this case is significant as another example of Texas courts requiring proof of both negligence and causation in order for a litigant to prevail in a legal malpractice case. Plaintiffs should not rely on what they perceive to be a bad result without adequate proof that such result was actually caused by some negligence by the attorney.

B. The Dallas Court Rejects Attempt at Fracturing

The Dallas Court of Appeals refused to allow plaintiffs to fracture their malpractice claim into multiple causes of action in *Pak v. Harris*.[12] As we have discussed in previous surveys, the "anti-fracturing rule prevents plaintiffs from converting what are actually professional negligence claims against an attorney into other claims such as fraud, breach of contract, breach of fiduciary duty, or violations of the DTPA."[13]

The attorney in this case represented six individuals in forming several related business organizations.[14] Shortly after the entities were formed, three of the clients voted to exclude two of the others from employment by and management of one of the entities.[15] The two excluded investors sued the attorney, Harris, claiming that he "represented them with divided loyalties contrary to his oral promise to treat each person 'equally and fairly' and failed to inform them of the conflict of interest between appellants and the other investors as well as other material facts."[16]

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8. *Id.*
9. *Id.*
10. *Id.* at 69–70.
11. *Id.* "Cunningham also failed to prove that she would have received a bigger settlement from Classic had she been awarded attorneys' fees in the underlying case." *Id.*
12. 313 S.W.3d 454, 456 (Tex. App.—Dallas 2010, pet. denied).
13. *Id.* at 457 (citing Beck v. Law Offices of Edwin J. (Ted) Terry, Jr. P.C., 284 S.W.3d 416, 426–27 (Tex. App.—Austin 2009, no pet.)).
14. *Id.* at 456.
15. *Id.*
16. *Id.* at 457.

In particular, the plaintiffs alleged that Harris failed to inform them of discussions with some of the investors, who had asked Harris not to share those discussions with the other investors.[17] The appellate court concluded that the plaintiffs had improperly fractured their claims because the "allegations involve the question of whether Harris failed to exercise the degree of care, skill, or diligence in performing his duty to inform appellants about issues that could arise during the representation of multiple clients and his duty to communicate with and among the clients he represented in this matter," which constitutes, if anything, a claim for legal malpractice.[18] Plaintiffs' allegation that Harris had failed to disclose a conflict of interest was not sufficient to maintain a separate claim for breach of fiduciary duty.[19] There was no claim that Harris received "improper benefit" from the representation.[20] Therefore, because the allegations involved the quality of the representation rather than questions regarding "the integrity and fidelity of the attorney," there could be no claim for breach of fiduciary duty or fraud.[21]

This is an important case for attorneys defending against multiple claims arising out of a legal representation. In reaction to recent cases, plaintiffs' counsel have become better at trying to articulate independent causes of action for fraud and breach of fiduciary duty, but this case is helpful for defendants because it focuses on the inherent difference between a malpractice claim and a breach of fiduciary duty claim, despite the plaintiff's use of buzz words such as "conflict of interest."[22]

C. Claims By Non-Clients—Part One

The Houston Fourteenth Court of Appeals wrestled with potential claims by non-clients in *Valls v. Johanson & Fairless, L.L.P.*[23] In that case, Michael Valls sued two parties for breach of a settlement agreement and also sued his opponents' attorneys, who had drafted the agreement.[24] The trial court granted summary judgment as to all defendants.[25] The court of appeals reversed the summary judgment as to the two parties, but affirmed as to the lawyer defendants.[26]

On appeal, the court rejected Valls's claims for legal malpractice and breach of fiduciary duty on the grounds that there was no attorney-client relationship between Valls and the lawyer defendants.[27] The court noted that both claims required proof that "the defendant in fact owed some legal duty to the plaintiff arising from the relationship between the par-

17. *Id.* at 458.
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.* at 457.
22. *Id.*
23. 314 S.W.3d 624, 633 (Tex. App.—Houston [14th Dist.] 2010, no pet.).
24. *Id.* at 627.
25. *Id.*
26. *Id.*
27. *Id.* at 634.

ties."[28] Valls argued that he became the lawyers' *de facto* client by signing a settlement agreement prepared by the lawyers.[29] The court of appeals disagreed.[30] Generally, in order for an attorney-client relationship to exist, both parties have to expressly agree on the services to be performed and the fees to be paid.[31] Even in the case of an implied agreement, the evidence must demonstrate that both parties intended to form an attorney-client relationship.[32] An attorney-client relationship cannot be created simply by the mistaken belief of the purported client.[33] Because Valls was represented by his own attorney at all times and the defendants were clearly representing the adverse party in the settlement, there was no evidence to support Valls's claim that the lawyer defendants were representing him.[34]

Valls also brought a claim for negligent misrepresentation, which does not require the existence of an attorney-client relationship.[35] The lawyer defendants did not dispute the fact that the settlement agreement contained a misrepresentation regarding how the settlement proceeds would be distributed.[36] They argued, however, that Valls could not have justifiably relied on the misrepresentation.[37] The court of appeals agreed, noting that "a party may not justifiably rely on an opposing attorney's statements made in an adversarial setting, such as litigation."[38] This rule holds true for statements made by opposing counsel in settlement negotiations.[39] Because the negotiations at issue "involved an arms-length transaction in which both sides were represented and advised by their own counsel," there could be no justifiable reliance and summary judgment on the negligent misrepresentation claim was proper.[40]

These types of claims by non-clients are a very dangerous area for practicing attorneys. In zealously representing his or her own client, an attorney is almost necessarily going to be acting contrary to the interests of the other party to a transaction or litigation. To allow suits against the attorney by these non-parties would place the attorney in an almost untenable position. Fortunately, Texas courts, like the court in *Valls*, have been fairly consistent in rejecting these non-client claims.

28. *Id.* at 633.
29. *Id.*
30. *See id.*
31. *Id.* at 633–34.
32. *Id.* at 634.
33. *Id.*
34. *Id.*
35. *Id.* at 634–35.
36. *Id.* at 635.
37. *Id.*
38. *Id.*
39. *See id.*
40. *Id.* at 636.

III. ACCOUNTING/AUDITOR MALPRACTICE

A. CLAIMS BY NON-CLIENTS—PART TWO

The Texas Supreme Court reaffirmed limits on negligent misrepresentation claims against auditors and limited the scope of potential "holder claims" in *Grant Thornton L.L.P. v. Prospect High Income Fund.*[41] The plaintiffs in that case sued the public accounting firm of Grant Thornton L.L.P. related to its audit of the financial statements of Epic Resorts, L.L.C.[42] Plaintiffs were bond and hedge funds (the "Funds") who had either purchased Epic bonds and/or chosen not to sell Epic bonds allegedly in reliance on reports and statements by Epic's auditor, Grant Thornton.[43] The trial court in Dallas granted summary judgment for Grant Thornton on all claims, the Dallas Court of Appeals reversed in part, and Grant Thornton appealed to the Texas Supreme Court.[44]

The first issue addressed by the supreme court was a professional's scope of liability for negligent misrepresentations to non-clients.[45] The court reviewed the history of these non-client claims and the current landscape in other jurisdictions, noting that the cases "fall along a spectrum," with some courts requiring actual privity or "near privity" to assert a claim[46] and others allowing claims where a non-client's reliance is merely foreseeable.[47] It also noted that most states have adopted the "middle-ground" approach provided in section 552 of the Restatement (Second) of Torts, which allows claims by a "'known party' [which] is one who falls in a limited class of potential claimants, 'for whose benefit and guidance [one] intends to supply the information or knows that the recipient intends to supply it.'"[48] Under this limitation, a professional providing information for use by third parties is only liable when he is "aware of the nonclient and intends that the nonclient rely on the information."[49] The supreme court reaffirmed that this standard, as expressed in the legal misrepresentation claim of *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*,[50] remains the law in Texas.

