Corporations

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CORPORATIONS

Glenn D. West*
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HERE were several interesting corporate law cases decided by Texas courts\(^1\) during the survey period.\(^2\) Grouped into categories of those that deal with (i) honoring the corporate form, (ii) disregarding the corporate form, (iii) drafting of corporate agreements, (iv) jurisdiction over and venue for corporations, and (v) shareholder derivative actions, Section II of this article presents summaries of these cases. Although the 76th Texas Legislature was in session during the survey period, there were no remarkable amendments or enactments relating to Texas corporations. The much anticipated H.B. 2681,\(^3\) which proposes to recodify and consolidate most Texas business organization statutes, was presented too late in the session to be passed. Since H.B. 2681 is expected to emerge from the next legislative session, Section III of this article includes a brief description of the bill.

## II. JUDICIAL DEVELOPMENTS

### A. Honoring the Corporate Form

A survey of the law of corporations should begin with a discussion of the corporate form and the obligation of the courts to honor that form. Fortunately, during this survey period two courts of appeals had the opportunity to address the issue of the corporate form and its sanctity. Not unexpectedly, these courts reaffirmed the long-standing rule that the corporate entity is a creature of statute, separate and distinct from its shareholders, and that few facts and circumstances warrant an exception to this rule.\(^4\)

#### 1. *Louis v. Discount Tire Co. of Texas, Inc.*\(^5\)

In *Louis*, the Amarillo Court of Appeals reviewed plaintiff Rita Louis's attempt to bring a negligence cause of action against corporate defendant Discount Tire one day after the applicable statute of limitations for such

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\(^1\) For purposes of this article, "Texas courts" include decisions by federal district courts sitting in Texas and the United States Court of Appeals for the Fifth Circuit interpreting Texas law where appropriate. Since we limited the scope of our survey to Texas law issues, federal cases focusing on purely federal issues affecting the corporation, such as federal securities litigation, are not addressed.


\(^3\) Tex. H.B. 2681, 76th Leg., C.S. (1999).


\(^5\) 1 S.W.3d 698 (Tex App.—Amarillo 1999, no pet.).
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claim had lapsed. Louis argued that since the corporation’s registered agent was absent from the state for at least one day during the two-year limitations period, the trial court’s entry of summary judgment for Discount Tire should be overturned. Citing a nineteenth-century Texas Supreme Court case, Sherman v. Buffalo Bayou, Brazos, and Colorado R.R. Co., the court of appeals affirmed the trial court ruling that a corporation carrying on its business in Texas is not considered absent from the state merely because its officers or its registered agent are absent from the state since “a corporation is not its officers and officers are not the corporation.”

2. Pellow v. Cade

At issue in Pellow was whether a suit brought against a corporation could be maintained if the corporation had dissolved thirty years earlier. Citing the Texas Supreme Court’s decision in Hunter v. Fort Worth Capital Corp., the Texarkana Court of Appeals held that the three-year survival period set forth in Article 7.12 of the Texas Business Corporation Act is the exclusive method of recovering against a dissolved corporation. Absent such statute, “no claim exists against a dissolved corporation or its shareholders.” If a plaintiff fails to bring an action within the time limits of the applicable survival statute, “there is no longer an entity that can be sued.”

B. Disregarding the Corporate Form

Notwithstanding the general reluctance of the courts to disregard the corporate form, officers, directors, and shareholders of corporations are frequently subjected to suits seeking to impose personal liability on them. As in years past, this survey period was not without its handful of share-

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6. 21 Tex. 349 (1858).
7. Louis, 1 S.W.3d at 700. On the other hand, as other cases decided during the survey period noted, a corporation can only act through its officers and agents, who are generally not responsible personally for actions they take on behalf of the corporation. See Powell Indus., Inc. v. Allen, 985 S.W.2d 455, 457 (Tex. 1998); GTE Southwest Inc. v. Bruce, 998 S.W. 2d 605, 618 (Tex. 1999); Household Credit Servs., Inc. v. Driscoll, 989 S.W.2d 72 (Tex. App.—El Paso 1999, pet. denied); Palmer v. Wal-Mart Stores, 65 F. Supp. 2d 564 (S.D. Tex. 1999). Indeed, corporations can be held liable, along with the responsible officers, for the malicious actions of their officers acting within the scope of their authority. See Bradford v. Vento, 997 S.W.2d 713 (Tex. App.—Corpus Christi 1999, no pet.); Fontenot Petro-Chem and Marine Servs., Inc. v. Labono, 993 S.W.2d 455, 459 (Tex. App.—Corpus Christi 1999, pet. denied); ONI, Inc. v. Swift, 990 S.W. 2d 500, 503 (Tex. App.—Austin 1999, no pet.); Green Tree Fin. Corp. v. Garcia, 988 S.W.2d 776, 779 (Tex. App.—San Antonio 1999, no pet.).
8. 990 S.W.2d 307 (Tex. App.—Texarkana 1999, no pet.).
10. See Pellow, 990 S.W.2d at 313.
11. Id.
12. Id. Another case decided during the survey period reaffirmed the rule that a corporation cannot be held liable for something that occurred before it was formed. See Edmonds v. Sanders, 2 S.W.3d 697, 704 (Tex. App.—El Paso 1999, pet. denied).
holder liability cases. Citing cornerstone cases such as *Castleberry*¹³ and *Old Republic Insurance Co.*,¹⁴ Texas courts held firm on prior rulings as to reaching individuals or parent corporations through the alter ego and the single business enterprise doctrines, generally refusing on the facts of the particular case to disregard the corporate form.

1. *Hall v. Timmons*¹⁵

*Hall* illustrates the type of evidence necessary to support an alter ego finding, as well as the necessity of giving full weight to all of the *Castleberry* factors. Kenny Timmons sued his employer, Si-Bon Beverage Corporation, for personal injuries sustained while working in an unsafe business environment. Timmons’s petition also named Robert Hall, chairman of Si-Bon, as a co-defendant under the alter ego and the single business enterprise doctrines. In support of his claims, Timmons introduced strong evidence that (i) Si-Bon was undercapitalized, (ii) Hall made all the decisions for Si-Bon and often overruled decisions made by Si-Bon employees, (iii) Si-Bon’s registered address was Hall’s personal office, (iv) all Si-Bon meetings were held at Hall’s office, (v) Hall had a lien on all of Si-Bon’s assets, and (vi) a majority of the checks written by Si-Bon were made to a partnership owned 99% by Hall.¹⁶ Instead of placing all the *Castleberry* factors¹⁷ in the jury instruction, however, the trial court omitted the factors relating to fraud, monopoly, and crime since it found no evidence of those in the presented facts.¹⁸ Based upon the court’s excised alter ego instruction, the jury found for Timmons and the trial court entered judgment in accordance with the verdict.¹⁹

On appeal, Hall challenged both that there was “no evidence” to support the alter ego finding and that the alter ego instruction was legally defective because it omitted some of the *Castleberry* factors. Turning first to the no evidence challenge, the court of appeals concluded that there was some evidence to disregard the corporate fiction between Si-Bon and

