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BUSINESS TORTS:
A Review of Recent Cases & Strategies Involving Various Business Torts

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A. Background

Texas has adopted the tort of negligent misrepresentation as described by the Restatement (Second) of Torts Sec. 522. *See Federal Land Bank Ass'n of Tyler v. Sloane,* 825 S.W.2d 439, 442 (Tex. 1991). In *Sloane*, the court endorsed section 522 to define the scope of a lender's duty to avoid negligent misrepresentation to prospective borrowers. Section 522 (1) provides:

> One who, in the course of his business, profession or employment, or in any transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Courts applying Texas law have recognized a section 522 cause of action against a variety of professionals and business. *See, e.g.*, *Steiner v. Southmark Corp.*, 734 F. Supp. 269, 279-80 (N.D. Tex. 1990) (auditor); *Smith v. Sneed*, 938 S.W.2d 181, 185 (Tex. App. – Austin 1997, no writ) (physician); *Hagans v. Woodruff*, 830 S.W.2d 732, 736 (Tex. App. – Houston 1992, no writ) (real-estate broker); *Lutheran Bhd. v. Kidder Peabody & Co.*, 829 S.W.2d 300, 309 (Tex. App. – Texarkana 1992, writ granted w.r.m.), judgment set aside, 840 S.W.2d 384 (Tex. 1992) (securities placement agent); *Blue Bell v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 411-12 (Tex. App. – Dallas 1986, writ ref'd n.r.e.) (accountant); *Cook Consultants, Inc. v. Larson*, 700 S.W.2d 231, 234 (Tex. App. – Dallas 1985, writ ref'd n.r.e.) (surveyor); *Great Am. Mortgage Investors v. Louisville Title Ins. Co.*, 597 S.W.2d 425, 429-30 (Tex. Civ. App. – Fort Worth 1980, writ ref'd n.r.e.) (title insurer); *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873, 880 (Tex. Civ. App. – Fort Worth 1971, writ ref'd n.r.e.) (accountant). *Nast v. State Farm Fire and Cas. Co.*, 82 S.W.3d 114 (Tex. App. - San Antonio 2002, no pet.) (insurance agents).

Applying section 522, Texas courts have set out the following four elements for a cause of action in negligent misrepresentation: (1) a representation is made by the defendant in the course of his business, or in a transaction in which the defendant has a pecuniary interest; (2) the defendant supplies "false information" for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers pecuniary loss by justifiably relying on the defendant's misrepresentations. *Federal Land Bank Ass'n of Tyler v. Sloane, Id.*

To establish a negligent misrepresentation claim, the plaintiff must prove that the defendant misrepresented an existing fact rather than a promise of future conduct. *Miller v. Raytheon Aircraft Company*, 229 S.W.3d 358, 380 (Tex. App.—Houston [1st Dist.] 2007). In *Miller*, an airplane pilot appealed a summary judgment entered in favor of his former employer Raytheon Aircraft. Miller sued Raytheon for breach of contract, negligent misrepresentation, fraud, and other claims. The court of appeals held that Miller's negligent misrepresentation and fraud claims failed as a matter of law because the statements made were promises of future conduct rather than statements of existing fact. *Id.* 380. *See also Scherer v. Angell*, 253 S.W.3d 777, 781 (Tex. App.—Amarillo 2007) (Promises of future action were not actionable as negligent misrepresentation); *Petras v. Criswell*, 248 S.W.3d 471 (Tex. App.—Dallas 2008); *Hunter v. PriceKubecka, PLLC*, 339 S.W.3d 795 (Tex. App.—Dallas 2011) (Failure to perform, standing alone, is no evidence of the promissor's intent not to perform when the promise was made nor does is constitute a false representation for purposes of a negligent misrepresentation claim). Careful draftsmanship of pleadings can often avoid confusion on these issues.

B. Specific Application

1. Application to Attorneys

In *McAmish, Martin, Brown, and Loeffler v. F. E. Appling Interests, et al.*, 991 S.W.2d 787 (Tex. 1999), the Texas Supreme Court held that non-clients could sue attorneys for negligent misrepresentation without regard to the non-client's lack of privity with the attorney. The court rejected arguments that a negligent misrepresentation claim is equivalent to a legal malpractice claim, stating that liability is not based on the breach of duty that a professional owes his or her clients, but on an independent duty to the non-client based on the professional's manifest awareness of the non-client's reliance on the misrepresentation and the professional's intention that the non-client so rely.

The Court made it additionally clear that there were several inherent limits on the cause of action as it applied to attorneys. First, negligent misrepresentation is available only when information is transferred by an attorney to a known party for a known purpose. A lawyer may avoid or minimize the risk of liability by setting forth (1) limitations as to whom the representation is directed and who should rely on it, or (2) disclaimers as to the scope and accuracy of the factual investigation or assumptions forming the basis of the representation or the representation itself.

Second, the Court stated that the "justifiable reliance" element required a consideration of the nature of the relationship between the attorney, client, and non-client. Generally, a third party's reliance on an attorney's representation is not justified when the representation takes place in an adversarial context. *Id.* at 794.

Recently, in *Valls v. Johanson & Fairless, L.L.P.*, 314 S.W.3d 624, 633-35 (Tex. App.—Houston [14th Dist.] 2010), the court held that any reliance by Valls on the alleged misrepresentation by lawyers for his former employer and former business partner was not justified. Valls sued his opponent's attorneys, who drafted the Settlement Agreement, for professional negligence, breach of fiduciary duty, conspiracy to defraud and negligent misrepresentation. Valls argued that he became a de facto client of the lawyers who were hired by his former employer when he signed the Settlement Agreement. *Id.* at 633. In essence, Valls contended that the Settlement Agreement created an attorney-client relationship. However, the record clearly showed that both before and after the execution of the Settlement Agreement, Valls was represented by his own attorneys. *Id.* at 634. Therefore, the court held that Valls did not raise a genuine issue of material fact as to his professional negligence and breach of fiduciary duty claims. *Id.* The court also held that the evidence did not suggest anything other than an adversarial relationship between the parties at the time of the alleged misrepresentation. *Id.* at 635. As a result, Valls was not justified in relying on statements made by opposing counsel during that time period. *Id.*

In *Alexander v. Malek*, 2008 WL 597652 (Tex. App.—Houston [1st Dist.]), the plaintiff appealed a summary judgment in favor of Malek, the opposing counsel in an underlying personal injury suit. The plaintiff represented herself pro se in the underlying personal injury suit. The plaintiff alleged that Malek persuaded her to agree to waive her right to a jury trial by assuring her that if she was not satisfied with the outcome of the bench trial, she could then request a jury trial. The court of appeals affirmed the lower court's granting of summary judgment for Malek, holding that such reliance on opposing counsel's statements was not justifiable or reasonable given that the plaintiff affirmed before the trial court her agreement to a bench trial. The court rejected the plaintiff's argument that she was more likely to rely on opposing counsel's statements because she represented herself pro se. *Id.* at *3. The court held that pro se litigants are held to the same standard as licensed attorneys. *See also Kanow v. Brownshadel*, 691 S.W.2d 804, 806 (Tex. App.—Houston [1st Dist.] 1985, no writ).

Similarly, in *Mitchell v. Chapman*, 10 S.W.3d 810 (Tex. App.—Dallas, 2000, pet. denied), the plaintiff had sued an insurer for disability benefits, and the insurer's attorney allegedly withheld the underwriting file during discovery, which was necessary for the plaintiff to prove his claim. After the plaintiff's suit against the insurer failed, he sued the opposing attorney for not producing the file, which allegedly the attorney had in his office. The Dallas Court of Appeals held that the unsuccessful litigant did not have a cause of action for negligent misrepresentation because the attorney was an adversary. *Id.* at 812 (citing *McAmish* and Section 522 of the Restatement (Second) of Torts).

Outside of the litigation, it may not always be clear whether the relationship between non-client and attorney is adversarial, and the relationship may change over time. In *McMahan v. Greenwood*, et al, 108 S.W.3d 467 (Tex. App.—Houston [14th Dist.] 2003, pet. denied) an attorney made representations to a non-client in forming a business in which the non-client participated. Subsequently, the non-client and attorney's clients became adversarial, resulting in a settlement agreement and release. The non-client's claims against the attorney included negligent misrepresentation and fraudulent inducement for allegedly false representations made by the attorney that caused the non-client to enter into the settlement. In this summary judgment case, the Court held that statements made before the relationship became adversarial could give rise to liability, and that the extent to which the change in nature of the relationship may have affected the non-client's justifiable reliance was a question of fact for trial. *Id.* at 497.