In *Grant Thornton*, summary judgment was appropriate on Cayman's negligent misrepresentation claims because one of the plaintiffs, Cayman, was not within a limited group to whom Grant Thornton knew its statements would be provided.[51] The supreme court rejected Cayman's claim that it fell within a "limited class of potential claimants" simply because it

41. 314 S.W.3d 913, 914 (Tex. 2010).
42. *Id.* at 915.
43. *Id.*
44. *Id.*
45. *Id.* at 198.
46. *Id.* (citing Ultramares Corp. v. Touche, Niven & Co., 174 N.E. 441 (N.Y. 1931) and Credit Alliance Corp. v. Arthur Andersen & Co., 483 N.E.2d 110 (N.Y. 1985)).
47. *Id.* (citing H. Rosenblum, Inc. v. Adler, 461 A.2d 138 (N.J. 1983)).
48. *Id.* at 919–20.
49. *Id.* at 920.
50. 991 S.W.2d 787, 791 (Tex. 1999).
51. *Grant Thornton*, 314 S.W.3d at 922.

was one of very few potential investors for this type of bond, concluding that Cayman's argument would extend the scope of liability from the Restatement approach to a foreseeability approach, which the supreme court has "refused to embrace."[52]

Related to the plaintiffs' fraud claim, the supreme court confirmed that the intent standard for fraud is the professional's "reason-to-expect" that her representations will affect other parties' conduct, which "requires more than mere foreseeability; the claimant's reliance must be 'especially likely' and justifiable, and the transaction sued upon must be the type the defendant contemplated."[53] Prospective bond purchasers, like Cayman, did not meet this standard.[54]

The supreme court also considered the reliance requirements for both fraud and negligent misrepresentation. It held that the Funds could not have justifiably relied on Grant Thornton's audit reports after they had knowledge of certain "red flags" concerning Epic's funding.[55] "[A] person may not justifiably rely on a representation if there are 'red flags' indicating such reliance is unwarranted."[56] The Funds also could not rely on Grant Thornton's "negative assurance statement" because they had never received or reviewed the statement.[57] The supreme court rejected the Funds' attempt to rely on the imputed reliance of U.S. Trust, their escrow agent and trustee, agreeing with Grant Thornton that Texas courts have not recognized such a "vicarious reliance" theory and, even if such a theory were recognized, the Funds also would have to accept imputation of U.S. Trust's knowledge of certain escrow account irregularities, which would defeat reliance.[58] The supreme court held that the Funds could not rely on its agent's reliance as its own while simultaneously asserting that it is not bound by its agent's knowledge.[59]

Finally, in an issue of first impression, the supreme court considered the Funds' "holder claims," in which they alleged that they held some of Epic's bonds (rather than bought or sold them) in reliance on Grant Thornton's alleged misrepresentations.[60] Courts have reached differing conclusions on the question of whether a fraud claim can be based on the alleged victim refraining from taking some action, such as the buying or selling of investments. The United States Supreme Court has specifically rejected holder claims arising under federal securities laws.[61] The Texas

52. *Id.* at 921 (citing Scottish Heritable Trust, PLC v. Peat Marwick Main & Co., 81 F.3d 606, 613 (5th Cir. 1996)).

53. *Id.* at 922 (citing Ernst & Young, L.L.P. v. Pac. Mutual Life Ins. Co., 51 S.W.3d 573, 580 (Tex. 2001)).

54. *See id.*

55. *Id.* at 923–24.

56. *Id.* at 923 (citing Lewis v. Bank of Am. N.A., 343 F.3d 540, 546 (5th Cir. 2003)).

57. *Id.* at 924.

58. *Id.*

59. *Id.* at 925.

60. *Id.* at 924.

61. *Id.* at 926-27 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 734–35 (1975)).

Supreme Court did not reach the question of whether viable holder claims could ever be asserted under Texas law, because it ruled that any such claims would have to require specific and direct communications between the plaintiff and defendant, which were not present in this case.[62] The court held that communications made in publicly available documents, such as audit reports and financial statements, cannot give rise to holder claims as a matter of law.[63]

This case is significant for two reasons, both of which are beneficial to defendant professionals. First, the supreme court limited the universe of potential non-client plaintiffs who can bring a professional liability claim and refused to extend that universe beyond that contemplated by section 552 of the Restatement. Second, although the supreme court did not reach the important question of whether "holder claims" are recognized at all under Texas law, it did articulate much needed guidelines regarding who, if anyone, could bring such a claim. Taken together, these rulings should provide additional protections to accounting and other professionals.

IV. MEDICAL MALPRACTICE

A. STATUTES OF LIMITATIONS AND REPOSE

The Texas Supreme Court decided *Methodist Healthcare System of San Antonio, Ltd. v. Rankin*[64] and *Walters v. Cleveland Regional Medical Center*[65] on the same day. Both cases presented issues concerning time limits to bring medical malpractice claims. In these companion cases, the supreme court determined that a plaintiff is always barred by the statute of repose from bringing a claim more than ten years after the alleged negligence occurs, but the same statute of repose may save claims brought after the two year statute of limitations has run.[66]

In *Rankin*, physicians discovered that a surgical sponge had been left inside of Emmalene Rankin during a November 1995 hysterectomy.[67] Rankin quickly filed a lawsuit against the hospital and doctors a few months after the sponge's discovery in October 2006.[68] In their motions for summary judgment, the defendants argued that the ten-year statute of repose for healthcare-liability claims barred plaintiff's suit.[69] The trial

62. *Id.* at 930. The court referred a Houston Fourteenth Court of Appeals case in which plaintiffs received numerous in-person and telephone assurances that the company was doing well and that they should not sell their stock. *Id.* at 929.

63. *Id.* at 930–31.

64. 307 S.W.3d 283, 284 (Tex. 2010).

65. 307 S.W.3d 292, 293 (Tex. 2010).

66. *Rankin*, 307 S.W.3d at 284; *Walters*, 307 S.W.3d at 293.

67. *Rankin*, 307 S.W.3d at 285.

68. *Id.*

69. *Id.* The applicable statute of repose is found in TEX. CIV. PRAC. & REM. CODE ANN. § 74.251(b) (West 2011) and states: "A claimant must bring a health care liability claim not later than 10 years after the date of the act or omission that gives rise to the claim. This subsection is intended as a statute of repose so that all claims must be brought within 10 years or they are time barred."

court granted the motion for summary judgment.[70] The court of appeals reversed, holding that the statute of repose was unconstitutional under the Open Courts provision of the Texas Constitution because it curtailed Rankin's right to sue "before she had an opportunity to discover the wrong and bring suit."[71] The Open Courts provision states: "All courts shall be open, and every person for an injury done him, in his lands, goods, person or reputation, shall have remedy by due course of law."[72]

The supreme court reversed the appellate court, rendering judgment for the defendant, explaining that there is no discovery rule or other exception to the statute of repose.[73] Rather, the statute of repose is an absolute bar to suits brought more than ten years after the alleged negligence, even when the claim could not have been discovered within ten years.[74] This rule holds true even for "sponge cases" although the supreme court acknowledged that such injuries are inherently difficult to discover.[75] "A statute of repose, by design, creates a right to repose precisely where the applicable statute of limitations would be tolled or deferred. More to the point, a statute of repose serves no purpose *unless* it has this effect."[76] A statute of repose serves an important function that outweighs the plaintiff's constitutional right to an open court: it benefits the general welfare by providing some end to otherwise "indeterminate" potential liabilities.[77] Accordingly, Rankin's claims were time barred.[78]

Walters posed a similar but distinguishable situation. In that case, doctors discovered a surgical sponge left over from a tubal ligation performed in December 1995 on Tangie Walters.[79] During the nine and a half years the sponge was in her, Walters experienced intermittent severe abdominal pain, but no doctor or other health care provider blamed the abandoned sponge.[80] Soon after a doctor finally discovered the sponge, Walters filed suit in August 2005 against her tubal ligation doctors and the hospital where the surgery was performed.[81] The defendants each moved for summary judgment, claiming that Walter's lawsuit was barred by the two-year statute of limitations.[82] Walters argued that the statute of limitations violated the Open Courts provision of the Texas Constitution. The trial court granted summary judgment, which was affirmed by the

70. *Rankin*, 307 S.W.3d at 285.

71. Rankin v. Methodist Heathcare Sys. of San Antonio, Ltd., 261 S.W.3d 93, 103 (Tex. App.—San Antonio 2008), *rev'd by* 307 S.W.3d 283 (Tex. 2010).

72. Tex. Const. art. I, § 13.

73. *Rankin*, 307 S.W.3d at 285, 290.

74. *Id.* at 292.

75. *Id.* at 288.

76. *Id.* at 290 (emphasis added).

77. *Id.* at 286–87.

78. *Id.*

79. Walters v. Cleveland Reg'l Med. Ctr., 307 S.W.3d 292, 294 (Tex. 2010).

80. *Id.* at 294–95.