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¹³ 721 S.W.2d 270 (Tex. 1986).
¹⁴ 920 S.W.2d 393 (Tex. App.—Houston [1st Dist.] 1996, no writ).
¹⁵ 987 S.W.2d 248 (Tex. App.—Beaumont 1999, no pet.).
¹⁶ See id. at 250-51.
¹⁷ Under *Castleberry*, “alter ego” may be found:
   (1) when the [corporate] fiction is used as a means of perpetuating fraud; (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation; (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation; (4) where the corporate fiction is employed to achieve or perpetrate monopoly; (5) where the corporate fiction is used to circumvent a statute; and (6) where the corporate fiction is relied upon as a protection of a crime or to justify a wrong. *Castleberry*, 721 S.W.2d at 272. The court of appeals noted that Tex. Bus. Corp. Ann. art. 2.21(A)(3) partially overruled *Castleberry* such that a failure to observe corporate formalities is no longer a factor in proving alter ego and is thus not included in this list. See *Hall*, 987 S.W.2d at 250 n.2.
¹⁸ See *Hall*, 987 S.W.2d at 253-54.
¹⁹ See id. at 250.
Hall.\textsuperscript{20} Despite concluding that there was some evidence to support the alter ego finding, the court also reviewed whether the alter ego instruction submitted to the jury was complete. Hall stressed that the jury instruction represented an improper statement of the law because it omitted factors for which the court predetermined that there was no evidence—fraud, monopoly, and crime. The court of appeals agreed. On the strength of \textit{Castleberry}, the court held that "a proper alter ego instruction should include all the relevant factors and consider the total dealings of the corporation and the individual," not only those factors of which there is some evidence.\textsuperscript{21} Otherwise, the selective instruction risks treating the alter ego factors as if each factor alone were sufficient to support an alter ego finding while \textit{Castleberry} requires consideration of the totality of factors.\textsuperscript{22} After finding the instruction defective, the court also held that, given the serious contested nature of the alter ego dispute, the improper instruction probably caused the rendition of an improper judgment, requiring reversal and remand for a new trial.\textsuperscript{23} Consequently, despite some evidence for the jury's alter ego finding, the Beaumont Court of Appeals stood firm on requiring a complete \textit{Castleberry} instruction to support a judgment based on alter ego.

2. \textit{Seminole Pipeline Co. v. Broad Leaf Partners, Inc.}\textsuperscript{24}

\textit{Seminole} addressed the parent-subsidiary version of corporate veil-piercing. Twenty-two plaintiffs sued three corporations, one of which was the parent company of a codefendant, for damages resulting from an explosion at a natural gas reservoir. The plaintiffs blended the alter ego and the negligence doctrines in an attempt to reach the deep pockets of the parent entity. They argued that a wholly-owned corporate structure, common executive officers, central hiring and payment of employees, similar business activities, and identical principal business addresses were sufficient evidence to demonstrate that the parent was the alter ego of the subsidiary. The court disagreed, however, stating that a mere showing of "stock ownership, a duplication of some or all of the directors or officers, or an exercise of control that stock ownership gives to stockholders" was not enough to invoke the doctrine under a \textit{Castleberry} analysis.\textsuperscript{25} Without a showing of some wrongdoing on the part of the parent or a showing of more than just a unity of financial interest, ownership and control,

\begin{itemize}
  \item \textsuperscript{20} See \textit{id.} at 251. The court also conducted no evidence review on the jury's negligence, proximate cause, single business enterprise, and medical expenses findings and concluded that all were supported by some evidence. See \textit{id.} at 251-53.
  \item \textsuperscript{21} \textit{Id.} at 254.
  \item \textsuperscript{22} \textit{Id.} (citing \textit{Castleberry}'s mandate that "a proper alter ego jury instruction should include all the relevant indicators and consider the total dealings of the corporation and the individual."). Even though the factors are listed in the disjunctive, under \textit{Castleberry} they must be considered by the jury in their totality in light of the particular facts and circumstances. See \textit{Hall}, 987 S.W.2d at 254.
  \item \textsuperscript{23} See \textit{Hall}, 987 S.W.2d at 254.
  \item \textsuperscript{24} 979 S.W.2d 730 (Tex. App.—Houston [14th Dist.] 1998, no pet.).
  \item \textsuperscript{25} \textit{Id.} at 739.
\end{itemize}
“Texas courts have refused to make the parent liable for its subsidiary’s torts.”26

3. Gardemal v. Westin Hotel Co.27

Much as in Seminole above, the plaintiffs in Gardemal attempted to reach a parent company through the doctrines of alter ego and single business enterprise. Lisa Gardemal brought wrongful death and survival actions on behalf of her husband’s estate against Westin Hotel Company and one of its Mexican subsidiaries, Westin Mexico, S.A. de C.V., alleging that the concierge at the Westin Regina Resort Los Cabos (a hotel managed by Westin Mexico) negligently directed her husband and several others to a dangerous snorkeling beach where he and another hotel guest drowned in the strong undercurrents. To support her claim, Gardemal presented evidence that: (i) the two corporations shared common corporate officers, (ii) Westin exercised various quality controls over Westin Mexico, (iii) Westin oversaw Westin Mexico’s advertising and marketing operations, (iv) both entities used similar operations manuals and trademarks, and (v) Westin Mexico was “grossly undercapitalized.”28 As in Seminole, the court quickly pointed out that these facts showed nothing more than a “typical corporate relationship between a parent and a subsidiary.”29 In the absence of “complete domination by the parent,” this does not alone establish an alter ego relationship. The court focused on the issue of undercapitalization, since that is an important factor in the Castleberry analysis, but did not find that Westin Mexico’s assets were deficient.30 In addition, the court determined that there was insufficient evidence that the operations of Westin and Westin Mexico were so intertwined as to constitute a single business enterprise.31

C. Drafting Corporate Agreements

Given the courts’ general judicial reluctance to disregard the corporate form, it is critical to emphasize the importance of drafting corporate agreements that clearly contemplate the corporation’s identity as an entity and the identity of person signing the document as merely an officer or an agent of the corporate entity. The effects of corporate transactions,

26. Id. (citing Lubrizol v. Cardinal Constr., 868 F.2d 767, 711 (5th Cir. 1989)).
27. 186 F.3d 588 (5th Cir. 1999).
28. Id. at 593.
29. Id. The court held that the evidence actually suggested the opposite since Westin Mexico (i) maintained separate bank accounts in Mexico, (ii) was incorporated in Mexico rather than Delaware, like its parent, (iii) fully adhered to corporate formalities and (iv) separately maintained its assets, staff, and insurance policies. See id. at 594.
30. See id. at 594 (citing United States v. Jon-T Chems., Inc., 768 F.2d 686 (5th Cir. 1985)).
31. See id. at 595. As opposed to the direct piercing actions brought in Hall, Seminole, and Gardemal, the plaintiff in Schimmelpennick v. Byrne (In re Schimmelpennick), 183 F.3d 347 (5th Cir. 1999), brought a “reverse” piercing action in an attempt to reach the subsidiary of a corporate parent. While the court recognized the validity of a reverse piercing action under Texas law, it did not undertake an analysis of the theory in reaching its decision, so we note it only for reference.
such as mergers and stock sales, must also be clearly contemplated and dealt with. During the survey period, Texas courts confronted a number of situations involving the failure to clearly draft documents involving transactions with corporations, as opposed to individuals, with the corporate entity in mind.