2. Application to Accountants

Accountants' representations in written documents such as audit reports are often disseminated and read by persons that have no direct contact with the accountant, raising the question of what persons can bring a negligent misrepresentation claim under section 522 of the Restatement. Recently, the Texas Supreme Court reaffirmed that the scope of liability for negligent misrepresentation is limited. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 920-21, 929-30 (Tex. July 2, 2010). In *Grant Thorton*, a case considering an auditor's liability to third parties, the court determined that the scope of liability continues to be that which is set forth in *McCamish* for third-party claims against attorneys and auditors. *Id.* at 920 (citing *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787,788 (Tex. 1999)).

The *McCamish* standard provides that a section 552 cause of action is available only when information is transferred by an attorney to a *known* party for a *known* purpose. 991 S.W.2d at 794. A "known" party 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." *Id.* This formulation limits liability to situations in which the professional who provides the information "is aware of the non-client and intends that the non-client rely on the information." *Id.* Unless a plaintiff falls within this scope of liability, a defendant cannot be found liable for negligent misrepresentation. *Id.*

The *Grant Thorton* case provided the Supreme Court the opportunity to expand the scope of liability to include persons within the defendant's general knowledge, but it declined to do so. "Predicating scope of liability on [the defendant's] general knowledge that investors may purchase Epic bonds would 'eviscerate the Restatement rule in favor of a de facto foreseeability approach—an approach [we] have refused to embrace.'" 314 S.W.3d at 921 (quoting *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 614 (5th Cir. 1996)).

Additionally, as should be clear from the discussion below of the various elements of negligent and fraudulent-misrepresentations, the scope of liability for negligent misrepresentation is limited in another way. It is intended to be narrower than the scope of liability for fraudulent-misrepresentation claims, the reason being, the difference between the obligations of honesty and of care. RESTATEMENT (SECOND) OF TORTS § 552 cmt. a.; *see D.S.A., Inc. v Hillsboro Indep. Sch. Dist.*, 973 S.W.3d 662, 664 (Tex. 1998). "Negligent misrepresentation implicates only the duty of care in supplying commercial information; honesty or good faith is no defense, as it is to a claim for fraudulent misrepresentation."*D.S.A.*, 973 S.W.3d at 664.

As a matter of first impression, the Court addressed the requirements for "holder" claims in Texas. In a "holder" claim, the plaintiff alleges not that the defendant wrongfully induced the plaintiff to purchase or sell stock, but that the defendant wrongfully induced the plaintiff to continue holding his stock. As a result, the plaintiff seeks damages for the diminished value of the stock, or the value of a forfeited opportunity, allegedly caused by the defendant's misrepresentations. The Court noted that other jurisdictions have permitted holder claims only upon proof of direct communication from the defendant to the plaintiff to support a claim that the fraud induced inaction. In *Grant Thorton* it was undisputed that there was no direct communication, instead, the alleged misrepresentations were publicly available documents. Thus, the Court declined to permit the holder claim in absence of any direct communication. *Id.* at 930. The Court declined to decide whether a holder claim involving more specific and direct communications is actionable under Texas law. *Id.*

3. Damages

Texas courts have adopted the independent injury requirement of Section 552B of the Restatement (Second) of Torts for negligent misrepresentation claims. RESTATEMENT (SECOND) OF TORTS §552b (1977). Under the economic loss rule, a plaintiff may not bring a claim for negligent misrepresentation unless he can establish that he suffered an injury that is distinct, separate, and independent from the economic losses recoverable under a breach of contract claim. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663-64 (Tex. 1998). The plaintiff's damages are limited to out-of-pocket damages and the burden is on the plaintiff to provide evidence of an independent injury. *Id.* at 664. While benefit of the bargain damages are available for a breach of contract, under Section 552B, such damages are not recoverable for a negligent misrepresentation.

In *Sterling Chemicals, Inc. v. Texaco, Inc.*, 259 S.W.3d 793, 798 (Tex. App.—Houston [1st Dist.] 2007, pet. denied), the First Court held that the economic loss rule barred Sterling's negligent misrepresentation claim. The court found Sterling's argument that the economic loss rule should not apply in this case because there was no contractual privity between Sterling and Texaco to be contrary to Texas law, which holds that privity is not required for the economic loss rule to apply. *Id.* at 799.

In *Esty v. Beal Bank S.S.B*, 298 S.W.3d 280, 302 (Tex. App.—Dallas 2009, no pet.) Robert Esty appealed the trial court's summary judgment in favor of Beal Bank. The dispute involved Esty's failed effort to secure a loan to purchase assets in a bankruptcy proceeding. The Court of Appeals held Esty could not recover on his negligent misrepresentation claim because he did not suffer an injury independent of his claims for breach of contract. *Id.* at 302. Esty argued that Beal made multiple misrepresentations related to his loan application and that he was led to believe Beal would issue the commitment letter when Beal failed to provide notice that the loan had been rejected. The alleged misrepresentations involved the timely issuance of a rejection letter, submission of the application to the executive loan committee, timely completion of the due diligence, and the timely completion and consideration of the appraisal. The court found that all of Beal's duties arose under the contract and fell within the pleaded breach of contract claim. Esty argued that he asserted these theories in the alternative, and noted that he abandoned the breach of contract claim based on the promise to extend the loan. The court held that Esty's abandonment of one aspect of his breach of contract claim on appeal was immaterial because he still claimed the contract was breached by Beal's failure to use its best efforts. *Id.*. Moreover, the court pointed out that pleading in the alternative did not preclude the application of the

independent injury rule. *Id*.

In *Wohlstein v. Aliezer,* 321 S.W.3d 765, 773-4 (Tex. App.—Houston [14th Dist.] 2010, no pet.), Wohlstein filed suit against a competing subcontractor, the subcontractor's company and others asserting fraud and negligent misrepresentation among other claims. Wohlstein alleges Aliezer deceitfully removed money from the partnership bank account and that Aliezer misrepresented his plans to wire the withdrawn funds to Aanashe, when his actual intent was simply to wrest the money from Wohlstein's control. *Id.* at 773. Appellees moved for summary judgment on the fraud and negligent misrepresentation claims, arguing Wohlstein did not incur any damages as a result of the money transfer. In support, they offered Wohlstein's deposition testimony, in which he (1) denied any ownership interest in the transferred funds and (2) admitted that Sandstone, and by extension, Manashe, could freely distribute its own money in its sole discretion. *Id.* The court rejected Wohlstein's argument that he suffered an injury because the transfer reduced his bargaining leverage with Manashe. The court observed that Texas law does not currently recognize "lost bargaining leverage," by itself, as a legally compensable injury. *Id.* at 774.

In *CCE, Inc. v. PBS & J Construction Services, Inc.*, 2011 WL 345900 (Tex. App.—Houston [1st Dist.]), the Houston court of appeals held that the trial court erred in rendering summary judgment for PBS & J on CCE's negligent misrepresentation claim. The court held that PBS&J made affirmative misrepresentations of material facts in its engineering plans and the economic loss rule did not bar CCE's recovery of its damages. PBS&J was hired by TxDot to draft engineering plans and specifications for a new road. TxDot awarded the construction contract for the road to CCE, a general contractor. CCE began constructing the road according to PBS&J's engineering plans. However, during the construction erosion and "siltation" problems arose. TxDot declared CCE in default and notified CCE that it was obligated to arrange for completion of the road project. PBS & J argued that all of the damages requested by CCE were economic in nature and were thus barred by the economic loss rule. The court found, however, that CCE's damages were actually for its pecuniary loss suffered otherwise as a consequence of CCE's reliance on PBS&J's misrepresentations. *Id.* at *8. The damages CCE sought were reimbursement for expenses "over and above what it would have cost CCE" to complete the project itself. Further, the court of appeals concluded those damages constituted "reliance damages as measured by [CCE's] out-of-pocket expenditures and consequential losses, not damages for the benefit of its bargain on its contract with TxDOT as measured by any lost sales or profits." *Id.* CCE incurred additional completion costs and lost compensation which totaled $4,893,364.00. Accordingly, the court of appeals found that the trial court erred in finding the economic loss rule barred CCE's recovery of its damages.

4. Statute of Limitations – Discovery Rule

The Texas Supreme Court in *HECI Exploration Co., et al. v. Neel, et al.*, 982 S.W.2d 881 (Tex. 1999) discussed the issue of whether the discovery rule tolled the statute of limitations in a negligent misrepresentation claim arising from an oil and gas lessee's failure to notify royalty owners of a cause of action against an adjoining operator for depleting a common reservoir.