81. *Id.* at 295.

82. *Id.*; *see* TEX. CIV. PRAC. & REM. CODE ANN. § 74.251(a) (West 2011).

court of appeals, and Walters appealed.[83]

The Texas Supreme Court reversed and remanded, holding that Walters had raised a fact issue as to whether she had brought her suit within a "reasonable time."[84] Although the two-year statute of limitations does not expressly exempt sponge cases, which are "exceedingly difficult to discover," the "Texas repose statute implicitly urges" their salvation.[85] In sum, "[t]he repose statute appears to be a legislative recognition that while two years may be constitutionally too short for some claims, ten years may be constitutionally enough for all claims."[86] And while the Open Courts provision does not guarantee a tolling of time based on lack of discovery, it gives litigants a "reasonable time to discover their injuries and file suit."[87] Walters had raised a fact issue as to whether she had reasonable time to discover the sponge because repeated doctors had examined her but none located or suspected a retained sponge for nine and a half years.[88]

These cases are both important steps along the supreme court's journey to strike the appropriate balance between providing patients adequate time to assert malpractice claims on the one hand and providing health care providers (and their insurers) some finality to potential liability on the other. Because the negligence involved in "sponge cases" is often very difficult to discover and may, in fact, go undiscovered for ten years or more, these cases provide the perfect backdrop for the supreme court to explore and determine these important issues of public policy.

B. What Is a "Heath Care Liability Claim"?

Chapter 74 of the Texas Civil Practice and Remedies Code has strict rules that apply to all "health care liability claims" including that a claimant must serve expert reports within 120 days of their original petition.[89] Failure to serve such a report may result in dismissal of the plaintiff's entire case.[90] For the past several years, Texas courts have faced the question of which claims are health care liability claims and thus require expert reports to be served within 120 days of the petition.

During this Survey period, Texas courts continued to grapple with the parameters of a "health care liability claim." Most notably, the Texas Supreme Court withdrew and superseded an opinion reported on in last year's Survey, *Marks v. St. Luke's Episcopal Hospital*.[91] In the new opinion, the majority of justices agreed that Marks's claims based on the fail-

83. Walters v. Cleveland Reg'l Med. Ctr., 264 S.W.3d 154, 159 (Tex. App.—Houston [1st Dist.] 2007), *rev'd by* 307 S.W.3d 292 (Tex. 2010).
84. Walters v. Cleveland Reg'l Med. Ctr., 307 S.W.3d 292, 293 (Tex. 2010).
85. *Id.* at 297.
86. *Id.* at 298.
87. *Id.* at 295.
88. *Id.* at 294.
89. Tex. Civ. Prac. & Rem. Code Ann. § 74.351(a) (West 2011).
90. *Id.* at § 74.351(b).
91. *See* Kelli M. Hinson, Jennifer Evans Morris & Jennie C. Bauman, *Professional Liability*, 63 SMU L. Rev. 730, 737–38 (2010) (discussing Marks v. St. Luke's Episcopal

ure of a hospital bed rail fell within chapter 74's definition of a health care liability claim—and not a premises liability claim—although the justices differed on where to draw the line.[92]

Irving Marks was a patient recovering from back surgery in the defendant hospital.[93] When attempting to get out of his hospital bed, he pushed off the bed's footboard.[94] The footboard allegedly came loose, causing Marks to fall and become injured.[95] Marks claimed the hospital was negligent under a variety of theories including "(1) failing to train and supervise its nursing staff properly, (2) failing to provide him with the assistance he required for daily living activities, (3) failing to provide him with a safe environment in which to recover, and (4) providing a hospital bed that had been negligently assembled and maintained by the hospital's employees."[96] Marks served a medical report more than 500 days after filing his claim—well outside the 120-day deadline. Upon the Hospital's motion, the trial court dismissed all of Marks's claims.[97] Because no report was timely served, the statute mandated dismissal.[98] The trial court further declined to extend Marks's time to file an expert report.[99] The court of appeals ultimately affirmed the dismissal of all of the claims, concluding that they were all heath care liability claims and a report should have been served; Marks appealed.[100]

The Texas Supreme Court agreed that the claims should be dismissed.[101] Marks argued that at least his last claim was not a health care liability claim because the footboard posed an unsafe condition in the nature of a premises liability claim.[102] But, said the plurality, "it is the gravamen of the claim, not the form of the pleadings, that controls" whether the claim is a heath care liability claim.[103] The plurality looked to the definition of a "heath care liability claim":

> [A] cause of action against a health care provider or physician for treatment, lack of treatment, or other claimed departure from ac-

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Hosp., No. 07-0783, 2009 WL 2667801 (Tex. Aug. 28, 2009), *superseded by* 319 S.W.3d 658 (Tex. 2010)).

92. Marks v. St. Luke's Episcopal Hosp., 319 S.W.3d 658, 660 (Tex. 2010).

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.* The appellate court originally reversed the dismissal, holding that Marks's claims were not health care liability claims. The Texas Supreme Court remanded the case in light of its opinion in Diversicare Gen. Partner, Inc. v. Rubio, 185 S.W.3d 842, 854 (Tex. 2005). On remand, the appellate court affirmed the dismissal, deciding that the claims were in fact heath care liability claims. *Id.*

101. *Id.* TEX. REV. CIV. STAT. art. 4590i section 1.03(a)(4) applied to define "heath care liability claim" in this case. That section has since been repealed, but, as the Court noted, similar legislation is now codified in sections 74.301–.303 of the Texas Civil Practice and Remedies Code. *Marks*, 319 S.W.3d at 660 n.2.

102. *Id.* at 662.

103. *Id.* at 664 (citing *Diversicare*, 185 S.W.3d at 854).

> cepted standards of medical care, or health care, or safety or professional or administrative services directly related to health care, which proximately results in injury to or death of a claimant, whether the claimant's claim or cause of action sounds in tort or contract.[104]

The justices held that Marks's claim concerning the footboard fell well within that definition.[105] "[A]n accepted standard of safety is implicated under the [statute] when the unsafe condition or thing, causing injury to the patient, is an inseparable or integral part of the patient's care or treatment."[106] While not every accidental injury that occurs at a health care facility leads to a claim under the statute, the "relationship between the injury causing event and the patient's care or treatment must be substantial and direct for the cause of action to be a health care liability claim."[107] The medical equipment used in a patient's care—including footboards—is an "inseparable part" of the health care services provided.[108]

Marks further argued that he should be allowed the statutorily-allowed grace period to file an expert report because the failure to file one the first time was an accident or mistake within the meaning of the statute.[109] Marks provided an affidavit from his attorney explaining that the attorney was retained after the claim had been filed and "understood the case to be an ordinary negligence case, not a health care liability claim."[110] Later, the attorney determined that there was a potential health care liability claim, at which point he served a medical report, albeit more than 380 days late.[111] The Texas Supreme Court was not persuaded by the affidavit, noting the lack of explanation of the first attorney to serve an expert report and a failure to explain what triggered the second attorney to file the late expert report.[112] The trial court did not abuse its discretion in failing to grant a grace period to file the required expert report.[113]

Justice Johnson concurred because he believed that "accepted standards of . . . safety" were too narrowly construed in the plurality opinion.[114] He believed "safety" under the statute should mean "untouched by danger; not exposed to danger; secure from danger, harm or loss" as the supreme court had previously written in *Diversicare General Partner, Inc. v. Rubio*.[115] This definition is broader and would more fully honor the legislative intent to broadly cover claims by patients against health

104. *Id.* at 662 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 74.001(a)(13) (West 2011)).
105. *Id.* at 664.
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 665.
110. *Id.*
111. *Id.* at 666.
112. *Id.*
113. *Id.*
114. *Id.* at 667 (Johnson, J. concurring).
115. *Id.* at 672 (Johnson, J., concurring) (quoting Diversicare Gen. Partner, Inc. v. Rubio, 185 S.W.3d 842, 855 (Tex. 2005)).

care providers.[116]

Chief Justice Jefferson wrote separately, in dissent, urging for consistency in the law.[117] Jefferson noted that the plurality strayed from its decision in *Diversicare*, in which the supreme court stated a patient's claim involving a staircase falling under her would give rise to a premises claim, not a health care claim.[118] Jefferson argued that the footboard claims related to Marks's treatment "in the same way that the stairs, walls, and utilities do: without access to the room, shelter from the elements, power to adjust the room's temperature and to run medical equipment, doctors would be unable to deliver medical services."[119] He also noted the plurality's failure to fully explain "how a piece of wood at the end of a bed is integral to medical care."[120]

The determination of whether a claim constitutes a "health care liability claim" can dramatically affect the litigation and ultimately the outcome and potential damages in a personal injury case. This opinion is very significant because the court attempts to further define the limits of what types of cases are covered by chapter 74. Because of the lack of a unified voice from the court on this issue, however, this opinion may serve to create more uncertainty in the short term as lower courts struggle to categorize the cases before them.