1. M. D. Mark, Inc. v. Nuevo Energy Co. 32

This survey period brought an interesting pair of Texas cases that addressed whether or not a merger or consolidation of two corporate entities constitutes an assignment with respect to the assets and liabilities of the merged or consolidated entity for the purposes of a contractual restriction on assignment. 33 The corporate attorney frequently encounters this question. It can often be a difficult one to answer depending on the jurisdictional context and the type of merger involved. 34 The precise question of whether a merger constitutes an assignment of the assets of the merging corporation to the surviving corporation had never been specifically addressed by a Texas court prior to this survey period. 35

In the first of two related cases, M.D. Mark, Inc. v. Nuevo Energy Co. ("Mark I"), M.D. Mark, Inc. sued Nuevo Energy Company for breach of certain licensing agreements pursuant to which Mark licensed seismic data to a predecessor of Nuevo. 36 In 1992, the original licensee, TXP Operating Company, a subsidiary of Transco Energy Company, obtained Mark's consent to transfer its rights under the license agreements to another subsidiary of Transco called TXPRO. 37 In 1994, without seeking Mark's consent, Transco sold the stock of TXPRO to Paramount Co., Inc., and TXPRO remained as licensee under the agreements following

32. 988 S.W.2d 463 (Tex. App.—Houston [1st Dist.] 1999, no pet.).
33. There was actually an equally interesting federal district court opinion from the Eastern District of Texas that addressed whether a merger constituted a transfer of a claim pursuant to Fed R. Bankr. P 3001(e)(2) thereby requiring the filing of evidence of the transfer by the merging corporation if the merger took place after proof of the claim has been filed. While the court had doubts about the rule's applicability to a merger, it found no authority and ordered the parties to file a joint document satisfying the rule. See Southern Pacific Transp. Co. v. Voluntary Purchasing Groups, 229 B.R. 119, 121-22 (E.D. Tex. 1999).
34. See Jay M. Zitter, Annotation, Merger or Consolidation of Corporate Lessee as Breach of Clause in Lease Prohibiting, Conditioning, or Restricting Assignment or Sublease, 39 A.L.R. 4th 879 (1985) (generally discussing state and federal cases in which the courts have considered whether the merger or consolidation of a corporate tenant constitutes a breach of a non-assignment covenant in a lease).
36. M.D. Mark, Inc. v. Nuevo Energy Co., 988 S.W.2d 463, 464 (Tex. App.—Houston [1st Dist.] 1999, no pet.). Plaintiff M.D. Mark, Inc. also filed suit against TXO Production Co. which was appealed to the Houston Court of Appeals for the Fourteenth District. This case is discussed briefly in the next section.
37. See id.
Shortly thereafter, TXPRO merged into its parent Paramount, and two years later, Paramount merged with and into defendant Nuevo, an unrelated company, in a separate transaction. Mark's suit against Nuevo claimed that the mergers of TXPRO into Paramount, and Paramount with and into Nuevo breached the license agreements because they "resulted in the unauthorized disclosure of licensed seismic data to Paramount and Nuevo, [both] non-licensees." Relying on the Texas Supreme Court's holding in *Tenneco, Inc. v. Enterprise Products Co.*, the court in *Mark I* noted that "[t]he purchaser of stock in a corporation does not purchase any of the corporation's assets, nor is a sale of all of the stock of a corporation a sale of the physical properties of the corporation." Holding that a merger is effectively a purchase of stock by the surviving company, the court concluded that the prohibitions in the license agreements were not violated since they focused on transfers of the licensed seismic data itself and did not contain any provisions addressing mergers, stock sales, or similar change of control events.

In a concurring opinion, Justice Hedges agreed with the majority's disposition in the case, but rejected its reliance on *Tenneco* and rejected the focus on whether the merger was a sale of assets or just a sale of stock. According to Justice Hedges, the license agreements on their face only prohibited transfers of the seismic data, and a merger is not a transfer. Rather, "the rights, title, and interests in property of the merging corporations vest in the surviving corporation upon merger without further act or deed and without any transfer having occurred."


The second case involved the same clause in another seismic data licensing agreement. The licensee, TXO Production Co., a wholly owned

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38. See id.
39. See id.
40. Id. The license agreements provided that "[Licensee] agrees that data hereunder shall be for his own use in his exploration and development efforts, and shall not be sold, traded, disposed of, or otherwise made available to third parties, except it may be shown to partners as support evidence for joint ventures." Id. at 465. Mark appeared to concede that the sale of TXPRO stock to Paramount did not violate the terms of the license agreements.
41. 925 S.W.2d 640, 645 (Tex. 1996).
42. *M.D. Mark*, 988 S.W.2d at 465 (citing *Tenneco*, 925 S.W.2d at 645).
43. See id. at 465.
44. See id. at 465-66.
45. Id. at 466 (Hedges, J., concurring). Article 5.06 of the Texas Business Corporation Act states: "[A]ll rights, title and interests to all real estate and other property owned by each domestic or foreign corporation and by each other entity that is a party to the merger shall be allocated to and vested in one or more of the surviving or new domestic or foreign corporations and other entities as provided in the plan of merger without reversion or impairment, without further act or deed, and without any transfer or assignment having occurred, but subject to any existing liens or other encumbrances thereon." TEX. BUS. CORP. ACT ANN. art. 5.06(Á)(2) (Vernon Supp. 2000).
46. 999 S.W.2d 137 (Tex. App.—Houston [14th Dist.] 1999, pet. denied).
47. See supra note 40.
subsidiary of Marathon Oil Co., eventually merged into its parent company. In this case ("Mark II"), the trial court held that the merger violated the specific provisions of the seismic data license agreement because the merger constituted a transfer of that data. The Houston Court of Appeals for the Fourteenth District noted that Mark II was a case of first impression for Texas. Unlike Mark I, decided by the Houston Court of Appeals for the First District, it did not rely on Tenneco. It did not treat a merger as the equivalent of a sale of stock by the merging corporation to the surviving corporation. Accordingly, the court looked to cases from other jurisdictions for guidance. As the court noted, other jurisdictions that have addressed this issue, have held that a merger was not an assignment in violation of the nonassignment clause at least where the merger was of a subsidiary into a parent, or a reverse merger with no change in the ownership, possession, or control of the property.\textsuperscript{48}

Mark, however, relied on two cases from other jurisdictions that specifically found that a merger violated the express terms of a nonassignment clause. The first of those cases was PPG Industries, Inc. v. Guardian Industries Corp.\textsuperscript{49} PPG involved the granting of rights to certain patents by PPG Industries to Permaglass, pursuant to an agreement containing a nonassignment provision. PPG Industries claimed that the nonassignment provision was breached when Permaglass merged with an unrelated third party. The court in PPG agreed.\textsuperscript{50} The second case Mark relied on was Nicolas M. Salgo Associates v. Continental Illinois Properties.\textsuperscript{51} Salgo involved a prohibition on assignment contained in a partnership agreement, where a third party acquired a controlling interest in one of the partners and then merged with that partner.\textsuperscript{52} Again, as in PPG, the court in Salgo held that the merger was a violation of the partnership agreement.