The Court first noted that the statute of limitations for negligent misrepresentation is two years, which was not a disputed issue between the parties in this particular case. *Id.* at 884. *See also, Milestone Properties, Inc. v. Federated Metals Corp.*, 867 S.W.2d 113 (Tex. App. – Austin 1993, no writ). The Court then analyzed the discovery rule issue by focusing on the type of injury suffered in this implied covenant case, following the reasoning of *Computer Associates International v. Altai*, 918 S.W.2d 453 (Tex. 1996).[1] The Court held that the type of injury in this case – failure to notify about certain facts – was not inherently undiscoverable because the royalty owners should have known about other operators in the area and the existence of a common reservoir. The Court's reasoning made it clear that the type of injury suffered by the plaintiffs in future cases will govern whether the discovery rule applies in other negligent misrepresentation cases.

In more recent cases, lower courts have applied the rule set out in *HECI Exploration Co.* In *Sabine Towing and Transportation Co., Inc. v. Holliday Insurance Agency, Inc.*, 54 S.W.3d 57 (Tex. App. – Texarkana 2000, pet. denied), the Texarkana Court of Appeals also followed the *HECI* rule to find that the discovery rule did apply to negligent misrepresentation causes of action, but did not apply to the particular case they were reviewing. The Court of Appeals used the two prong test to find that a denial of insurance coverage was not an "inherently undiscoverable injury," in a case in which the plaintiff complained about not being added as an insured under a commercial insurance policy. *See also Matthiesen v. Schafer*, 27 S.W.3d 25, 31 (Tex. App. – San Antonio 2000, pet. denied) (discovery rule may be applied to negligent misrepresentation); *Prieto v. John Hancock Mutual Life Insurance Company*, 132 F. Supp.2d 506

[1]In *Altai*, a trade secret case, the Court articulated two principles that generally apply in discovery rule cases: (1) the nature of the injury must be inherently undiscoverable, and (2) the injury itself must be objectively verifiable.

(N.D. Tex. 2001) (discovery rule applied to negligent misrepresentation, but did not apply in insurance misrepresentation case because not "objectively verifiable"); *Heller Healthcare Finance, Inc. v. Boyes*, 2002 WL 1558340 (N.D. Tex.). But *see In re: Precept Business Services, Inc., and Steve Turoff, Trustee v. Jackson Walker, L.L.P.*, 2004 WL 2074169 (Bankr.N.D.Tex.) (discovery rule does not apply to negligent misrepresentation in Texas, but fraudulent concealment doctrine does apply).

5. Justifiable Reliance

Recently, in *Affordable Power, L.P. v. Buckeye Ventures, Inc.*, 2011 WL 2675431 (Tex. App.—Dallas), the court concluded that the evidence established that Lepovitz' statements were a substantial factor in bringing about Buckeye's termination of the TXU contract, resulting in a $30,266.17 fee owed to TXU. *Id.* at *4. This case involved Buckeye's contract with TXU to supply electricity to Buckeye's two car washes. Lepovitz approached Buckeye about entering into an electricity supply agreement with Affordable. Lepovitz reviewed part of Buckeye's contract with TXU and said he would take it to his legal department. Lepovitz later said that he met with the legal department, and "they" said the contract was not binding in Texas. He explained that the contract did not say anything about "a termination fee or amount" in the default and remedies section. *Id.* at *1. Lepovitz told Buckeye that he would "take care of everything." After switching over to Affordable, Buckeye received a bill from TXU for $13,822 for a "cancellation fee." TXU sued Buckeye and Buckeye filed a third-party petition adding Affordable as a party. The evidence showed that Lepovitz represented that he had Affordable's legal department review Buckeye's contract with TXU, even though Affordable did not have an in-house legal department. The court found that, based on the evidence, Lepovitz' representation concerning a termination fee was intended and understood as a representation of fact. *Id.* at *4. Thus, the evidence was legally and factually sufficient to establish Affordable supplied false information to Buckeye, Buckeye justifiably relied on a representation made by Affordable, and the damages awarded to Buckeye were proximately caused by Affordable. *Id.*

In *Sierra Associate Group, Inc. v. Hardeman*, 2009 WL 416465 *6 (Tex. App.—Austin February 20, 2009, no pet.), the court held that Sierra was charged with knowledge of the facts that a reasonable investigation would have revealed and a reasonable investigation would have revealed restrictions against building a boat dock on the land owned by another entity. This dispute involved the sale of a waterfront property on Lake Travis in which the buyer alleged negligent misrepresentation based on the description of the property as "waterfront" and failing to disclose the restrictions against building a boat dock on land owned by another entity. The court found that Sierra could not have relied on real estate agent's affirmative representation that property was waterfront property and thus could not prevail on claims for common-law fraud, statutory fraud, and negligent misrepresentation. The property was only a waterfront property when the water was high. The court held that Sierra was aware that another entity owned the adjoining land below contour line. Furthermore, if Sierra exercised reasonable care and diligence, it could have learned of the restrictions against building a dock on the other entity's land.

In *Pleasant v. Bradford*, 260 S.W.3d 546, 554-55 (Tex. App.—Austin, 2008, pet. filed Aug. 7, 2008, review denied Dec. 19, 2008), the Austin Court of Appeals held that the opportunity for an independent investigation does not, by itself, negate reliance. In the *Pleasant* case, the purchasers of a residential home brought action for fraud, negligent misrepresentation, and violations of the DTPA against the seller's real estate agent and the real estate broker. The trial court awarded the purchasers damages on their fraud, negligent misrepresentation, and DTPA claims based on an alleged overstatement by the realtor representing the sellers of the square footage of the home. On appeal, the seller's realtor complained of the jury finding that the purchasers acted in reliance on the realtor's representation, rather than on their own independent investigation. The realtor relied on *Bartlett v. Schmidt*, 33 S.W.3d 35 (Tex. App.—Corpus Christi 2000, pet. denied), to argue that a subsequent source of a misrepresentation will negate reliance on an earlier source. *Id.* at 554. *Bartlett* stands for the proposition that an investigation that does *not* uncover the truth can still negate reliance on the statement. *See Bartlett* at 38. In other words, the fact that a purchaser conducted his own investigation, despite someone else's representations, is evidence that he did not rely on those representations. The realtor also argued that the fact the purchasers lived in the house for over thirty days prior to closing, during which time they made repairs and had the opportunity to inspect the square footage of the house, negated reliance. *Id.* at 555. The Court of Appeals rejected both arguments, holding that the purchasers did not engage in an independent investigation as contemplated by *Bartlett* and that the mere opportunity to conduct an investigation, without evidence that opportunity resulted in an actual investigation, is insufficient for the rationale in *Bartlett* to apply. *Id.*

In *Bynum v. Prudential Residential Services*, Ltd. Partnership, 129 S.W.3d 781 (Tex. App.—Houston [1st Dist.] 2004, pet. denied), the 1st Court of Appeals wrote on an "as is" clause. A purchaser of a home brought a claim against the seller of the home and others for failure to disclose structural and electrical

problems in the home in response to a statutory disclosure form. The earnest money contract had an "as is" clause. The Court reviewed the "totality" of the circumstances, as required by the *Prudential* case, including whether the "as is" clause was a basis of the bargain, and whether the parties had relatively equal bargaining positions. Since the plaintiffs had a licensed real estate broker, had the home inspected, and had entered into "as is" contracts before, the Court held that they were barred by the "as is" clause from their negligent misrepresentation claim.

In contrast, the Dallas Court of Appeals held in *Kupchynsky v. Nardiello*, 230 S.W.3d 685, 689 (Tex. App.—Dallas 2007, pet. filed October 14, 2008, review denied (Aug. 29, 2008), rehearing of petition for review denied (Nov. 21, 2008), that an "as is" clause *in a standard, preprinted residential contract* was not a basis of the bargain that negated causation as a matter of law. This case also involved the sale of a private residence. Nardiello brought suit against the company who built their home and company's vice president, alleging construction defects. The trial court awarded damages to Nardiello and the company and its vice president appealed. The court rejected the appellant's argument that Nardiello "assumed the risks of repairs to the home" because the sales contract included an "as is" provision and rejected the argument that causation was negated as a matter of law. *Id.* at 689.

The Dallas Court of Appeals distinguished this case from *Prudential Insurance Co. of America v. Jefferson Associates, Ltd.*, 896 S.W.2d 156, 161 (Tex.1995). *Prudential* involved a commercial real estate transaction where the buyer purchased an office building. The provision in *Prudential* was contained in a contract submitted by the buyer and contained *specific language* that the buyer took the property as is with all latent and patent defects (emphasis added). In contrast, the provision in *Kupchynsky* was contained in a standard, preprinted One to Four Family Residential Contract. Nardiello testified the provision was neither discussed nor negotiated. Likewise, Kupchynsky testified the clause was never discussed and was not a part of the original negotiations or renegotiations. Rather, Kupchynsky acknowledged the clause was part of the boilerplate language in the contract. *Id.* at 691. The Court held that the seller cannot misrepresent the condition of the property and then hide behind an "as is" clause ("A seller cannot have it both ways.").