C. Agreements To Extend the 120-Day Deadline for Expert Reports

The Texas Supreme Court held in *Spectrum Healthcare Resources, Inc. v. McDaniel* that, while parties may agree to extend the 120-day deadline for threshold expert reports, they must do so expressly.[121] In that case, Janice McDaniel filed a medical malpractice case against a medical center and others based on injuries she received while in physical therapy.[122] The parties entered into a docket control order that provided deadlines for designation of expert witnesses: "Plaintiffs will designate all expert witnesses that they intend to call at the trial of this case, live or by deposition, and shall provide written reports and curriculum vitae of all retained experts in this case on or before January 11, 2006."[123]

The docket control order additionally provided that its deadlines controlled to the extent they conflicted with another rule or statute.[124] When McDaniel did not serve expert reports within 120 days of filing her petition, the trial court dismissed her case.[125] A divided court of appeals re-

116. *Id.* at 673 (Johnson, J., concurring).
117. *Id.* at 674 (Jefferson, C.J., dissenting).
118. *Id.*
119. *Id.* at 674 (Jefferson, C.J., dissenting).
120. *Id.* at 675 (Jefferson, C.J., dissenting).
121. 306 S.W.3d 249, 254 (Tex. 2010).
122. *Id.* at 250.
123. *Id.* at 251.
124. *Id.* at 252.
125. *Id.* at 250.

versed, holding that the docket control order unambiguously expressed intent to replace statutory deadlines for serving all expert reports, including the threshold reports.[126] McDaniel appealed.

McDaniel argued to the supreme court that the docket control order provided the deadline for providing reports from all retained experts, which would necessarily include those retained to write the threshold expert reports.[127] She further claimed that the docket control order expressly stated that it controlled cases of conflicts with other laws.[128] Moreover, the docket control order elsewhere provided that discovery would continue when discovery would normally be stayed under chapter 74.[129] This, McDaniel reasoned, demonstrated that the docket control order (regardless of whether it expressly mentioned chapter 74 expert reports) controlled and provided the preliminary expert report deadline.[130]

The supreme court disagreed, holding that an "agreed docket control order must explicitly reference [Chapter 74] threshold expert reports if the order is to constitute an agreement to extend that deadline."[131] Three considerations dictated this result. First, the threshold expert reports have a separate purpose wholly distinguishable from "typical" expert reports.[132] The threshold reports are intended to create a substantive hurdle to frivolous lawsuits. Holding that the docket control order's routine expert report deadline superseded this purpose would contravene legislative intent. Second, not all retained experts' reports are discoverable—if the expert is a consulting expert whose opinions are not reviewed by a testifying expert, these reports would never be subject to discovery.[133] But a threshold expert report is a separate category entirely—it must be produced but is generally not admissible at trial.[134] Finally, the court emphasized the "ubiquity" of agreed docket control orders and expressed concern whether these "simple standard" orders were sufficient to supersede the threshold expert report requirement.[135] It would be "impractical" to require courts and parties to inquire deeper into the standard docket control order to determine if its intent was to do away with the 120-day deadline.[136] Because, under the court's analysis, the docket control order did not do away with the chapter 74 requirement for a threshold report and no report was served, the supreme court reversed the court of appeals and affirmed the trial court's dismissal of the

126. McDaniel v. Spectrum Healthcare Res., Inc., 238 S.W.3d 788, 795 (Tex. App.—San Antonio 2007), *rev'd by* 306 S.W.3d 249 (Tex. 2010).
127. *McDaniel*, 306 S.W.3d at 252.
128. *Id.*
129. *Id.* Section 74.351(s) of the Texas Civil Practice and Remedies Code provides that most discovery is stayed until the required expert report and CV are served. TEX. CIV. PRAC. & REM. CODE ANN. § 74.351(s) (West 2011).
130. *Id.*
131. *Id.* at 253.
132. *Id.*
133. *Id.* at 253–54 (citing Tex. R. Civ. P. 192.7(c)–(d), 192.3(e)).
134. *Id.* at 254.
135. *Id.*
136. *Id.*

case.[137]

This case presents an important lesson for attorneys seeking to extend the deadline to serve chapter 74 preliminary expert reports. Plaintiffs' attorneys cannot rely on vague language setting the deadline for expert reports. If the parties have truly agreed to extend the deadline for the required chapter 74 reports, that intention needs to be explicitly spelled out in a Rule 11 agreement. As is evidenced by the *McDaniel* case, a mistake in the timing of a preliminary expert report can have disastrous consequences.

D. Deadline To Serve Expert Reports Runs from the First Petition Naming Defendant

During the Survey period, several courts of appeals agreed that the 120-day expert report deadline begins to run when the defendant is sued—even if they are sued months after the plaintiff's first petition.[138] These decisions directly conflict with the decision of the Dallas Court of Appeals in *Lone Star HMA, L.P. v. Wheeler*, reported on in the last Survey.[139] In *Wheeler*, the court relied on the precise language of the statute and held that the expert report deadline ran from the "original petition"—the first petition filed in the case.[140] Appellate courts during this Survey period, however, held that the statute was meant to require an expert report within 120 days of the first petition naming the particular defendant at issue.

One example is *Hayes v. Carroll*. In that case, Janet Carroll's left leg was amputated allegedly because of the "tourniquet-like effect" of a too-tight bandage placed below her knee.[141] Carroll filed her original petition and expert reports on May 8, 2007. On October 30, 2007, Carroll added physician and nurse defendants in her first amended petition.[142] In January 2008, Carroll served the new defendants with expert reports that discussed the new defendants' liability.[143] The new defendants moved to dismiss Carroll's claims, arguing that the expert reports as to them should

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137. *Id.* Several justices wrote in agreement of the supreme court's bright-line rule but not with its application to McDaniel: "Had she known that following the trial court's order would lead to dismissal of her claim, she could have taken steps to preserve her rights. Instead, having complied with the order, she now finds herself without recourse." *Id.* at 255 (Jefferson, C.J., dissenting). The dissenters would apply the holding prospectively rather than retroactively have plaintiffs' claims dismissed. *Id.*

138. *See* Stroud v. Grubb, 328 S.W.3d 561, 562 (Tex. App.—Houston [1st Dist.] 2010, pet. denied); Hayes v. Carroll, 314 S.W.3d 494, 501 (Tex. App.—Austin 2010, pet. denied); Padre Behavioral Health Sys., LLC v. Chaney, 310 S.W.3d 78, 84 (Tex. App.—Corpus Christi 2010, no pet.); Daybreak Cmty Servs., Inc. v. Cartrite, 320 S.W.3d 865, 873 (Tex. App.—Amarillo 2010, no pet.); Kingwood Specialty Hosp., Ltd. v. Barley, 328 S.W.3d 611, 613 (Tex. App.—Houston [14th Dist.] 2010, no pet.).

139. *See* Kelli M. Hinson, Jennifer Evans Morris & Jennie C. Bauman, *Professional Liability*, 63 S.M.U. L. Rev. 730, 742 (2010) (discussing Lone Star HMA, L.P. v. Wheeler, 292 S.W.3d 812 (Tex. App.—Dallas 2009, no pet.)).

140. *Wheeler*, 292 S.W.3d at 816.

141. *Hayes*, 314 S.W.3d at 497–98.

142. *Id.* at 497.