\textsuperscript{49} 597 F.2d 1090 (6th Cir. 1979).
\textsuperscript{50} See TXO Prod. Co., 999 S.W.2d at 140 (citing PPG, 597 F.2d at 1095).
\textsuperscript{52} See TXO Prod. Co., 999 S.W.2d at 140-41 (citing Salgo, 532 F. Supp. at 280-81).
agreement's anti-assignment provision.53

The Houston Court of Appeals for the Fourteenth District disagreed with both the rationale and the outcome of PPG and Salgo.54 First, the court noted that both cases are distinguishable from the facts in Mark II, because each involved a merger with an unrelated third party, whereas Mark II involved a subsidiary that merged into its parent. As a result of the mergers in PPG and Salgo, unlike the merger in Mark II, a third party had gained access to a patent it would not have had access to in the absence of the merger, and a partner was forced into partnership with a third party (the unrelated entity into which the original partner was merged) with whom it had not agreed to form a partnership.55

More importantly, however, the Houston Court of Appeals for the Fourteenth District, like Justice Hedges's concurring opinion in Mark I, specifically held that in a statutory merger after the 1987 amendments to the Texas merger statute,56 "there is no transfer of the rights of the merging corporation; rather, the rights vest automatically and without further action."57 The court noted that while an earlier version of the Texas merger statute "provided that the property of the merging corporation was deemed transferred upon the merger,"58 the Texas Legislature specifically intended to make clear in 1987 that "vesting of rights pursuant to a merger occurred without a transfer or assignment of rights."59 The court further noted that the Texas Legislature was specifically trying to avoid the result in PPG when it amended the Texas merger statute in 1987.60

Because the anti-assignment provisions related only to the transfer of rights and did not specifically address a statutory merger, the court of appeals construed the contract language narrowly. The court in Mark II held that the merger did not constitute transfer or disclosure of seismic data to a third party, and that the applicable merger statutes authorized the use of seismic data by a surviving corporation, such as the licensee's parent company, after the merger.61

53. See id. (citing Salgo, 532 F. Supp. at 280).
54. See TXO Prod. Co., 999 S.W.2d at 141.
55. See id.
56. TEX. BUS. CORP. ACT ANN. art. 5.06 (Vernon Supp. 2000).
57. TXO Prod. Co., 999 S.W.2d at 142.
58. Id. at 142 n.7.
59. Id.
60. See id. at 141 n.3.
61. See id. at 143. It is important to note that based on the courts interpretation of Article 5.06 of the Texas Business and Commerce Code, because no transfer occurs in a merger by operation of law or otherwise, those wishing to prevent mergers in anti-assignment provisions cannot rely simply upon the parenthetical clause "by operation of law or otherwise" contained in many anti-assignment clauses; rather the drafter of an anti-assignment provision must specifically reference a merger or change of control to make it an "anti-merger" or "anti-change of control" clause.
3. *Boustany v. Monsanto Co.*

Careful drafting was also in issue in *Boustany*, where the court interpreted a stock option agreement under Delaware law. Employees of a former subsidiary of Monsanto sued Monsanto for breach of contract, fraud, conversion, and breach of the duty of good faith. The claim arose out of stock options granted to the plaintiffs pursuant to Monsanto’s employee stock option plans prior to the sale of the subsidiary. Each of the plaintiffs were granted options to purchase Monsanto stock at a time when Fisher International Controls, Inc., the company which employed them, was a subsidiary of Monsanto. The stock option plans provided a ten year period after vesting in which the plaintiffs could exercise the options, provided that once a participant’s employment had been terminated “by [Monsanto] and its subsidiaries,” the participant forfeited the option unless it was exercised within three months.

The dispute in *Boustany* was simply this: did the sale of 100% of the Fisher stock by Monsanto to another owner, where the plaintiffs continued their employment with Fisher, constitute a termination of employment by Monsanto and its subsidiaries and trigger the three month period for the exercise of the plaintiffs’ options. The court of appeals held it did not. The court adopted the plaintiffs’ premise that when there was a change in the ownership of Fisher, plaintiffs’ rights under their stock option certificates were unaffected, because plaintiffs were still employed by Fisher in the same management positions performing the same job tasks; the fact that Fisher was now owned by a different group of shareholders did not alter the contractual rights plaintiffs held as continuing employees of Fisher.

Citing the often repeated contract construction refrain that “[a] court may not, in the guise of construing a contract, in effect rewrite it to supply an omission in its provisions,” the court held the plaintiffs’ rights under Monsanto’s stock option plans remained the same before and after the change in ownership of Monsanto’s former subsidiary Fischer. The missing provision in this court’s mind was one regarding a change of control of the subsidiary. Courts will honor the corporate form; the fact that Fisher was no longer controlled by Monsanto did not change the fact that Fisher still employed the plaintiffs.

D. Jurisdiction and Venue

1. Jurisdiction over the Corporation

This Survey period also produced a stream of cases relating to jurisdiction over corporate entities. Following the jurisdictional principles articu-
lated by the Texas Supreme Court in *Guardian Royal Exchange Assurance, Ltd. v. English China Clays, P.L.C.* and *Schlobohm v. Schapiro*, personal jurisdiction now collapses into a single inquiry of whether it is consistent with federal constitutional requirements of due process for Texas to assert personal jurisdiction over the defendant. In conducting the constitutionally-required "minimum contacts" analysis, now refined into specific and general jurisdiction, the courts of appeals have reached some interesting results.


The most interesting opinion in this Survey period relating to the exercise of jurisdiction over a foreign corporation is *Jones*. In *Jones*, the trial court sustained the special appearance of Beech, a Kansas aircraft manufacturer, in a wrongful death action brought by survivors, all foreign nationals, of an airplane crash in New Zealand. Beech's contacts with Texas were limited to maintenance of a homepage on its parent corporation's website; a telephone listing in Houston; four sales representatives in Texas; conducting business in Texas through wholly-owned subsidiaries; and selling aircraft to Texas residents in Kansas. The San Antonio Court of Appeals reversed the decision of the trial court and held that Texas courts had general jurisdiction over Beech. First, the court found that, despite the general rule that a foreign corporation is not subject to jurisdiction of a forum state simply because a subsidiary is present and doing business there, an exception exists where "a close relationship between a parent and its subsidiary" justifies a "finding that the parent 'does business' in a jurisdiction through the local activities of its subsidiaries." The court pointed out several factors reflecting the existence of a "close relationship." Beech had common officers and directors with two wholly-owned subsidiaries amenable to Texas jurisdiction, one of which employed four sales representatives in Texas, and the other one that referred to Beech in its signs, vehicles, and literature so that "those who came into contact with [the subsidiary] were not apprised of the separate identity of the entities." The court held that "the relationship between Beech and [its subsidiaries] is so close that we conclude Beech does business in Texas through the local activities of these subsidiaries." How-

67. 815 S.W.2d 223 (Tex. 1991).
68. 784 S.W.2d 355 (Tex. 1990).
69. See *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475-76 (1985).
70. See *Guardian*, 815 S.W.2d at 230.
71. 995 S.W.2d 767 (Tex. App.—San Antonio 1999, pet. dism'd).
72. See id. at 769.
73. Beech was a wholly-owned subsidiary of Raytheon Company. The Beech homepage appeared on the Raytheon website. See id. at 771.
74. See id.
75. Id. at 771.
76. The subsidiaries were Raytheon Aircraft Services ("R.A.S.") and Raytheon Aircraft Holdings, Inc. ("R.A.H."). See id.
77. Id.
78. Id. at 772.
ever, the factual basis for the court’s conclusion seems like a slender reed on which to base a “close relationship” sufficient to vitiate the general rule.\textsuperscript{79}