In *Ortiz v. Collins*, 203 S.W.3d 414, 422 (Tex. App. – Houston [14th Dist.] 2006), Ortiz sued Collins and others for negligent misrepresentation arising out of negotiations to settle a forcible detainer action. The court affirmed a summary judgment for the defendants on this claim. "Defendants argue that, as a matter of law, reliance on any alleged misrepresentations is unjustified in this case because all representations were made in an adversarial context. We agree." *Id.* at 422. *See also Texas Technical Institute, Inc. v. Silicon Valley, Inc.*, 2006 WL 237027, at *7 (S.D. Tex. Jan. 31, 2006) ("Generally, reliance on representations made *in a business or commercial transaction* is not justified when the representation takes place in an adversarial context.")

The Ortiz court further elaborated on the meaning of "adversarial." For purposes of determining if a business relationship was adversarial, "courts should look to the relationship of the parties and the extent to which their interests are aligned." *Id.* (citing *McCamish*, 991 S.W.2d at 794). In *Ortiz*, the defendants allegedly misrepresented that they would agree to settle the lawsuit on certain terms. The court held that this alleged agreement alone did not remove the adversarial nature of the relationship between the litigants.

In *Swank, et al v. Sverdlin, et al*, 121 S.W.3d 785 (Tex. App.—Houston [1st Dist.] 2003, no pet.), a corporation's investors and agents brought an action for an injunction against a former CEO of the corporation. The First Court analyzed whether plaintiff had proven justifiable reliance. The First Court focused on both the "nature of the relationship and the contract" to hold that the reliance was not justified as a matter of law. *Id.* at 19. The Court cited *McCamish, et al v. F.E. Appling Interests, supra*, holding that reliance on representations made in a business or commercial transaction were not justified when the representation took place in an adversarial context. The contracts were also contrary to the misrepresentations. The Court further held that the representations were promises of future conduct, and, as such, could not form the basis for negligent misrepresentation.

Several Texas court of appeal cases have indicated that plaintiff's reliance can be unreasonable as a matter of law when terms of the parties' contract specifically contradict representations on which plaintiff claims to have relied. *See Anaheim Industries, Inc. v. General Motors Corp.*, 2007 WL 4554213 (Tex. App.—Houston [1st Dist.] 2008, pet. denied) (Because agreement expressly prohibited reliance on any waiver or modification of any term or creation of additional terms unless made in writing and executed, reliance on any oral assurances was unreasonable as a matter of law); *Jeffries v. Pat A. Madison, Inc.*, 2008 WL 4516647 (Tex. App.—Eastland 2008, no pet.) (Insured was not entitled as a matter of law to rely on alleged misrepresentations by agent where policy application and brochure clearly and unambiguously disclaimed any coverage for preexisting conditions); *Biosilk Spa, L.P. v. HG Shopping Centers, L.P.*, 2008 WL 1991738 (Tex. App.—Houston [14th Dist.] 2008, pet. denied) (Lease contained ample language precluding a reasonable business person from relying

exclusively on any alleged oral representations that contradicted the terms of the lease); *Prudential Insurance Company of America v. Italian Cowboy Partners, Ltd.*, 2008 WL 2841848 (Tex. App.—Eastland 2008, no pet.) (Agreement that there were no representations outside of the contract and that the lease constituted the entire agreement conclusively negated the element of reliance).

It is unclear whether these court of appeal cases are still good law in light of the Texas Supreme Court case in *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008). The Supreme Court of Texas held in this case that a waiver of reliance disclaimer in a contract did not automatically preclude a fraudulent inducement claim. The Court found the disclaimer language in *Forest Oil* to be virtually identical to the language in *Schlumberger*. In this case, the Court clarified that the relevant facts courts should examine when determining whether a waiver-of-reliance provision is binding are: 1) the terms of the contract being negotiated, rather than boilerplate, and during negotiations the parties specifically discussed the issue which had become the topic of the subsequent dispute; 2) the complaining party was represented by counsel; 3) the parties dealt with each other in an arm's length transaction; 4) the parties were knowledgeable in business matters; and 5) the release language was clear. *Id.* at *5. However, the Court stated that "parties who contractually promise not to rely on extra-contractual statements-*more than that, promise that they have in fact not relied upon such statements*- should be held to their word." *Id.* The Court ultimately held that the parties' broad disclaimer of reliance in this particular settlement agreement defeated the fraudulent inducement claim.

II. BREACH OF FIDUCIARY DUTY

A. Background

Under Texas law, the first step in determining whether a breach of fiduciary duty has occurred is determining whether a fiduciary relationship exists between the parties. A fiduciary relationship will be found in some relationships as a matter of law. *See e.g., Langford v. Shamburger*, 417 S.W.2d 438 (Tex. Civ. App. – Fort Worth 1967, writ ref'd n.r.e.) (trustee-beneficiary); *Archer v. Griffith*, 390 S.W.2d 735 (Tex. 1965) (attorney-client); *Johnson v. Peckam*, 120 S.W.2d 786 (Tex. 1938) (partners) (*See also* Texas Revised Partnership Act, Art. 6132b-1.01 et seq.); *Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App. – Fort Worth 1973, writ ref'd n.r.e.) (real estate brokers and agents); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963) (directors and officers-corporation); *Hyde Corporation v. Huffines*, 314 S.W.2d 763 (Tex. 1958) (licensee-licensor).

In other relationships, the plaintiff must prove the fiduciary relationship as a question of fact. See e.g., *Crim Truck & Tractor Co. v. Navistar Int'l Transport Corp.*, 823 S.W.2d 591 (Tex. 1992) (no fiduciary duty as a matter of law between franchiser and franchisee – existence of relationship is a fact question); *Associated Indemnity Corp. v. CAT Contracting*, 964 S.W.2d 276 (Tex. 1998) (no fiduciary relationship as a matter of law between surety and principal on construction bond); *Insurance Co. of North America v. Morris*, 981 S.W.2d 667 (Tex. 1998) (no fiduciary duty on surety-principal on securities investment bonds); *Meyer v. Cathey*, 167 S.W.3d 327, 331 (Tex. 2005) (no fiduciary duty as a matter of law between parties who were friends and frequent dining partners for four years).

The courts have focused on the entire relationship between the parties, and more specifically, on the defendant's acts, to determine whether the finding of a fiduciary relationship is warranted. *See English v. Fisher*, 660 S.W.2d 521 (Tex. 1983). Subjective belief and trust on the part of the plaintiff is not enough. The defendant must, by some undertaking, give the plaintiff a reasonable basis for believing that the defendant would act in the plaintiff's best interests. *Crim Truck & Tractor Co. v. Navistar, Id.* To impose a fiduciary relationship in a simple business transaction, Texas courts typically have required a finding of a fiduciary relationship prior to and apart from the transaction in question. *See Swanson v. Schlumberger Tech. Corp.*, 959 S.W.2d 171 (Tex. 1997); *Insurance Co. of North America v. Morris, Id.; Meyer*, 167 S.W.3d at 331 ("To impose an informal fiduciary duty in a business transaction, the special relationship of trust and confidence must exist prior to, and part from, the agreement made the basis of the suit.").

Other general factors that Texas courts have considered in deciding fiduciary relationships have included family ties, *Texas Bank and Trust Co. v. Moore*, 595 S.W.2d 502 (Tex. 1980) (aunt-nephew); *Sauvres v. Christian*, 253 S.W.2d 470 (Tex. Civ. App. – Fort Worth 1952, writ ref'd n.r.e.) (accountant); *Pace v. McEwen*, 574 S.W.2d 792 (Tex. Civ. App. – El Paso 1978 writ ref'd n.r.e.) (stockbroker); *Hammon v. Ritchie*, 547 S.W.2d 698 (Tex. Civ. App. – Fort Worth 1977, writ ref'd n.r.e.) (co-tenants); *Garcia v. Vera*, 342 S.W.3d 721 (Tex. App—El Paso 2011) (uncle-nephew). In these cases, the relationship alone does not create the fiduciary relationship, but it may be a factor in establishing a factual fiduciary relationship.

The duties of a fiduciary, once the relationship has been established, can vary depending on the instrument involved, special statutes, and the common law. However, in general, the following duties have been recognized by Texas Law:

1) duty of competence; TEXAS PROP. CODE Sec. 113.056 (trustee); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567

(Tex. 1963) (corporate directors) (*See also* Tex. Bus. & Corp. Act Art. 2.41 D and Art. 2.42 C; T.R.P.A. Tex. Rev. Civ. Stat. Art. 6132b-4.04(c) - "business judgment rule") (partners); *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. App. – Houston [1st Dist.] 1988, writ denied) (minority shareholders against majority).