143. *Id.*

have been served 120 days after May 8, 2007—when the "original petition" was filed.[144] The trial court denied the motion to dismiss, and the defendants appealed.[145]

On appeal, Carroll argued that the deadline to file an expert report should run from the date that particular defendant was first sued.[146] The Austin Court of Appeals agreed, holding that "[i]f the pleading is the first pleading naming a defendant, it is the 'original' petition as to that defendant regardless of its title, and the 120-day expert report deadline is triggered by that filing as to that defendant."[147] According to the Court, This reading is consistent with the legislative intent, which contemplates the 120 days being triggered by the filing of a lawsuit.[148] A lawsuit is first filed against a defendant with the petition that adds that defendant regardless of whether other defendants were previously sued under the same cause number.[149] The court further noted "interpretational and logical problems" if the statute was read to require an expert report within 120 days of the original petition regardless of when the defendant was added to the case.[150] Primarily, that reading would serve as a "*de facto* statute of limitations" on the plaintiff's claim, and a plaintiff ought to be able to bring a claim against a new defendant outside of 120 days from first filing suit.[151]

These cases are significant in that they create a conflict between the courts of appeals on the critical issue of the timing of preliminary expert reports. Under the *Wheeler* case, a plaintiff has a 120-day window from the filing of his first petition to sue and serve all potential defendants as well as to serve them with expert reports. Under the *Hayes* case, however, a plaintiff's deadline to sue and serve potential defendants is governed only by the statute of limitations (or potentially a court's docket control order). Given this split of authority and the outcome-determinative nature of this timing question, plaintiffs would be wise to make sure all potential defendants are served with expert reports within the initial 120 day period.

E. Health Care Providers Protected in Emergency Situations—Even When the Emergency Is Not Recognized

As a part of 2003 tort reform legislation, the Legislature provided that in a health care liability claim involving "emergency medical care," the

144. *Id.* at 499.
145. *Id.* at 497. Section 51.014(a)(9) of the Texas Civil Practice and Remedies Code allows for interlocutory appeal of a denial of a motion to dismiss based on failure to timely serve expert reports. Tex. Civ. Prac. & Rem. Code Ann. § 51.014(a)(9) (West 2008).
146. *Id.* at 499.
147. *Id.* at 501.
148. *Id.* at 500.
149. *Id.*
150. *Id.*
151. *Id.*

health care provider may be found liable only if it "with *wilful and wanton negligence*, deviated from the degree of care and skill that is reasonably expected of an ordinarily prudent physician or health care provider in the same or similar circumstances."[152] In *Turner v. Franklin*, the Dallas Court of Appeals became the first Texas appellate court to squarely address this provision, and it potentially limited heath care provider liability by including situations that actually are emergencies even if they are not diagnosed or recognized as such.[153]

The case began when a 14-year-old patient presented at a hospital in Allen, Texas, shortly after midnight with severe pain in his lower abdominal region and a swollen left testicle.[154] There were two possible diagnoses: testicular torsion or epididymitis.[155] Testicular torsion requires immediate attention within four to six hours or the testicle will die.[156] Epidiymitis, on the other hand, is treated on a non-emergent basis with antibiotics.[157] Defendant emergency room doctor, Jonathan Franklin, and Defendant on-call radiologist, Dr. Evan Cohn, ultimately diagnosed epididymitis, and the patient was discharged with an antibiotics prescription.[158] The epididymitis diagnosis was confirmed over the next few days by the young man's pediatrician and a separate emergency room physician.[159] However, six days after the original hospital presentation, a doctor correctly diagnosed testicular torsion, and the then nonviable left testicle was removed.[160]

The patient's parents brought a health care liability claim against Drs. Franklin and Cohn, claiming that the doctors had misdiagnosed the condition and that they should have consulted a urologist.[161] Both doctors filed traditional motions for summary judgment, arguing that the willful and wanton standard applied and their conduct did not, as a matter of law, rise to that level.[162] Dr. Cohn also filed a no evidence summary judgment motion, claiming the plaintiffs could not raise a genuine issue of material fact as to whether he had "acted with willful and wanton negligence."[163] The trial court granted summary judgment for both doctors and the plaintiffs appealed.[164]

The plaintiffs argued that physicians should not get the benefit of the willful and wanton standard when they misdiagnose a problem and treat it on a non-emergency basis.[165] The willful and wanton standard, they

152. TEX. CIV. PRAC. & REM. CODE ANN. § 74.153 (West 2011) (emphasis added).
153. 325 S.W.3d 771, 779 (Tex. App.—Dallas 2010, pet. denied).
154. *Id.* at 774.
155. *Id.*
156. *Id.*
157. *Id.*
158. *Id.* at 774–75.
159. *Id.*
160. *Id.* at 775.
161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*

argued, was designed only to apply when the "physician diagnoses a condition as an emergency and treats it accordingly."[166] But the court disagreed.[167] Whether a situation was an emergency did not depend on whether the heath care provider recognized it as such.[168] The appellate court determined that the patient in this case had received "emergency medical care" based on the statutory definition:

> *[B]ona fide emergency services* provided after the sudden onset of a medical or traumatic condition manifesting itself by acute symptoms of sufficient severity, including severe pain, such that the absence of immediate medical attention *could reasonably be expected* to result in placing the patient's health in serious jeopardy, serious impairment to bodily functions, or serious dysfunction of any bodily organ or part.[169]

The court held that application of the willful and wanton standard set out in chapter 74 depends on "(1) the type of care provided (i.e. 'bona fide emergency services'), and (2) the circumstances under which those services are provided."[170] Under the first prong, the court concluded that "bona fide emergency services" meant to apply to both diagnosis and treatment.[171] This is because the chapter 74 definition of "medical care" included "any act defined as practicing medicine under § 151.002, Occupations Code."[172] The Occupations Code, in turn, included both diagnosis and treatment as "practicing medicine."[173] Therefore, "'bona fide emergency services' means any actions or efforts undertaken in a good faith effort to *diagnose or treat* a mental or physical disease or disorder or a physical deformity or injury by any system or method, or the attempt to effect cures of those conditions."[174] The court also reasoned that if heath care providers benefited from the willful and wanton standard only when they diagnosed emergencies, there would be incentive for them to always "assume the most dire of possibilities," which was not the Legislature's intent.[175]

Under the second prong, the court held that the circumstances of care should be determined on a prospective basis to determine whether there was a need for immediate medical attention.[176] This view of emergency care was compelled by the statute, which included situations where "immediate medical attention *could reasonably be expected*" or else risk harm to the patient.[177]

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166. *Id.* at 778–79.
167. *Id.* at 779.
168. *Id.*
169. TEX. CIV. PRAC. & REM. CODE ANN. § 74.001(7) (West 2005) (emphasis added).
170. *Id.*
171. *Id.* at 778.
172. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 74.001(19) (West 2005)).
173. *Id.* (citing TEX. OCC. CODE ANN. § 151.002(13) (West Supp. 2009)).
174. *Id.* (emphasis added).
175. *Id.* at 779.
176. *Id.* at 777.
177. *Id.*

Additionally, the court held that "wilful and wanton negligence" meant the same thing as "gross negligence" and that claims subject to the willful and wanton standard could be disposed of at the summary judgment stage of a case.[178] In this case, the plaintiffs had not raised a genuine issue of material fact that Dr. Cohn (who filed a no evidence motion) had an "actual, subjective awareness of the risk involved and [chose] to proceed in conscious indifference to the rights, safety, or welfare of others,"[179] and the court therefore affirmed summary judgment for Dr. Cohn.[180] However, Dr. Franklin (who filed only a traditional motion) had not proved as a matter of law that he had not acted with willful and wanton negligence, and the summary judgment was reversed and remanded as to him.[181]

This case is significant in that it extends the benefit of the "wilful and wanton" standard to a whole range of situations that may not have been considered "emergencies" at the time the health care was provided. This higher standard can create a substantial obstacle for a plaintiff at the summary judgment stage and at trial. The opinion also raises questions about the proof that is necessary to raise a fact issue on the subjective element of willful and wanton negligence, i.e., that the health care provider had "an actual, subjective awareness of the risk and chose to proceed in conscious indifference."[182]

V. DIRECTOR AND OFFICER LIABILITY

A. Personal Jurisdiction Over Non-Resident Directors

Non-resident officers of foreign corporations doing business in Texas can rest easier knowing they are not subject to personal jurisdiction in Texas merely by their status as officers. But non-resident officers of Texas corporations may not be so lucky. In *Kelly v. General Interior Construction, Inc.*, the Texas Supreme Court examined whether a plaintiff established specific jurisdiction over non-resident officers of a foreign corporation pleading a connection between the officers' alleged wrongdoing and the forum state.[183] After a dispute arose over a Houston hotel renovation gone awry, the owner of the hotel sued the general contractor and subcontractor.[184] The subcontractor then filed third-party claims against the general contractor's two officers, both Arizona residents, for breach of contract, violations of the Texas Trust Fund Act,[185] and