The second component of the court’s jurisdictional analysis involved the Beech homepage on Raytheon Company’s website. The court applied a sliding scale categorization of Internet usage for jurisdictional purposes.\textsuperscript{80} At one end of the scale are situations where a defendant clearly does business over the Internet by entering into contracts with residents of other states involving repeated transmission of computer files over the Internet. At the other end are passive websites, where the posting of an ordinary website homepage is insufficient to expose a defendant to personal jurisdiction. In the middle are interactive sites where “jurisdiction is determined by examining the level of interactivity between the parties.”\textsuperscript{81} The court described Raytheon Company’s website, including the Beech homepage, as “somewhat interactive” with information about employment, acquiring Beech aircraft, and an email icon.\textsuperscript{82} While the court explicitly disclaimed that the website alone would be sufficient to establish jurisdiction in Texas, the court obviously believed it was a significant factor given its holding that Beech’s “ability to solicit sales in Texas through its subsidiaries and through the Internet, are sufficient to subject Beech to general jurisdiction in Texas.”\textsuperscript{83} This holding is especially problematic given that neither Internet usage, nor the level of subsidiary contacts, gave rise to general jurisdiction independently, but the combination of the two did just that.

b. \textit{Mink v. AAAA Development LLC}\textsuperscript{84}

While the application of the sliding scale approach to Internet usage in \textit{Jones} is troubling, the three-part spectrum test is now fully entrenched in Texas law. The Fifth Circuit formally adopted the approach in \textit{Mink}. In \textit{Mink}, a Texas resident sought to maintain personal jurisdiction over a Vermont corporation based solely upon its Internet site.\textsuperscript{85} Characterizing the issue as one of first impression, the Fifth Circuit relied upon \textit{Zippo

\textsuperscript{79} None of the cases relied upon by the court of appeals for the exception to the general rule actually found a relationship close enough to alter application of the general rule. \textit{See Hargrave v. Fibreboard Corp.}, 710 F.2d 1154, 1159-61 (5th Cir. 1983); \textit{Conner v. Conticarriers & Terminals, Inc.}, 944 S.W.2d 405, 418-19 (Tex. App.—Houston [14th Dist.] 1997, no writ); \textit{3-D Elec. Co., Inc. v. Barnett Constr. Co.}, 706 S.W.2d 135, 139-40 (Tex. App.—Dallas 1986, writ ref’d n.r.e.). Indeed, it is especially troubling that the \textit{Jones} court did not more scrupulously apply the multi-factor test articulated in \textit{Conner}. \textit{See Conner}, 944 S.W.2d at 419 (outlining twelve factors to consider in fusing the parent with the subsidiary for jurisdictional purposes).
\textsuperscript{80} \textit{See Jones}, 995 S.W.2d at 772-73. The sliding scale approach was first articulated in \textit{Zippo Mfg. Co. v. Zippo Dot Com, Inc.}, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997).
\textsuperscript{81} \textit{Jones}, 995 S.W.2d at 773.
\textsuperscript{82} \textit{Id.}
\textsuperscript{83} \textit{Id.}
\textsuperscript{84} 190 F.3d 333 (5th Cir. 1999).
\textsuperscript{85} \textit{See id. at 335.}
Manufacturing Co. v. Zippo Dot Com, Inc., and adopted its reasoning that personal jurisdiction depends upon the nature and quality of commercial activity that an entity conducts over the Internet. Embracing the categorization of three levels of Internet usage (active, passive, and middle), the Fifth Circuit held that a website that only provides a passive advertisement is not sufficient contact for the exercise of personal jurisdiction. The approach taken by Mink to personal jurisdiction and the Internet is clearly the prevailing view under Texas law.


Another interesting example of the level of corporate activity necessary to give rise to personal jurisdiction under the Texas long-arm statute is Cole. In Cole, the class action plaintiffs sued tobacco manufacturers and others, including B.A.T. Industries P.L.C ("B.A.T."), a holding company based in Great Britain. B.A.T. moved to dismiss for lack of personal jurisdiction, contending that it did not manufacture cigarettes, but was merely a holding company that owned a tobacco manufacturer. The district court rejected this contention, finding specific jurisdiction permissible under several theories, including stream of commerce, the Calder doctrine, and tortious fraud. Significantly, the court also held that general jurisdiction existed over B.A.T. because it had sufficient continuous and systematic activity established by: (i) its active marketing of shares of stock in the United States; (ii) its encouragement of trading on the American Stock Exchange; (iii) its frequent meetings with American investors in the United States; and (iv) its Texas Commissioner of Insurance application for approval of an insurance company acquisition. The court concluded, after examining over 400 exhibits containing more than 10,000 pages, that B.A.T. "waged a highly integrated campaign to fraudulently misrepresent the true risks of cigarette smoking." Because a significant number of "victims of this campaign" were citizens of

87. See Mink, 190 F.3d at 336.
88. See id.
91. TEX. CIV. PRAC. & REM. CODE ANN. §§ 17.041-.045 (Vernon 1997).
92. See Cole, 47 F. Supp. 2d at 813.
93. Under the Calder doctrine, a defendant should reasonably anticipate being haled into court where the effects of its conduct have been intentionally caused through the purposeful direction of activity toward the forum state, even if the defendant never physically entered the state. See Calder v. Jones, 465 U.S. 783, 788-90 (1984).
94. See Cole, 47 F. Supp. 2d at 814-17.
95. See id. at 817.
96. Id. at 818.
Texas, the court denied the motion to dismiss. Notwithstanding the merits of specific jurisdiction attaching to B.A.T.'s activity regarding cigarette smoking, the contacts giving rise to general jurisdiction, especially in Texas, seem stretched.

d. **BHP de Venezuela, C.A. v. Casteig**

For a more traditional application of general jurisdictional principles in the context of a foreign corporation, consider the Corpus Christi Court of Appeals' decision in *BHP*. Eugene Casteig, an employee of BHP Engineering and Consulting (E&C), sued E&C, a Texas corporation, and BHP de Venezuela ("Venca"), a foreign corporation organized under Venezuelan law, in Nueces County claiming he was entitled to unemployment benefits under Venezuelan law for consulting services performed in Venezuela. The trial court denied Venca's special appearance, and the Corpus Christi Court of Appeals reversed for lack of personal jurisdiction. Venca's contacts with Texas included the following: (i) a technical services agreement between Venca and E&C; (ii) Casteig, as an employee of E&C, performed consulting services for Venca and was paid by E&C; (iii) Venca purchased $95,000 worth of computer equipment from E&C; and (iv) the president of Venca was also the secretary and treasurer of E&C and was domiciled in Texas. The court found that while Venca had contacts with Texas, they "were neither continuous nor systematic, but merely fortuitous" and hence insufficient to confer general jurisdiction over Venca. The court similarly rejected specific jurisdiction, finding that Casteig was not "recruited" to work for Venca. Rather, Casteig was not even recruited by E&C, much less Venca, and was already an E&C employee when he was sent to Venezuela.

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97. *Id.*

98. 994 S.W.2d 321 (Tex. App.—Corpus Christi 1999, pet. denied).

99. Another case during the survey period reflecting traditional application of jurisdictional principles to a nonresident individual based upon the contacts of a foreign corporation is *Cadle v. Graubart*, 990 S.W.2d 469 (Tex. App.—Beaumont 1999, no pet.). In *Cadle*, the Beaumont Court of Appeals reversed the trial court's denial of a special appearance by an Ohio resident who was the president, CEO, sole director, and sole shareholder of Cadle Co., an Ohio corporation which had not challenged jurisdiction. *See id.* at 472. The court premised its holding on the principle that "jurisdiction over an individual generally cannot be based on jurisdiction over a corporation with which he is associated," absent a finding of alter ego. *Id.* at 472; *see also supra* note 4.

100. *See id.* at 324.