2) duty to exercise reasonable discretion; *Sassen v. Tanglegrove Townhouse Condo Assoc.*, 877 S.W.2d 489 (Tex. App. – Texarkana 1994, writ denied) (condo association designated as atty-in-fact); *Corpus Christi Bank and Trust v. Roberts*, 597 S.W.2d 752 (Tex. 1980) (trustee exercise of discretion always subject to review).
3) duty of loyalty; *Slay v. Burnett Trust*, 187 S.W.2d 377 (Tex. 1945) (fiduciary cannot gain any benefit for himself at expense of his beneficiary); *Texas Bank and Trust Co. v. Moore*, 595 S.W.2d 502 (Tex. 1980) ("presumption of unfairness" that arises from any gift or advantage of opportunity); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963) (corporate officers took secret commissions on sale of corporate real estate).
4) duty of full disclosure; *Montgomery v. Kennedy*, 669 S.W.2d 309 (Tex. 1984) (affirmative duty to make a full and accurate confession of transactions, profits, and mistakes); *Willis v. Maverick*, 760 S.W.2d 642 (Tex. 1988) (breach of duty of disclosure is same as fraudulent concealment); *Archer v. Griffith*, 390 S.W.2d 735 (Tex. 1965) (beneficiary not required to prove elements of fraud); *Johnson v. Peckam*, 120 S.W.2d 786 (Tex. 1938) (beneficiary not required to prove he relied on fiduciary to disclose).

When a fiduciary profits or benefits in any way from a transaction with the beneficiary, a presumption of unfairness arises that shifts the burden of persuasion to the fiduciary to show: 1) that the transaction was made in good faith; 2) that the transaction was fair and equitable to the beneficiary; and 3) after full and complete disclosure of all material information to the principal. *Stephens County Museum, Inc. v. Swenson*, 517 S.W.2d 257 (Tex. 1974); *Texas Bank and Trust Co. v. Moore*, 595 S.W.2d at 509. If there is no evidence rebutting the presumption, no breach of fiduciary question is necessary. *Id.*

B. Specific Application

1. Stockbrokers and Financial Advisors

In *Edward Jones & Co., et al v. Fletcher*, 975 S.W.2d 539 (Tex. 1998), the Texas Supreme Court addressed the question of whether a stockbroker has a legal duty to ascertain the mental competence of the investor prior to assisting in transferring securities. Plaintiff, the independent executrix of an estate, brought suit against Edward Jones & Co. based on the transfer of securities to the nephew of the decedent prior to the decedent's death. The lawsuit was based on negligence, breach of fiduciary duty, duty of good faith and fair dealing, and negligent misrepresentation, among other causes of action. The jury found in favor of plaintiff and the Court of Appeals affirmed. The Texas Supreme Court held that the stockbroker had no duty, fiduciary or otherwise, to determine the competence of the investor, reasoning that the law afforded protection already to incompetents through guardianships and by making their agreements voidable. *Id.* at 545. The Texas Supreme Court in did not really analyze the case from the standpoint of a fiduciary duty, choosing instead to focus on whether any duty at all was owed to the customer.

The Austin Court of Appeals has followed the *Edwards* case to hold that an investment firm had no fiduciary duty to inform a spouse of a change in beneficiary, even though she was also their client. *Anton v. Merrill Lynch, et al*, 36 S.W.3d 251 (Tex. App. – Austin 2001, pet. denied)

By way of contrast, in *Western Reserve Life Assurance Company of Ohio*, a broker assumed the role to act as a financial advisor to the Clients. His relationship with the Clients went well beyond mere "mutual benefit." *Western Reserve Life Assurance Company of Ohio v. Graben*, 233 S.W.3d 360, 374 (Tex. App.—Fort Worth 2007). The court held that any arm's-length transaction that may have existed between the parties was elevated into a fiduciary relationship by the very nature of the broker's actions. *Id.* at 374. The Clients brought action against the broker for misrepresentations and breach of fiduciary duty which caused them losses when the stock market took a downturn. The court of appeals held that (1) the broker had a fiduciary relationship to the clients when he became a financial advisor; (2) the duty went beyond a duty to execute stock trades; and (3) evidence supported the finding of breach by selecting investments in securities, rather than bonds. *Id.* The court held that there was legally sufficient evidence to support the jury's finding that a fiduciary duty existed. The court also rejected the argument that Hutton did not breach his duty because his only duty was to execute the trade orders that the Clients authorized. The court held that the duty Hutton owed the Clients went well beyond the narrow duty of executing trade orders. *Id.* at *12.

In *Lee v. Hasson*, 286 S.W.3d 1, 24, 34 (Tex. App.—Houston [14th Dist.] 2007), the Houston Court of Appeals held that the evidence was sufficient to establish that Hasson, an insurance broker/financial

advisor, owed Lee, his wealthy friend and client, an informal fiduciary duty. Lee retained Hasson's services as an advisor regarding the division of property incident to her divorce. Hasson contended that under their oral agreement he would receive 10% of the amount of the marital estate Lee received in her divorce settlement. The trial court entered judgment for Hasson and Lee appealed. The court of appeals found that the oral agreement regarding Hasson's compensation under which he would have been paid between $4.7 and $5.4 million in the first year was not fair to Lee. *Id.* at 24. Additionally, the court held that Hasson did not make reasonable use of the confidences that Lee placed in him, he failed to exercise the utmost good faith and scrupulous honesty, he did not fully and fairly disclose the necessary information; thus, he breached the informal duty he owed to Lee. *Id.* at 34.

2. Attorneys

In *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999), the Texas Supreme Court held that a client need not prove actual damages to obtain forfeiture of an attorney's fee once a breach of fiduciary duty by the attorney is established. Once the jury finds that an attorney has breached his fiduciary duty to the client, the trial court determines the amount of any fee forfeiture, since it is an equitable remedy. *Id.* at 234. It is within the discretion of the trial court to determine whether the attorney receives full compensation or whether compensation will be reduced or denied. *Id.* at 243. In *Jackson Law Office, P.C. v. Chappell, et al*, 37 S.W.3d 15, (Tex. App. – Tyler 2000, pet. denied), the Tyler Court of Appeals followed *Arce* in determining that a trial court had exercised his discretion in reducing a fee by $5000.

The Houston Court of Appeals followed *Arce* in deciding that a trial court had improperly directed a verdict for the defendant attorneys regarding claims for fee forfeiture based on the law firm's alleged breaches of fiduciary duty. *Deutsch v. Hoover, Bax & Slovacek, L.L.P.*, 97 S.W.3d 179 (Tex. App. - Houston [14th Dist.] 2002, no pet.).

Subsequent appellate courts have made it clear that the forfeiture of attorney fees for the breach of fiduciary duty are reserved for "clear and serious" violations of duty. *See e.g., Malone v. Watkins*, 2004 WL 1120005 (Tex. App. – Houston [1st Dist.]) (holding that attorney's breach of fiduciary duty in allegedly disseminating confidential information was inadvertent, did not cause significant injury to the client, and therefore did not warrant forfeiture of attorney fees). Relevant factors include (1) the gravity and timing of the violation, (2) its willfulness, (3) its effect on the lawyer's work for the client, (4) any other threatened or actual harm to the client, (5) the adequacy of other remedies, and, to be given great weight, (6) the public interest in maintaining the integrity of attorney-client relationships. *Goffney v. O'Quinn*, 2004 WL 2415067, at *7 (Tex. App. – Houston [1st Dist.] Oct. 28, 2004, no pet.)

The Supreme Court in 2002 held that an associate owes a fiduciary duty to his law firm not to personally profit or realize any financial gain from referring a matter to another law firm or lawyer, absent the employer's permission. *See Johnson v. Brewer & Pitchard, P.C.*, 73 S.W.3d 193 (Tex. 2002). In *Manon v. Solis*, 142 S.W.3d 380 (Tex. App.—Houston 2004 [14th Dist.] pet. denied), the Court reviewed the evidence of a casual friendship in law school, social contact, and separate career paths after law school to reach the conclusion that no fiduciary relationship was present pre-employment.