178. *Id.* at 780–81, 783.
179. *Id.* at 783 (citing Columbia Med. Ctr. of Las Colinas, Inc. v. Hague, 271 S.W.3d 238, 248 (Tex. 2008)).
180. *Id.* at 786.
181. *Id.* at 785.
182. *Id.* at 783.
183. 301 S.W.3d 653, 655 (Tex. 2010).
184. *Id.* at 656.
185. The Texas Trust Fund Act provides that payments to a contractor or its officers or agents are funds held in trust by the contractor or its officers or agents for the subcontractor beneficiaries. Tex. Prop. Code. Ann. § 162.001 et seq. (West 2011).

fraud.[186] Both the claim under the Texas Trust Fund Act and the fraud claim were based on the same alleged set of facts—that the officers provided an affidavit to the owner saying they had paid or would pay all subcontractors, when in fact those statements were untrue.[187]

The trial court denied the officers' special appearance, and a divided court of appeals affirmed in part, reversing only as to the breach of contract claim.[188] The dissent argued that because none of the alleged acts occurred in Texas and the subcontractor failed to allege that the officers committed any act or conducted any business in Texas, the officers' special appearance on all claims should have been granted.[189]

The supreme court agreed, finding that the subcontractor failed to meet its initial burden to show minimum contacts in Texas sufficient to support specific jurisdiction.[190] It failed to plead that any tortious acts, including making the alleged misrepresentations or executing the false affidavits, occurred in Texas.[191] Finding that the court of appeals erred by reasoning that the fraud sufficiently "relate[d] to" conduct purposely directed to Texas, the supreme court explained that it had previously rejected the concept of "directed-a-tort jurisdiction" in *Michiana Easy Livin' Country, Inc. v. Holten*.[192] Because the subcontractor failed to plead Texas-specific allegations, the officers negated all jurisdictional bases by proving they did not live in Texas.

The officers in *TexVa, Inc. v. Boone* were not so fortunate.[193] In that case, a dispute arose between California directors and the Texas director of a Texas corporation concerning whether the California officers had breached an agreement or a fiduciary duty arising out of their business relationship.[194] The trial court granted the California officers' special appearance, and the Texas officer appealed.[195]

The parties initially started working together selling skin care products through a partnership, agreeing to operate their business out of their respective homes in Bakersfield, California and Plano, Texas.[196] The parties subsequently decided to incorporate their business as a Texas corporation, CoreTex Products, Inc. ("CoreTex"), though it was undisputed that the corporation's headquarters were at all times in Bakers-

186. *Kelly*, 301 S.W.3d at 655–56.

187. *Id.* at 656.

188. Kelly v. Gen. Interior Constr., Inc., 262 S.W.3d 79, 99 (Tex. App.—Houston [14th Dist.] 2008), *rev'd in part by* 301 S.W.3d 653 (Tex. 2010).

189. *Id.*

190. *Kelly*, 301 S.W.3d at 661.

191. *Id.* at 659–60.

192. *Id.* at 661 (citing Michiana Easy Livin' Country, Inc. v. Holten, 168 S.W.3d 777 (Tex. 2005) (finding phone call initiated by Texas plaintiff, in a suit alleging misrepresentations on the call, was not sufficient contacts by Indiana defendant to support specific jurisdiction)).

193. 300 S.W.3d 879 (Tex. App.—Dallas 2009, pet. denied).

194. *Id.* at 885.

195. *Id.* at 884.

196. *Id.* at 883–84.

field, California.[197] Almost all of CoreTex's business was conducted out of the Bakersfield office.[198] The Texas officer, however, continued to maintain his home office in Plano and conducted CoreTex business there.[199] CoreTex also maintained Texas customers from the start.[200] The California officers traveled to Texas four times—only two of which were related to the corporation's business.[201]

Rejecting general jurisdiction, the Dallas Court of Appeals focused on specific jurisdiction.[202] Most of the California officers' contacts with Texas related to the management and control of CoreTex.[203] The court noted that in *Rittenmeyer v. Grauer*, it had previously rejected subjecting "a non-resident director of a foreign corporation . . . to personal jurisdiction solely because the corporation has its headquarters in Texas."[204] The court also noted that the Texas Supreme Court had not created a bright line test whereby a non-resident officer was subject to Texas specific jurisdiction merely by being an officer of a Texas corporation.[205]

Performing a traditional minimum contacts test by looking at whether the officers purposefully availed themselves of Texas jurisdiction and whether the causes of action arose out of that availment, the court focused on the California officers' choice to incorporate their business in Texas and to serve as officers of a Texas corporation.[206] The officers "clearly sought to profit . . . through formation of a Texas corporation."[207] The court rejected the officers' argument that all of their contacts were in their representative capacity, finding that this confuses the fiduciary shield doctrine, which applies only to general jurisdiction and does not shield an officer from his own tortious and fraudulent actions.[208] Because the underlying litigation concerned whether one of the parties had breached an agreement or a fiduciary duty arising out of the business relationship incorporated in Texas that the California officers agreed to, the court found specific personal jurisdiction.[209]

Clearly, a corporate officer's ability to be sued in a Texas court can have significant ramifications, and these cases are, therefore, very important additions to the mix on Texas law in this area.

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197. *Id.* at 884.
198. *Id.*
199. *Id.*
200. *Id.*
201. *Id.* at 884–85.
202. *Id.* at 886.
203. *Id.* at 884.
204. *Id.* at 887 (quoting Rittenmeyer v. Grauer, 104 S.W.3d 725 (Tex. App.—Dallas 2003, no pet.)).
205. *Id.*
206. *Id.* at 887–88.
207. *Id.* at 889.
208. *Id.*
209. *Id.*

B. THE TAX MAN COMETH

Pay your taxes. During the Survey period, several courts of appeals imposed liability on directors and officers when their corporations forfeited their right to do business in Texas by failing to pay their tax obligations or file related reports. In *Taylor v. First Community Credit Union*, the Fourteenth Court of Appeals explored whether a "relation back" doctrine applies when a director or officer is subject to liability for a corporation's debts after its corporate privileges are forfeited.[210] An automobile dealership, chartered in Georgia and authorized to do business in Texas, failed to file its required franchise report by its due date of September 7, 2004, and subsequently forfeited its corporate privileges and certificate.[211] Taylor, a director of the automobile dealership, served in that capacity from the dealership's inception through and after forfeiting its privileges.[212]

A year prior to missing its reporting deadline, the dealership executed a dealership agreement whereby a credit union "was granted the right to purchase retail installment contracts from [the dealership.]"[213] Pursuant to the agreement, the credit union purchased four installment contracts in December 2004 and January 2005.[214] The dealership subsequently breached the agreement by failing to provide good title to the purchasers of cars under the installment contracts assigned to the credit union.[215] After the dealership failed to respond to a demand to repurchase the installment contracts, the credit union filed suit against the dealership and its director, claiming that he should be held personally liable under sections 171.252 and 171.255 of the Texas Tax Code.[216]

The trial court found in favor of the credit union.[217] On appeal, Taylor's only argument was that the installment contracts "related back" to the original dealership agreement, which was executed prior to the corporation's loss of privileges.[218] Consequently, he argued he was not liable for breaches of that agreement even though the installment contracts were purchased after the loss of privileges.[219] After distinguishing *Schwab v. Schlumberger Well Surveying Corp.*,[220] where the Texas Supreme Court found that renewal notes were new evidence of an existing debt and not new debt, the court noted that it had previously recognized

210. 316 S.W.3d 863, 864 (Tex. App.—Houston [14th Dist.] 2010, no pet.).
211. *Id.* at 865.
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.* Under sections 171.252 and 171.255, "if the corporate privileges . . . are forfeited for the failure to file a report or pay a tax or penalty, each director or officer of the corporation is liable for each debt [. . .] of the corporation that is created or incurred in [Texas] until the privileges are revived. TEX. TAX CODE ANN. § 171.255(a) (West 2011).
217. *Id.* at 866.
218. *Id.* at 868.
219. *Id.* at 867.
220. 145 Tex. 379, 383–84 (1946).