101. *See id.*

102. *See id.* at 327.

103. *Id.* at 327.

104. *Id.* at 328. Under the Texas long-arm statute, a nonresident defendant is doing business in Texas if it "recruits Texas residents, directly or through an intermediary located in this state, for employment inside or outside this state." *Tex. Civ. Prac. & Rem. Code Ann.* § 17.042(3) (Vernon 1997).

105. *See BHP*, 994 S.W.2d at 328.
e. *J & J Marine, Inc.* v. *Le*\textsuperscript{106}

The Corpus Christi Court of Appeals continued its vigilance in preventing "fortuitous" contacts from forming the basis for personal jurisdiction in *J & J Marine*. The trial court denied the special appearance of an Alabama ship builder and sole shareholder in a dispute over the construction of a shrimp boat.\textsuperscript{107} The court of appeals reversed the trial court's decision chiefly on the absence of general jurisdiction.\textsuperscript{108} The defendants' contacts were limited to: constructing seven vessels for Texas residents and deriving $3.5 million from the sale of these vessels; having telephone negotiations with Texas residents over the construction of two vessels; and filing applications for admeasurement in Houston\textsuperscript{109} for all vessels constructed.\textsuperscript{110} As in *Castieg*, the court again found these contacts were not "continuous and systematic" and therefore insufficient to permit general jurisdiction.\textsuperscript{111} The fact that *J & J Marine* knew that its shrimp boats were Texas-bound did not affect the court's analysis, because foreseeability alone does not amount to purposeful availment.\textsuperscript{112} *Castieg* and *J & J Marine* demonstrate that more than random contact with Texas, even in a business context, is required for general jurisdiction to attach.

f. *Transportacion Especial Autorizada, S.A. de C.V.* v. *Seguros Comercial Am., S.A. de C.V.*\textsuperscript{113}

Just how much more contact is necessary to sustain a denial of a special appearance is considered in *Transportacion*. In this case, the trial court denied the special appearance of a Mexican corporation, and the Austin Court of Appeals affirmed. The foreign corporation maintained that it only had offices in Mexico, had no employees or representatives in Texas, and had only limited contacts with customs brokers and Texas carriers in Nuevo Laredo.\textsuperscript{114} The court of appeals noted that the record was replete with additional contacts including: receipt of over 150 payments from a carrier in Austin for shipments originating in Texas; Texas insurance for its trucks; traffic tickets issued to its drivers in Texas; trailer exchange agreements with a dozen Texas companies; a Texas bank account; mail forwarded from Laredo to Mexico; and travel to Texas to solicit busi-

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\textsuperscript{106} 982 S.W.2d 918 (Tex. App.—Corpus Christi 1998, no pet.).

\textsuperscript{107} See id. at 921-22.

\textsuperscript{108} The court of appeals also held that specific jurisdiction was improper where the evidence reflected that the shrimp boat was built in Alabama pursuant to a contract negotiated and executed in Alabama. See id. at 925.

\textsuperscript{109} The court made special note of the fact that the defendant was required to file applications of admeasurement with the American Bureau of Shipping's national office, which happened to be located in Houston. The court correctly noted that jurisdiction could not attach because of the submission of these documents, otherwise Texas courts would have jurisdiction over every vessel registered with the Bureau. See id. at 927.

\textsuperscript{110} See id. at 925-26.

\textsuperscript{111} Id. at 927.

\textsuperscript{112} See *J & J Marine*, 994 S.W.2d at 926-27.

\textsuperscript{113} 978 S.W.2d 716 (Tex. App.—Austin 1998, no pet.).

\textsuperscript{114} See id. at 720.
ness. With this litany of additional contacts, it is not surprising that the Austin Court of Appeals found "sufficient evidence of continuous and systematic contacts with Texas." With half of Transportacion's business originating in Texas, the court held that it did not offend "traditional notions of fair play and substantial justice" for Transportacion to be haled into a Texas court.

2. The Meaning of "Principal Office"

Often a corollary to jurisdictional questions is determining proper venue for suits involving a corporation. A pair of cases during the survey period highlights the manner in which concepts such as principal office, citizen, and inhabitant should be determined for corporations.

a. In re Missouri Pacific Railroad Co.

The Texas Supreme Court in In re Missouri explored the concept of "principal office" under the mandatory FELA venue statute. In a consolidated mandamus proceeding, the court inquired into legislative history to develop four conclusions regarding the meaning of "principal office" under the venue statute:

1. A company may have more than one principal office.
2. The "decision makers" who conduct the "daily affairs" of the company are officials who run the company day to day.
3. A mere agent or representative is not a "decision maker" nor is a principal office one where decisions typical of an agency or representative are made, and
4. A principal office is not an office clearly subordinate to and controlled by another Texas office.

The unanimous court concluded that a company could have more than one principal office if it "control[s] or direct[s] its daily affairs in Texas through decision makers of substantially equal responsibility and authority in different offices in the state."

However, courts must look at the corporation's structure to determine the principal office or offices, ignoring titles of officials and examining

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115. See id.
116. Id.
117. Id. at 721. Compare with J & J Marine discussed supra which also had half of its business derived from Texas.
118. 998 S.W.2d 212 (Tex. 1999).
120. All suits under FELA must be brought in the county: (1) "in which all or a substantial part of the events or omissions giving rise to the claim occurred;" (2) "where the defendant's principal office is located;" or (3) "where the plaintiff resided at the time the cause of action accrued." Tex. Civ. Prac. & Rem. Code Ann. § 15.018(b) (Vernon Supp. 2000).
121. The "principal office" is defined as "a principal office of the corporation ... in this state in which the decision makers for the organization within this state conduct the daily affairs of the organization." Tex. Civ. Prac. & Rem. Code Ann. § 15.001(a) (Vernon Supp. 2000).
122. In re Missouri, 998 S.W.2d at 220.
123. Id. at 220.
responsibility and authority. The court fashioned what it described as a "flexible test" to allow for the myriad of corporate structures. Applying the new test to the facts at hand, the court found venue improper and should be transferred to Harris County. Recognizing that the test is not "precise," it remains to be seen how it will be applied by the lower courts.

b. **TV-3, Inc. v. Regal Insurance Co. of America**

In the context of a comprehensive choice of law analysis, the United States District Court for the Eastern District of Texas also distinguished "doing business" in Texas from being an inhabitant or citizen of Texas in TV-3. TV-3 Inc., a Mississippi corporation, brought a diversity suit in the Eastern District of Texas against property insurers for breach of good faith and fair dealing and related claims arising from the denial of coverage for the collapse of a television tower in Mississippi. The insurers moved to transfer venue to the Southern District of Mississippi under the venue statute for the convenience of parties and witnesses, and in the interests of justice. In making its venue transfer decision, the district court conducted a complete choice-of-law analysis, including differentiating between "doing business" in Texas from being a citizen or inhabitant. Surveying Texas law, the court concluded that neither a permit to do business in Texas nor having offices in Texas makes a corporation a "citizen." Moreover, Texas law defines an "inhabitant" essentially as a citizen—a corporation is an inhabitant of the state of incorporation. In contrast, a corporation is a "resident" where it conducts ordinary business. The court therefore refused to give an expanded reading of the concepts of "resident" and "doing business," thus precluding multistate and multinational businesses doing business in

124. *Id.*
125. See *id.* at 220-21.
126. *Id.* at 220.
128. *See id.* at 410.
130. The district court's transfer analysis is thorough, including separately analyzing each of the nine factors commonly considered in such discretionary transfers. *See TV-3, 28 F. Supp. 2d at 410-20.*
131. In an attempt to prove that Texas law governed the dispute, TV-3 contended that article 21.42 of the Texas Insurance Code applied, trumping the "most significant relationship" test of the Restatement (Second) of Conflict of Laws. *See id.* at 414-19. Article 21.42 provides that

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by any insurance company or corporation doing business within this State
shall be held to be a contract made and entered into under and by virtue of
the laws of this State relating to insurance, and governed thereby . . .