In *Gregan v. Kelly*, 2011 WL 1938249 (Tex. App.—Houston [1st Dist.]), the court of appeals held that the evidence was insufficient to support a finding that Kelly and Gregan had an informal fiduciary relationship that modified the at-will status of Kelly's employment at Gregan's law firm. Gregan terminated Kelly and Kelly brought suit for breach of contract, statutory fraud, and breach of fiduciary duty. Kelly argued that Gregan's deposition testimony in which Gregan stated that she believed she owed all of her employees, including Kelly, a fiduciary relationship, was "tantamount to a judicial admission." *Id.* at *4. The court held that Kelly and Gregan's relationship as lawyers practicing in a firm did not create a fiduciary relationship, and there was no evidence that Kelly justifiably relied on Gregan to put his interests above those of the law firm. *Id.*

In *Aiken v. Hancock*, 115 S.W.3d 26 (Tex. App. – San Antonio 2003, pet. denied), a client sued his attorney for misrepresenting that the attorney was ready for trial and that the retained expert was adequately prepared. The Court of Appeals rejected the breach of fiduciary duty claim because there was no indication that the attorney obtained an improper benefit. The Court distinguished breach of fiduciary duty from an ordinary negligence case. (For a similar perspective, *see Gonzales v. America Title Company of Houston*, 104 S.W.3d 588 (Tex. App. – Houston [1st Dist.] 2003, pet. denied). The Court held that the title company may have acted unprofessionally but that is not the same as a breach of fiduciary duty). *See also Archer v. Medical Protective Co. of Fort Wayne, Ind.*, 197 S.W.3d 422, 428 (Tex. App. – Amarillo, no pet. hist.) (plaintiff cannot fracture a legal malpractice claim into various causes of action such as breach of fiduciary duty; but claims arising out of allegations of conflicts of interest, self-dealing, or misusing confidential information state separate breach of fiduciary duty claims that are different from legal malpractice claims).

The Supreme Court of Texas, held in *Chu v. Hong*, 249 S.W.3d 441, 446 (Tex. 2008), that the

attorney for the purchaser of a donut shop could not be held liable, as a third party, for breach of fiduciary duty. In this case Hong's former husband sold their donut shop, which was community property, to third parties without her consent. Hong brought suit against the purchaser's attorney, Chu, on the ground that he conspired to fraudulently transfer the business and conspired with her former husband to convert the business. Specifically, Hong claimed that Chu should have refused to draw up the bill of sale, despite the fact that his clients asked him to, because he knew that Hong's former husband was selling the donut shop without her consent and even though neither Hong nor her former husband was his client. The Court held that as the purchaser's attorney Chu had a fiduciary duty to further the best interests of his clients, the purchasers. *Id.* at 446. To impose a second duty to Hong would create a conflict of interest. Thus, Hong must seek restitution from her own husband before seeking it from someone else's lawyer. *Id.*

In *Gordon v. Gordon*, 2006 WL 5961831 (Tex. App.—Beaumont 2008, pet. denied March 27, 2009), the Beaumont court of appeals reversed the trial court's take-nothing judgment after a bench trial on a breach of fiduciary claim on the ground that the trial court's finding that no confidential or informal fiduciary relationship existed was "so against the great weight and preponderance of the evidence as to be wrong and manifestly unjust." *Id.* at *9-10. Specifically, husband and wife plaintiffs, Greg and Lisa Gordon, sued Greg's brother, David Gordon, a corporate law attorney who had advised plaintiffs in connection with taking their jewelry business public, although the attorney-client relationship was never formalized. The evidence did not establish an arms-length business transaction; rather, it demonstrated that the brothers were close and had been business partners, that David Gordon had previously provided legal representation to plaintiffs and held a power of attorney on Greg Gordon's behalf with regard to other legal representation, and was known and respected by plaintiffs as an attorney who successfully specialized in mergers and acquisitions. David Gordon had initiated the discussions with plaintiffs about taking plaintiffs' company public, identified the opportunity, and represented that he would act as their attorney and prepare the documents needed for the transaction. Defendant also advised plaintiffs that they were only required to continue selling jewelry but, after the stock purchase agreement was signed and a public entity created by a reverse acquisition, defendant substituted plaintiff Greg Gordon as president and sole director of the public company and offered him no instruction regarding how to perform that position. Instead, the evidence showed that defendant was the de facto person running the public company. There was also evidence that David Gordon had given repeated assurances that he would protect plaintiffs' interests and act as their attorney. After the reverse acquisition, defendant continued to advise plaintiffs regarding the
SEC restrictions on the ability of insiders to sell stock in a public corporation on the open market and repeatedly counseled them against such sales to the point that plaintiffs never sold any stock before the corporation filed for bankruptcy.

The Appellants in *Avery Pharmaceuticals, Inc. v. Haynes and Boone, LLP*, 2009 WL 279334 *10 (Tex. App.—Fort Worth, February 5, 2009) alleged that their attorneys breached their fiduciary duties "in being disloyal," "in violating firm policies designed to prevent the type of conflicts, injuries, and damages complained of," "in favoring one client over the other," and "in violating and/or failing to comply with numerous provisions of the Texas Disciplinary Rule of Professional Conduct." *Id.* at 10. The court found that none of the evidence demonstrated that the complained of acts or omissions caused the Appellees to obtain an improper benefit. *Id.* Thus, the court held that the trial court did not err by granting summary judgment in favor of Appellees on Avery's breach of fiduciary duty claim.

3. Insurance Duties

In *Duddlesten v. Highland Insurance Co.*, 110 S.W.3d 85 (Tex. App.—Houston [1st Dist.] 2003, pet. denied) an employer sued its worker's compensation carrier, claiming that it had breached its fiduciary duty by inappropriately settling and paying claims. The Houston Court of Appeals [1st Dist.] held that there is no general fiduciary duty between an insurer and its insured. Citing its prior ruling in *R.R. Street*, the Court held that to impose an informal fiduciary relationship in a business transaction, the requisite special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit. Because the Appellant produced no evidence of such a relationship, the Court upheld the summary judgment on the breach of fiduciary duty claim. *See also E.R. DuPuis Concrete Co. v. Penn Mut. Life Ins. Co.*, 137 S.W.3d 311, 318 (Tex. App. – Beaumont 2004, no pet.) ("[T]here is no general fiduciary duty between an insurer and its insured."); *Ostrander v. Progressive County Mut. Ins. Co.*, 2005 WL 110352, *2 (Tex. App. – Dallas Jan. 20, 2005) (same). *See also Environmental Procedures, Inc. v. Guidry*, 282 S.W.3d 602, 628 (Tex. App.—Houston [14th Dist.] 2009, pet. filed) (the court expressly declined to extend the set of formal fiduciary relationships to include relationship an insurance agent, agency, or broker to a client).

The Supreme Court of Texas held in *National Plan Administrators, Inc. and CRS v. National Health Insurance Co.*, 235 S.W.3d 695 (Tex. 2007) that the Insurance Code does not impose a general fiduciary

duty on third-party insurance administrators. In the employer-agency context of agency relationships, courts take all aspects of the relationship into consideration when determining the nature of the fiduciary duties that flow between the parties. *Id.* at 700. The Court held that "it is neither an absurd nor an unjust result for the Legislature not to have imposed a general fiduciary duty on third-party administrators when the administrators are statutorily required to have a written contract with the party they serve as administrator. *Id.* at 701. *See also Sw. Texas HMO, Inc. v. Vista Health Plan, Inc.*, 2010 WL 4260976 (Tex. App.—Austin Oct. 28, 2010) (The insurance code does not create a general fiduciary duty applicable to third-party administrators).

4. Aiding and Abetting a Breach of Fiduciary Duty/Contribution

In *Hendricks, et al v. Grant Thornton*, 973 S.W.2d 348 (Tex. App. – Beaumont 1998, pet denied), the Beaumont Court of Appeals wrote on several issues in a fraud and breach of fiduciary duty case arising out of a failed government securities trading program. The primary defendant was the accounting firm of Grant Thornton

In regard to the aiding and abetting claim, the defendant claimed that since the trial court had ruled that the fiduciary duty claim was disposed of on limitation grounds, the aiding and abetting claim was gone as well, since it was just a "tag-along" claim. The Court of Appeals disagreed, stating that the claims were "distinct" and that "[i]t is settled as the law of this State that where a third party knowingly participates in the breach of duty of a fiduciary, such third party becomes a joint tortfeasor with the fiduciary and is liable as such." *Id.* at 372.