a "relation back" doctrine in *River Oaks Shopping Center v. Pagan*.[221] Since the *Pagan* decision, however, the Texas Legislature enacted a definition of debt used in section 171.255.[222] Under this definition, a debt is "a legally enforceable obligation measured in a certain amount of money."[223] Because the measurable obligation arose out of the installment contracts and those contracts were entered into after the failure to file the report, the director was personally liable for the debts.[224]

In *Greene v. State*, the Austin Court of Appeals addressed whether compliance with the Texas Tax Code's notice requirements under section 171.256 was a condition precedent for imposing director and officer liability after a forfeiture.[225] In that case, a jewelry business entered bankruptcy shortly after the Texas Comptroller notified the business that its tax liability was approximately $1.5 million.[226] The State of Texas, the City of Dallas, and the Transit Authority of Dallas filed suit against the jewelry company and its sole officer and director Bobby Blu Greene.[227] The trial court rendered judgment against the company and found Greene jointly and severally liable for $1.1 million.[228]

On appeal, Greene argued that "the State failed to establish that the Comptroller had fully complied with the notice requirements of § 171.256," which requires the Comptroller to mail notice to a corporation at least forty-five days prior to forfeiture of the corporate privileges.[229] The court of appeals disagreed, finding "no indication in . . . sections 171.255 or 171.256 that officer and director liability is contingent upon pre-forfeiture notice to the corporation."[230] Instead, officers and directors are statutorily on notice that a corporation's failure to fulfill franchise tax requirements will result in the forfeiture of corporate privileges.[231] According to the court, there was no question that the officer received actual notice of the forfeiture, given that the officer took the necessary steps to revive the privileges after each forfeiture.[232] Refusing to "judicially amend [the] statute," the court held that the notice requirements were not conditions precedent to officer and director liability under section 171.255.[233]

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221. 712 S.W.2d 190, 191–92 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).
222. *See* Act of May 30, 1987, 70th Leg., R.S., ch. 324, § 1, 1987 Tex. Gen. Laws 1734, 1735 (defining "debt" as used in chapter 171) (repealed effective 2008).
223. *Id.* at 280.
224. *Id.*
225. 324 S.W.3d 276, 286 (Tex. App.—Austin 2010, no pet.).
226. *Id.* at 279.
227. *Id.*
228. *Id.*
229. *Id.* at 280.
230. *Id.* at 286.
231. *Id.*
232. *Id.* at 287.
233. *Id.* The officer also argued that the imposition of tax liability on an officer or director without prior notice and a hearing unconstitutionally violated due process. *Id.* at 288. Because officers and directors are entitled to a full and complete hearing on their tax liability in district court (*see* TEX. TAX CODE ANN. § 111.010 (West 2008)) and because trial *de novo* affords "an adequate legal remedy to the taxpayer" (*Greene*, 324 S.W.3d at

The Fourteenth District Court in Houston in *McCarroll v. My Sentinel, L.L.C.* addressed whether a corporation incurred a debt for purposes of section 171.255 under the Texas Tax Code at the execution of a contract or at the rendition of a judgment.[234] Section 171.255 limits a director or officer's liability to debts "created or incurred in this state."[235] After revocation of its charter, a Texas corporation entered into the agreement selling security system monitoring accounts to a Utah corporation. It was undisputed that the contract was entered into in Texas.[236] The contract was breached, however, and the Utah corporation received a default judgment to that effect in Utah.[237] After the Utah corporation sought to hold the officers of the Texas corporation personally liable, the officers argued that the event creating the debt was the Utah default judgment.[238] The court of appeals disagreed, finding that the relevant event was when the contract in question was assented to—not breached.[239] "The issuance of the judgment did not . . . create the debt," but rather assessed liability for failure to pay the debt.[240] Since the legal right to collect on the debt was created by the contract and the contract was entered into in Texas, the officers and directors were properly liable for the debt under section 171.255.[241]

Because the failure to pay corporate taxes can subject the officers and directors to personal liability, and because the law in this area is not well settled and can be very fact-driven, the best course for officers and directors is to make sure the corporation stays current on its taxes rather than trying to litigate these issues of personal liability on the back end.

C. Courts Clarify Veil-Piercing

In a matter of first impression, the Waco Court of Appeals addressed whether to apply Texas or foreign veil-piercing law when determining directors' and officers' liability for debts of a foreign corporation.[242] In *Phillips v. United Heritage Corp.*, after an investment company was incorporated as an exempt company in the Turks and Caicos Islands (TCI), it entered into a subscription agreement with a Utah corporation—whose principal place of business was Johnson County, Texas—for a private offering of certain of the Utah corporation's securities.[243] After a majority of the shares were sold by the foreign investment company, the Utah cor-

288 (citing Tex. Alcoholic Beverage Comm'n v. Macha, 780 S.W.2d 939 (Tex. App.—Amarillo 1989, writ denied))), the sections do not offend due process.

234. No. 14-08-01171, 2009 WL 4667403, at *3 (Tex. App.—Houston [14th Dist.] Dec. 10, 2009).

235. Tex. Tax Code Ann. § 171.255(a) (West 2011).

236. *McCarroll*, 2009 WL 4667403, at *3.

237. *Id.* at *1.

238. *Id.* at *3.

239. *Id.*

240. *Id.*

241. *Id.*

242. Phillips v. United Heritage Corp., 319 S.W.3d 156, 161 (Tex. App.—Waco 2010, no pet.).

243. *Id.* at 159.

poration brought suit in Texas alleging the shares were disposed of in an untimely manner.[244] During this initial suit, the trial court rendered judgment in favor of the Utah corporation awarding damages, fees, costs, and interest.[245]

After the Utah corporation unsuccessfully attempted to execute the judgment, it sought to pierce the corporate veil and succeeded in holding the foreign corporation's non-shareholder officers liable for the debt.[246] On appeal, the officers made two arguments.[247] First, article 8.02(A) of the Texas Business Corporations Act requires application of the veil-piercing law of the TCI.[248] Second, article 2.21(A) requires an affirmative finding of "actual fraud" to hold officers liable for a corporation's contractual obligations.[249]

The Waco Court of Appeals first held that under article 8.02(A), TCI's veil-piercing law applied.[250] Under that article, a foreign corporation is subject to the same duties, restrictions, penalties, and liabilities imposed on a domestic corporation, but not in the area of "liability, if any, of *shareholders* of the foreign corporation for the debts, liabilities, and obligations of the foreign corporation."[251] The Utah corporation argued that the article did not apply to non-shareholder officers and directors.[252] Unpersuaded, the court relied on section 1.104 of the Texas Business Organizations Code, the successor of the Business Corporations Act, which makes clear that "the laws of a foreign corporation's state or place of incorporation shall apply when determining the liability of a managerial official . . . or a shareholder, for an obligation, debt, or liability of the corporation."[253] Significant to the court was that article 8.02(A) was one of the source statutes the Legislature relied on in adopting section 1.104, and the reviser's note indicated that no substantive change was intended.[254] Moreover, applying Texas law to non-shareholder officers but foreign law to shareholder officers seemed "unreasonable, illogical, and absurd."[255] Because the Utah corporation presented no evidence supporting liability under the laws of the Turks and Caicos Islands, the officers were not liable pursuant to article 8.02(A).[256]

The court also agreed with the officers that article 2.21(A) of the Texas Business Corporations Act precluded individual liability because it re-

244. *Id.*
245. *Id.* at 159–60.
246. *Id.* at 160.
247. *Id.*
248. *Id.*
249. *Id.*
250. *Id.* at 162–63.
251. *Id.* at 161 (quoting TEX. BUS. CORP. ACT ANN. art. 8.02(A) (West 2003)) (emphasis added).
252. *Id.* at 162.
253. *Id.* at 163 (citing TEX. BUS. ORGS. CODE ANN. § 1.104 (West Pamp. 2009)).
254. *Id.*
255. *Id.*
256. *Id.*

quires actual fraud.[257] That section defines alter ego liability for "a holder of shares, an owner . . . , or a subscriber . . . , or any affiliate thereof or of the corporation" for a corporation's contractual obligations upon a finding of actual fraud.[258] The court rejected the Utah corporation's argument that the officers were not shareholders and did not qualify as "affiliates" under the statute, finding that the plain meaning of "affiliate" under the article encompasses any individual who is affiliated simply with the corporation itself in some capacity, which included the officers.[259] The jury's finding of constructive fraud was not sufficient, and absent actual fraud, the veil-piercing claims failed.[260]

The Dallas Court of Appeals, in *Latham v. Burgher*, reiterated that the term "actual fraud" in an alter ego analysis is not the same as the tort of fraud.[261] In that case, after a roofing company failed to properly repair a roof, the homeowner sent a demand letter seeking the cost to properly finish the repair. The owner of the roofing company dissolved the company two months later. The homeowner sued the roofing company and its owner for breach of contract and violations of the Deceptive Trade Practices Act, and a jury pierced the corporate veil to hold the roofing company's owner liable.