**TEX. INS. CODE ANN.** art. 21.42 (Vernon 1981). In order to seize protection under this provision, TV-3 argued that it was a citizen or inhabitant of Texas. *See TV-3, 28 F. Supp.2d at 417.*
133. *Id.*
134. *Id.*
Texas from taking advantage of article 21.42 of the Texas Insurance Code for resolution of disputes in Texas and restricting forum-shopping through manipulation of these concepts.\textsuperscript{135}

**E. SHAREHOLDER DERIVATIVE ACTIONS**

This survey period offers two significant decisions concerning a particular type of lawsuit against the corporation—shareholder derivative actions.\textsuperscript{136} As these cases illustrate, Texas courts continue to refine both procedure and substance in handling this type of litigation. The evolving law in this area requires counsel to be especially vigilant when confronted with this type of corporate lawsuit.

1. *Pace v. Jordan*\textsuperscript{137}

Two cases from the Houston Court of Appeals for the First District address procedure in shareholder derivative actions. In the first decision, *Pace*, the court of appeals explored the procedures by which a corporation regains control over claims asserted by a shareholder purportedly on behalf of the corporation. Charles Pace, a shareholder of Houston Industries, Inc. ("HII")\textsuperscript{138} sent three demand letters to HII, demanding that the board of directors terminate the corporate officers and commence legal action to recover damages for alleged breaches of fiduciary duty because of bad investment strategies.\textsuperscript{139} The HII directors referred the first two demand letters\textsuperscript{140} to the board's audit committee for investigation. The audit committee, with assistance from HII's internal auditing department, Deloitte and Touche, and outside counsel, investigated the charges and found they were unsupported. The audit committee reported its findings, and the board concluded that Pace's demands warranted no further action. The board notified Pace that it had decided to refuse his demands.\textsuperscript{141} Pace sent a third demand letter in July of 1993, reiterating his claims from the earlier two and adding allegations about the South Texas Nuclear Project. In September 1993, the board considered Pace's STNP claims and the disinterested directors, based upon their familiarity with the events and discussions with federal regulators, voted to refuse Pace's third demand.\textsuperscript{142} The board again notified Pace of its decision. In response, Pace and another shareholder, Maria Fuentez, filed a share-

\begin{itemize}
  \item \textsuperscript{135} Id.
  \item \textsuperscript{136} A shareholder derivative action is brought by a shareholder of a corporation on behalf of the corporation naming the corporation as a nominal defendant. See Tex. Bus. Corp. Act Ann. art. 5.14(A)(1) (Vernon Supp. 2000).
  \item \textsuperscript{137} 999 S.W.2d 615 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).
  \item \textsuperscript{138} Pace was also a former employee of Houston Lighting & Power, a wholly owned subsidiary of HII, who had been terminated because of a company-wide reduction in force. See id. at 618.
  \item \textsuperscript{139} See id.
  \item \textsuperscript{140} The first demand letter was sent on October 5, 1992 and the second one was sent in March 1993. See id.
  \item \textsuperscript{141} See id.
  \item \textsuperscript{142} See id. at 618-19.
\end{itemize}
holder's derivative suit, purportedly on behalf of HII. The trial court rendered summary judgment in favor of HII on the basis that the claims belonged to the corporation and that suit was barred because of the directors' previous decision that litigation was not in HII's best interest. In affirming the summary judgment, the Houston Court of Appeals applied article 5.14 of the Texas Business Corporation Act and reinforced several fundamental principles regarding corporate control over derivative actions. First, the court rejected Pace's contention that the case should be treated as a "demand futile" case because his letters were inadequate to be considered a demand. The court opined that "[a] demand is sufficient if the board of directors had a fair opportunity to consider the shareholder's claims." Moreover, the remedy for an inadequate demand would be a dismissal, not treatment as a demand futile case.

The court also made a significant holding regarding whether the demand of one shareholder binds another. Fuentez contended that the trial court erred in dismissing her cause of action because she never made a demand on the board, only Pace had. Because Fuentez's claims were identical to Pace's, the court found "no logical reason why a board's decision should not bind similarly situated shareholders making identical claims." On the basis of judicial economy, the court held that "identical claims, which in actuality belong to the corporation, [may] be simultaneously disposed of by one demand." In so holding, the court dismissed as unpersuasive the authority from foreign jurisdictions to the contrary.

The Pace court also reaffirmed fundamental principles concerning the independence of the board and the adequacy of its investigation. The

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143. See Pace, 999 S.W.2d at 619.
144. Despite the fact that final judgment was rendered after the effective date of the 1997 amendments to article 5.14, the court of appeals applied pre-1997 law. The court reasoned that the amendments were in effect at the time of final judgment and that Pace had failed to object in the trial court to the application of pre-1997 law, thus failing to preserve error. See id. at 620.
145. Prior to the 1997 amendments to article 5.14, a shareholder had to either make a demand on the board or show that such a demand would have been futile. See Act of May 25, 1973, 73d Leg., R.S., ch. 545, § 37, art. 5.14(B)(2)(b), 1973 Tex. Gen. Laws 1486, 1508 (amended 1997). Under the current article 5.14, demand futility does not appear to be an option. See Tex. Bus. Corp. Act Ann. art. 5.14(C) (Vernon Supp. 2000). Texas has adopted what is known as the "universal demand requirement" proposed by the American Bar Association Section of Business Law's Model Business Corporation Act and the American Law Institute's corporate governance project, Principles of Corporate Governance: Analysis and Recommendations. For a general discussion of the universal demand requirement see Dennis J. Block et al., 2 THE BUSINESS JUDGMENT RULE 1562-72 (1998). For a comparison of the Model Act to article 5.14 see Block et al., supra at 1663-64.
146. Pace, 999 S.W.2d at 621.
147. See id.
148. Id.
149. Id.
court made clear that having invoked article 5.14 by making a demand on the board, the board’s decision not to pursue litigation was controlled by the business judgment rule. The threshold to show that the decision was governed by something other than sound business judgment is high, requiring proof of “an ultra vires, fraudulent, and injurious practice, an abuse of power, and an oppression on the part of the company or its controlling agency clearly subversive of the rights of the minority, or of a shareholder, and which, without ... interference, would leave the latter remediless.” The court specifically rejected the contention that naming the directors as defendants made them “interested.” The fact that the directors authorized the disputed transaction did not create a genuine issue of material fact as to the disinterestedness and independence of the board. Finally, the court reiterated that a derivative suit could not be maintained merely by a showing that a board’s decision was unwise, inexpedient, negligent, or imprudent. While Pace applies article 5.14 prior to the 1997 amendments, it reinforces many significant principles of corporate control over shareholder derivative actions.