In *Villarreal v. Wells Fargo Brokerage Services, LLC*, 315 S.W.3d 109, 126-27 (Tex. App.—Houston [1st Dist.] 2010, no pet.), Chapas asserted a breach of fiduciary duty claim against Pena, individually, and against Wells Fargo and Lewis as joint tortfeasors. Pena was a family friend of the Chapas and was named trustee of their trust. The Chapas alleged that Pena breached his fiduciary duty as trustee by failing to properly invest, manage, and preserve the trust's assets. In addition, the Chapas claimed that Wells Fargo and Lewis, as third parties, knew that Pena was committing a breach of his fiduciary duty. They alleged that Wells Fargo and Lewis knowingly participated in Pena's breach. Further, the Chapas alleged that Wells Fargo and Lewis became joint tortfeasors with Pena. They asserted that, as a result, Wells Fargo and Lewis are liable for participating in Pena's breach of trust. In their no-evidence summary judgment motion, Wells Fargo and Lewis alleged that there was no evidence that their conduct, separate from Pena's conduct, breached a duty to the Chapas. The court remarked that Wells Fargo and Lewis misinterpreted the Chapas' cause of action because with regard to their assisting-in-breach-of-fiduciary-duty claim, the Chapas did not allege that Wells Fargo and Lewis breached a duty that they owed to the Chapas. Instead, they allege that Wells Fargo and Lewis knowingly assisted Pena in breaching his fiduciary duty to the Chapas. The court made it clear that to succeed on their assisting-in-breach-of-fiduciary-duty claim, the Chapas need not show that Wells Fargo and Lewis owed them a fiduciary duty or that Wells Fargo's and Lewis's conduct breached such a duty. The court reversed the judgment of the trial court to the extent that it granted summary judgment on the Chapas' claims against Wells Fargo and Lewis for assisting Pena in breaching his fiduciary duty.

The third party liability rule set out by the Court of Appeals has been used both offensively and defensively in the past in Texas to either reach an additional defendant or to preclude a third party from enforcing a contract right against the principal if the right was obtained as the result of a breach of fiduciary duty. *See City of Fort Worth v. Pippen*, 439 S.W.2d 660 (Tex. 1969) and *Remenchik v. Whittington*, 757 S.W.2d 836 (Tex. App.—Houston [14th Dist.] 1988, no writ). The third party can also be held liable for accepting benefits from the transaction knowing the benefits were the result of a breach of fiduciary duty. *Cf. Stephens County Museum, Inc. v. Swenson*, 517 S.W.2d 257 (Tex. 1975).

A third party will not be held liable for knowingly participating in a breach of fiduciary duty when the third party is doing that which they have a legal right to do. *See Baty v. Protech Insurance*, 63 S.W.3d 841, 863 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

In regard to contribution, the Court of Appeals listed the various contribution schemes available in Texas and reached the conclusion that the case fell within TEX. CIV. PRAC. & REM. CODE ANN. Sec. 32.001, the original contribution scheme. The court was aided by the fact that the case had been filed before the effective date of the comparative responsibility statute, Ch. 33 of the Civil Practice and Remedies Code. However, the court noted that Ch. 33 would not apply in any event because the comparative negligence statute applies only to cases in which negligence is the only theory involved. *Id.* at 373. Since Ch. 32 only comes into play when a payment is made or a judgment rendered, the Court of Appeals found that the trial court was premature in granting summary judgment on this issue. *Id.* at 374.

5. Business Relationships

Recently, in *SJW Property Communications, Inc. v. Southwest Pinnacle Properties, Inc.*, 328 S.W.3d 121, 156-157 (Tex. App.—Corpus Christi 2010), the court of appeals held that there was ample evidence for

a juror to conclude SJW had a fiduciary duty and breached that duty and caused injury to Palmer. Palmer, a developer, believed SJW was working as his broker on a development project. SJW had worked as Palmer's broker on previous projects and Palmer gave SJW confidential pricing and contractual information based on this belief. SJW contended that it was Palmer's competitor on the project. The court held that the evidence supporting the jury's verdict as to Palmer's breach of fiduciary duty claim was legally sufficient. *Id.* at 157.

In *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867 (Tex. 2010), the Supreme Court held that contractual consideration received in the sale of a business is subject to equitable forfeiture as a remedy for breach in addition to other damages that result from the tortious conduct. The Texas Supreme Court held the equitable remedy of either forfeiture or disgorgement may apply regardless of whether actual damages are proven.

In *ERI Consulting* Larry Snodgrass ("Snodgrass") and Mark Swinnea ("Swinnea") owned equal interests in two business entities, namely ERI Consulting Engineers, Inc. ("ERI") and Malmeba Company, Ltd. ("Malmeba"). *Id*. at 870. ERI was a consulting company that manages asbestos abatement projects for contractors. *Id*. ERI leased office space from Malmeba, a partnership that owned the building. *Id*. Snodgrass and ERI purchased Swinnea's interest for $497,500. *Id*. ERI agreed to employ Swinnea for six years; and, in turn, Swinnea agreed not to compete with ERI. *Id*. Unknown to Snodgrass, Swinnea's wife created Air Quality Associates, an asbestos abatement company, one month before the buyout was executed. *Id*. The new company was not disclosed. *Id*. After the buyout, Swinnea's revenue production as an ERI employee dropped 30% to 50%. *Id*. Later Swinnea created a new company, Brady Environmental, which also performed asbestos abatement. *Id*. at 871. Snodgrass later fired Swinnea, released him from his non-compete, and filed suit. *Id*.

After a bench trial, the trial court found for Snodgrass and ERI awarding $1,020,700 in actual damages including forfeiture of the consideration paid for the buyout plus $1,000,000 in exemplary damages. *Id*. The Court of Appeals reversed and found there was no evidence of actual damages. *Id*. The issue before the Texas Supreme Court was whether forfeiture of the consideration paid by Swinnea was an appropriate measure of damages. *Id*. at 872.

Reversing the Court of Appeals, the Supreme Court held that "courts may disgorge *all* ill-gotten profits from a fiduciary when a fiduciary agent usurps an opportunity properly belonging to a principal, or competes with a principal." *Id*. (emphasis added) [citations omitted]. The Court further held that "where willful actions constituting a breach of fiduciary duty also amount to fraudulent inducement, the contractual consideration received by the fiduciary is recoverable in equity regardless of whether actual damages are proven ..." *Id*. at 873. The Court analogized this scenario to fee forfeiture in the attorney-client breach of fiduciary duty context. *ERI* held:

> [A] fiduciary who breaches his duty should not be insulated from forfeiture if the party whom he fraudulently induced into contract is ignorant about the fraud, or fails to suffer harm. Likewise, the innocent party should not be put into a difficult choice regarding termination of the contract upon discovering the breach of duty.

Id. at 874.

ERI stated that courts should consider the following factors in deciding whether full compensation should be awarded: (1) whether the trustee acted in good faith; (2) whether the breach of trust was intentional, negligent, or without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether the breach of trust occasioned any loss; and (5) whether the trustee's services were of value to the trust. *See id.* [citations omitted]. Thus, *ERI* holds that when a fiduciary fraudulently induces the formation of a contract such a breach may give rise to equitable forfeiture of the contractual consideration. *Id*. at 881. The Supreme Court remanded the case for an analysis of the above principles and for a determination as to whether the appropriate remedy of forfeiture would further the goal of protecting relationships of trust in this scenario. *ERI* could be read broadly to mean that the Texas Supreme Court has expanded the holding in *Burrow v. Arce*, 997 S.W.2d 229, 237-245 (Tex. 1999), where that Court held an attorney who breaches his fiduciary duty to his client may be responsible for disgorging his fee.

Both of the Houston Courts of Appeal wrote on the creation of a fiduciary duty in *Swineheart v. Stubbeman, McRae, Sealy, Laughlin & Browder, Inc.*, 48 S.W.3d 865 (Tex. App.—Houston [14th Dist.] 2001, pet. denied) and *R. R. Street & Co. v. Pilgrim Enterprises, Inc., et al*, 81 S.W.3d 276 (Tex. App. – Houston [1st Dist.] 2001, rev. granted). In *Swineheart*, a geologist brought a legal malpractice action against his former attorneys, claiming that the firm had not properly represented him in connection with a lawsuit against an oil company that had gone into bankruptcy. One of the issues involved in the appeal was whether the oil company had owed a fiduciary duty toward the

plaintiff geologist. The Houston 14th Court of Appeals considered two possible grounds for the imposition of the fiduciary duty: 1) the geologist had a joint venture with the oil company, which would give rise to a fiduciary relationship as a matter of law; and 2) an informal confidential relationship arose that created a question of fact. In holding that there was no duty created as a matter of law on the first ground, the Court pointed to testimony that indicated that the parties had not agreed to share losses in their business arrangement. In regard to the second ground, the Court reviewed the testimony and record to find that a prior confidential relationship (before the dispute in question) had not existed, nor did the record indicate anything other than an arm's length relationship, except for plaintiff's testimony that he had subjectively trusted the oil company. The Court found that subjective trust by one party to the agreement did not give rise to enough of a relationship to justify the imposition of a fiduciary duty.