To pierce the corporate veil under an alter ego theory, a plaintiff must show actual fraud.[262] At the charge conference, the lawyer for the roofing company's owner submitted a definition of fraud akin to the tort of fraud. The court of appeals rejected that definition and reiterated its prior definition from *Dick's Last Resort of West End, Inc. v. Market/Ross, Ltd.*, which defined "actual fraud" as "dishonesty of purpose or intent to deceive."[263] Because the trial court gave this exact definition to the jury, it did not abuse its discretion.[264] In reviewing whether the evidence was sufficient to support the jury's finding of actual fraud, the appellate court emphasized that the "ultimate expression" of the owner's use of the company was his dissolution after threat of suit.[265] The owner argued that the homeowner should look to the roofing company to be made whole, but his own actions destroyed that option. In these circumstances, the court held that a rational juror could conclude that the dissolution represented dishonesty of purpose or an intent to deceive.[266]

The *Phillips* case is significant in that it is a case of first impression regarding the application of the laws of a foreign jurisdiction in determining the potential liability of corporate officers and directors. In addition,

257. *Id.* at 166.
258. *Id.* (quoting TEX. BUS. CORP. ACT ANN. art. 2.21(A) (West 2003)).
259. *Id.*
260. *Id.*
261. 320 S.W.3d 602, 607 (Tex. App.—Dallas 2010, no pet.).
262. *Id.*
263. *Id.* (citing Dick's Last Resort of West End, Inc. v. Market/Ross, Ltd., 273 S.W.3d 905, 908 (Tex. App.—Dallas 2008, pet. denied)).
264. *Id.*
265. *Id.* at 610.
266. *Id.*

both the *Phillips* case and the *Latham* case are helpful for corporate defendants because they clarify that the fraud element necessary to pierce the corporate veil cannot be satisfied through mere constructive fraud but must be established through evidence of actual "dishonesty of purpose or intent to deceive."[267] With this clarification, plaintiffs will face a higher obstacle in getting past the corporate structure to the individuals' assets.

D. WHO DETERMINES "DETERMINED . . . IN FACT"?

The Fifth Circuit was tasked with interpreting the D&O liability policy of R. Allen Stanford and other executives who allegedly participated in a heavily publicized ponzi scheme. In *Pendergest-Holt v. Certain Underwriters of Lloyd's of London*, the Fifth Circuit addressed the difference between a "final adjudication" and "determined . . . in fact" as used in a D&O policy governed by Texas law.[268] The executives faced several criminal and civil proceedings that implicated coverage under a policy issued by Lloyd's of London and Arch Specialty Insurance Company with a $100 million policy limit.[269] The policy paid for loss "incurred in defending any judicial or administrative proceeding against a director or officer."[270] The policy did not "impose a duty to defend, [but] [r]ather, the executives must defend [the] claims themselves" with the underwriters responsible for costs submitted before they are incurred.[271]

"The underwriters initially agreed to advance defense costs, . . . but expressly reserved the right to deny coverage at any time based on the policy's terms, including exclusions for fraud and money laundering."[272] The money laundering exclusion "bar[red] coverage for loss . . . resulting from any claim 'arising . . . as a result of or in connection with . . . money laundering.'"[273] The policy defined money laundering as, in essence, the "use or possession of Criminal Property," which was in turn broadly defined as "property obtained from or as a result of . . . criminal conduct."[274] Despite the stated coverage bar, the policy "provide[d] for qualified reimbursement of defense costs, coupled with the ability to claw back reimbursed funds [at] . . . such time that *it is determined* that the alleged act or alleged acts did in fact occur."[275]

In November 2009, "the underwriters . . . advised the executives that [they] would no longer provide coverage . . . because they had deter-

267. *Id.*

268. 600 F.3d 562, 573 (5th Cir. 2010).

269. *Id.* at 566 n.2. There were actually two policies, but the court referred to them as a single policy.

270. *Id.* at 566.

271. *Id.*

272. *Id.*

273. *Id.* at 567.

274. *Id.*

275. *Id.* (emphasis modified).

mined" the money laundering exclusion applied.[276] The executives quickly filed suit in the Southern District of Texas seeking "a declaration that their defense costs must be reimbursed . . . and a preliminary injunction ordering the underwriters to pay [such] costs until a final judgment on the merits of the coverage dispute."[277] The trial court determined the exclusion would most likely not preclude coverage and granted the preliminary injunction.[278] The underwriters successfully sought a stay pending an expedited appeal of the preliminary injunction.

The executives argued that there could be no determination of whether the exclusion applied until a final adjudication of the underlying proceedings.[279] The underwriters, on the other hand, interpreted "it is determined" as giving them the authority to, in essence, unilaterally determine whether the exclusion applied.[280] The Fifth Circuit disagreed, first exploring the definitions of "determined" and "in fact," and concluding that "taken together they favor a judicial decisionmaker over any other."[281] The court found that if the policy intended the underwriters to make the determination, it could have said "we have determined" or "*Underwriters* determined."[282] The parties chose the phrase "it is determined," likely because selling a policy with such a "draconian power" as allowing the underwriters to unilaterally decide would be "difficult to sell."[283]

The Fifth Circuit disagreed with the executives as well, finding the fraud exclusion instructive.[284] That exclusion disclaimed loss for fraud "as determined by a final adjudication."[285] Thus, the court reasoned "determined" and "in fact" must have some meaning other than "final adjudication."[286] The court's review of precedent revealed that courts have consistently held "final adjudication" to require an adjudication in the underlying D&O proceeding.[287] By contrast, courts have generally interpreted "in fact" more broadly than a "final adjudication."[288] The Fifth Circuit ultimately concluded that the coverage decision should be made, not in the underlying proceedings, but in a parallel and independent proceeding, though both phrases place the determination of coverage in the

276. *Id.* at 567–68. The underwriters denied coverage back to August 27, 2009—the date of one of the executive's guilty plea. In other words, they were seeking to claw back costs incurred between that date and the November 2009 letter.

277. *Id.* at 568.

278. *Id.*

279. *Id.* at 569–70.

280. It appears that at oral argument both sides backed away from these positions. *Id.* at 570. The executives conceded that the "in fact" determination may be heard in a parallel coverage matter. The underwriters conceded that, at the very least, their determination was judicially reviewable.

281. *Id.* at 570–71.

282. *Id.* at 571.

283. *Id.* (quoting Assoc. Elec. & Gas Ins. Servs. v. Rigas, 382 F. Supp. 2d 685, 701 (E.D. Pa. 2004)).

284. *Id.* at 566–67.

285. *Id.*

286. *Id.* at 571–72.

287. *Id.* at 572.

288. *Id.* at 573.

first instance in the hands of the judiciary.[289]

This case is very significant for corporate officers and directors because whether or not the D&O insurer is required to fund or reimburse the costs of defense can have a dramatic (if not outcome determinative) effect on the officers' and directors' ability to mount a defense. By requiring a determination by the court, rather than by the insurer, that a coverage exclusion applies, this opinion provides some protection for the insured defendant.

VI. CONCLUSION

Texas courts remained busy during the Survey period deciding many issues affecting professional liabilities. From deciding when an injured plaintiff is forever barred from complaining about a sponge mistakenly left in her body to finding no specific jurisdiction over non-resident officers of foreign corporations doing business in Texas, the Texas Supreme Court showed its continued interest in professional negligence law. It remains to be seen whether the high court will agree with the many appellate court decisions in these areas such as disallowing fracturing of legal malpractice claims, application of a higher standard of care in cases of undiagnosed emergency medical conditions, and imposing liability squarely on officers and directors of defunct corporations. Regardless, it is clear from this Survey period that the professional negligence landscape is constantly changing and requires careful monitoring to stay abreast of these important topics.

289. *Id.* at 574–75.