2. Christian v. ICG Telecom Canada, Inc.

A second decision from the Houston Court of Appeals for the First District, Christian, involves the interplay between a shareholder derivative action under article 5.14 of the Texas Business Corporation Act and the general class action requirements under Rule 42 of the Texas Rules of Civil Procedure. In Christian, the court focused on the narrow question of whether class certification is necessary to assert a shareholder deriva-

151. See Pace, 999 S.W.2d at 622-23. Under the business judgment rule, the board of directors is presumed to be disinterested and to have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).
152. Pace, 999 S.W.2d at 623.
153. See id. at 624.
154. See id. at 625.
155. See id. at 620.
156. While the principles of corporate control over derivative actions reinforced by the court apply with equal force to article 5.14 both before and after amendment, the result might well have been different had current law applied. Even though article 5.14 requires a demand be made on the board, the determination to dismiss a derivative proceeding under article 5.14(F) must be made following a precise procedure.
Specifically, article 5.14(H)(1) allows the determination to be made by “a majority vote of independent and disinterested directors present at a meeting of the board at which interested directors are not present ... if the independent and disinterested directors constitute a quorum of the board.” Tex. Bus. Corp. Act Ann. art. 5.144(1) (Vernon Supp. 2000) Article 5.14(H)(2) allows for “a majority vote of a committee consisting of two or more independent and disinterested directors appointed by a majority vote of one or more independent and disinterested directors present at a meeting of the board of directors, whether or not the independent and disinterested directors so acting constitute a quorum of the board of directors.” Id. art. 5.14H)(2). Article 5.14(H)(3) allows for “a panel of one or more disinterested persons appointed by the court on motion by the corporation ... Id. art. 5.14(H)(3). Hence, the board’s vote to reject Pace’s demand may have been deficient if the interested members of the board were present at the time of the vote. See id. art. 5.14(H)(2).
157. 996 S.W.2d 270 (Tex. App.—Houston [1st Dist.] 1999, no pet. h.).
tive action. In 1995, the ICG companies\textsuperscript{158} purchased a controlling interest in Zycom Corporation and its two subsidiaries. Zycom minority shareholders asserted derivative claims on behalf of Zycom against the majority shareholders of the ICG companies for fraud and breach of fiduciary duty stemming from the alleged dumping of Zycom shares, underreported revenues, and mismanagement of Zycom.\textsuperscript{159} The derivative plaintiffs sought to have a class certified by fulfilling all of the requirements of the general class action rule.\textsuperscript{160}

While it is settled that a shareholder plaintiff bringing a derivative claim must comply with both the requirements of the “Derivative Suit” paragraph of Rule 42(a)\textsuperscript{161} and the procedures of article 5.14 of the Texas Business Corporation Act, the Christian court focused on whether a plaintiff must also comply with the additional class action requirement under Rules 42(b)-(f).\textsuperscript{162} The court rejected the need to comply with Rule 42(b)-(f) and surveyed the “considerable confusion” between the interplay of Rule 42 general class action requirements and Rule 42(a)/article 5.14 derivative actions.\textsuperscript{163} The Houston Court of Appeals traced the confusion to previous versions of Rule 42 which had deleted reference to derivative actions.\textsuperscript{164} The court concluded that: (i) the reintroduction of the derivative language into Rule 42(a);\textsuperscript{165} (ii) the provisions in article 5.14 parallel to the Derivative Suit paragraph in Rule 42(a); and (iii) the fact that article 5.14 sets forth detailed procedures applying to derivative actions,\textsuperscript{166} excluding the provisions of Rule 42(b)-(f), evidenced a legislative intent to establish a separate procedural system governing derivative actions.\textsuperscript{167} The court further noted the logical

\textsuperscript{158} ICG Telecom Canada, Inc., ICG Telecom Group, Inc., and ICG Communications, Inc.
\textsuperscript{159} See Christian, 996 S.W.2d at 272.
\textsuperscript{160} See Tex. R. Civ. P. 42.
\textsuperscript{161} The “derivative suit” paragraph states:
\begin{quote}
\textit{Derivative Suit.} In a derivative suit brought pursuant to Article 5.14 of the Texas Business Corporation Act, the petition shall contain the allegations (1) that the plaintiff was a record or beneficial owner of shares, or of an interest in a voting trust for shares at the time of the transaction of which he complains, or his shares or interest thereafter devolved upon him by operation of law from a person who was the owner at that time, and (2) with particularity, the efforts of the plaintiff to have suit brought for the corporation by the board of directors, or the reasons for not making any such efforts. The derivative suit may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders similarly situated in enforcing the right of the corporation. The suit shall not be dismissed or compromised without the approval of the court, and notice in the manner directed by the court of the proposed dismissal or compromise shall be given to shareholders.
\end{quote}
\textsuperscript{162} See Christian, 996 S.W.2d at 274.
\textsuperscript{163} Id. at 274-75.
\textsuperscript{164} See id. at 275.
\textsuperscript{165} In 1984, the Texas Supreme Court reintroduced the derivative language by adding a second paragraph under Rule 42(a) specifically relating to derivative actions.
\textsuperscript{167} See Christian, 996 S.W.2d at 275.
distinctions between pretrial procedures in general class actions and derivative actions, such as the need for a plaintiff to affirmatively seek class certification in a normal class action, in contrast to a derivative action where a plaintiff can maintain a properly-pled derivative cause unless challenged by the defendants. Consequently, the court held that it was unnecessary to seek class certification and comply with Rule 42(b)-(f) to maintain a shareholder derivative action, since the proper procedure in such an action is contained exclusively in article 5.14 and Rule 42(a).

III. LEGISLATIVE HIGHLIGHTS: IN ANTICIPATION OF THE TEXAS BUSINESS ORGANIZATIONS CODE

Although the Texas Legislature did not pass any remarkable amendments or enactments relating to Texas corporations during its last session, the much anticipated Texas Business Organizations Code ("TBOC") in H.B. 2681 drew a lot of attention. Although the bill died in the House Calendars Committee, it has already been approved by the House Business and Industries Committee and is expected to be passed by the 97th Texas Legislature.

The TBOC, which has been a work in progress of the Business Law Section of the State Bar of Texas, the Texas Legislative Counsel, and Texas Secretary of State since 1995, is a proposed recodification of several Texas acts designed to make the Texas code "more accessible and understandable." The monstrous 700-page bill proposes to: (i) rearrange the statutes into a more logical order; (ii) employ a new numbering format to facilitate citation and expansion; (iii) eliminate or condense repealed, duplicative, expired, or ineffective provisions; and (iv) attempt to present the law in modern American English. It remains to be seen how such recodification will indeed facilitate the work of corporate attorneys in Texas.

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168. See id.
169. See id. Given the stark differences between general class actions and derivative actions, it is somewhat surprising that there is controversy over the application of Rule 42(b)-(f) to derivative actions. However, confusion does exist. Compare Huddleston v. Western National Bank, 577 S.W.2d 778, 780 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.) with Zauber v. Murray Sav. Ass'n, 591 S.W.2d 932, 935-36 (Tex. Civ. App.—Dallas 1979), writ ref'd n.r.e per curiam, 601 S.W.2d 940 (Tex. 1980). See also PATRICK LANIER & DENNIS B. HELMER, 3 TEXAS CORPORATIONS: LAW AND PRACTICE, Shareholder Derivative Actions, § 122.01[3] (May 1991); 11 WILLIAM V. DORSANE, III & PETER WINSHIP, TEXAS LITIGATION GUIDE § 162.01[3] (2000).
172. H.B. 2681 § 1.001.
173. See id. § 1.001(1)-(4).