In *R. R. Street*, the Houston 1st Court of Appeals reviewed a case in which the owner of a dry cleaning plant (Pilgrim) brought both statutory and common law claims against the supplier of dry cleaning products, seeking to recover environmental cleanup costs and other damages. The case was tried to a jury and the trial court directed a verdict against the plaintiff on their breach of fiduciary claims. On appeal, the Houston 1st Court of Appeals reviewed the facts on the record that the plaintiff claimed created a special relationship:

In affirming the trial court, the Court focused on the fact that no evidence was offered of a special relationship of trust and confidence apart from the business relationship made the basis of the lawsuit. Additionally, neither party was in a dependent position since each was an accomplished businessman who knew how to deal with environmental issues.

In *Pabich v. Kellar*, 71 S.W.3d 500 (Tex. App.—Fort Worth 2002, pet. denied) a former employee and minority shareholder in a video reconditioning business sued the majority shareholder for breach of fiduciary duty, fraud, and tortious interference. The trial court held that as a matter of law a fiduciary duty existed between the shareholders. On appeal, the Fort Worth Court of Appeals held that the trial court committed error by assuming the existence of a fiduciary duty, instead of submitting it to the jury, stating that "a co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder." *Id.* at 48. The fact that the two parties worked together in several business ventures and at one time were close friends did not establish a fiduciary duty as a matter of law.

The *Pabich* case must be distinguished from the older case of *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied), which holds that minority shareholders are owed a fiduciary duty by the majority shareholder in close corporations. The *Davis* case has never been overruled and is cited by commentators as still being good law. *See* Moll, *Majority Rule Isn't What It Used To Be: Shareholder Oppression in Texas Close Corporations*, 63 Tex.B.J.434 (2000); Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 Vand.L.Rev. 749 (2000).

In *Willis v. Donnelly*, 118 S.W.3d 10 (Tex. App. – Houston [14th Dist.] 2003, pet. filed), the Court cited *Pabich* for the proposition that the existence of a fiduciary duty between co-shareholders in a closely held corporation depends on the circumstances. The Court focused on the defendant's oppressive conduct and dominating control of the business. The Court cited several facts that showed the defendant used his control to seek personal advantage. Based on these facts, the trial court instructed the jury that the defendant owed a fiduciary duty. On appeal, the defendant argued that it was error to instruct the jury on the fiduciary duty. The Houston Court of Appeals agreed that the existence of the duty was a fact question, but ruled that the defendant waived the error by not objecting to the charge prior to submission to the jury. Thus, the holding in *Pabich* remains the standard, leaving Willis as distinguishable on procedural grounds.

The Amarillo Court of Appeals went a little further than *Pabich* in *Robbins v. Payne*, 55 S.W.3d 740 (Tex. App.—Amarillo 2001, pet. denied), in holding that two founders of an internet business did not have a fiduciary duty toward each other, when the relationship was not longstanding and did not go "beyond that ordinarily existing between parties to a contract of this type." *Id.* at 749. The Amarillo Court also held that it did not create a fact issue for one of the parties to "admit" owing a fiduciary duty since from a "legal standpoint" the party stated that he did not understand the term and only knew what it meant "to him." *Id.*

Compare the *Robbins* case with *Carr v. Weiss*, 984 S.W.2d 753 (Tex. App.—Amarillo 1999, pet. denied). In *Carr*, the Amarillo Court of Appeals reviewed the evidence on the existence of a fiduciary duty in a case where the plaintiff sued based on an oral contract to jointly acquire an apartment complex with the defendant. After the complex was purchased, the defendant purchaser denied the agreement and the plaintiff brought suit based on breach of fiduciary duty, fraud, negligent misrepresentation, and breach of oral contract. After reviewing the personal relationship between the parties, the Court of Appeals held that the evidence was sufficient to present a jury question on the existence of a fiduciary duty. The evidence reviewed by the court included the social history of the parties, the business relationship, and representations

made by both parties during the time period in question. *Id.* at 766. The court stated that "the relationship between the parties, their activities, and their objectives was more than a mere personal relationship but was, rather, of a confidential nature. *Id.* at 765.

In *E.R. Dupuis Concrete Co. v. Penn Mutual Life Insurance Company*, 137 S.W.3d 311 (Tex. App.—Beaumont 2004, no pet.), a concrete company brought suit against a life insurance company and its agents for the purchase of a variable life insurance policy on the life of its president. The concrete company alleged that a fiduciary duty existed between the company and the agents because the agents gave an "estate planning kit" and prayed together at the local church. The Court held that this did not raise a fact issue because there was no indication from this evidence that there was a *pre-existing* relationship involving a high degree of trust and confidence over a long period of time.

By way of contrast, in *Flanary v. Mills*, 150 S.W.3d 785 (Tex. App.—Austin 2004, no pet.), a plaintiff shareholder in a home building corporation sued another shareholder, claiming a fiduciary duty existed. Plaintiff was defendant's nephew and the evidence was that he was "more like a big brother than an uncle." They worked together in several businesses prior to the home building business and the nephew relied on his uncle to handle the finances and profitability of the business. Under these circumstances, the judgment in favor of the plaintiff was affirmed as sufficient evidence of the fiduciary relationship.

In *Somers Ex Rel. EGL, Inc. v. Crane,* 295 S.W.3d 5, 12 (Tex. App.—Houston [1st Dist.] 2009, pet. denied), a former shareholder brought a derivative action individually and a class of shareholders brought a direct action against the CEO and board of directors of a corporation for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. The trial court granted the defendant's motion to dismiss and special exceptions. The Court of Appeals held that the CEO and board members did not owe a fiduciary duty to shareholders based on an alleged special relationship. The Plaintiffs argued that in the context of a cash out merger, a "special relationship" between directors and shareholders was created. *Id.* at 12. The court declined to recognize the existence of a fiduciary relationship owed directly by a director to a shareholder in the context of a cash out merger because "fiduciary relationships are of an 'extraordinary nature' and should not be recognized lightly, and because of the abundant authority stating that a director's or officer's duty runs only to the corporation, not to individual shareholders." *Id.*

In *Walston v. Anglo-Dutch Petroleum (Tenge) LLC,* 2009 WL 2176320 *7 (Tex. App.—Houston [14th Dist.]), the Appellants argued the Appellees owed them a fiduciary duty as co-investors in the joint enterprise TJE and that they breached that duty by failing to comply with the agreements. To support their claim Appellants cited *Rankin v. Naftalis*, 557 S.W.2d 940 (Tex. 1977). The court noted that *Rankin* does not hold that co-investors owe each other a fiduciary duty. Instead, *Rankin* established a fiduciary duty only upon a finding of a joint venture. The appellants did not contend they were joint ventures with appellees. *Id.* at *7. Moreover, they failed to explain how their status as co-investors created a fiduciary relationship under *Rankin.*

In *Gadin v. Societe Captrade*, 2009 WL 1704049, at *2 (S. D. Tex. June 17, 2009), the court denied a motion to dismiss a claim for breach of fiduciary duty asserted among members of a Texas limited liability company and concluded that, while no Texas court has determined that such members owe fiduciary duties to each other as a matter of law, the existence of a fiduciary duty among such members is a fact specific inquiry that considers the contract between the parties and the peculiarities of the relationship.

6. Partnerships

Prior to 1994, the law in Texas was clear that each partner owed a fiduciary duty to each of the other partners and this relationship was characterized as "highly" fiduciary in nature. *See Johnson v. Peckham*, 120 S.W.2d 786 (Tex. 1938). The adoption of the Texas Revised Partnership Act was intended to bring partnership law in line with modern business practices, including a rejection of the traditional "fiduciary" label, but cases still carry over the stricter language. *See e.g., Brosseau v. Ranzau,* 81 S.W.3d 381, 395 (Tex. App.—Beaumont 2002, pet. denied) (partners owe one another a fiduciary duty, included in which is a strict duty of good faith, while a managing partner owes his partners the highest fiduciary duty recognized in law).

Harris v. Archer, 134 S.W.3d 411 (Tex. App.—Amarillo 2004, pet. filed), is an example of the Amarillo Court of Appeals following the old presumption that partners still owe a traditional fiduciary duty to each other. In *Harris*, one partner bought out two others on a building, then sold the building for a profit. The Amarillo Court, without discussing the Partnership Act, stated that as long as the partnership existed, the remaining partner had a duty to disclose material negotiations on the building that were ongoing prior to terminating the partnership as a part of his fiduciary duty.

The Supreme Court of Texas held that to determine whether a partnership exists under the Texas Revised Partnership Act, courts should examine the totality of the circumstance in each case, with no single factor listed in the TRPA being either necessary or sufficient to prove the existence of a partnership.

Ingram v. Deere, 288 S.W.3d 886, 904, 52 Tex. Sup. Ct. J. 1030 (Tex. 2009). In this case, the question of how many of the TRPA factors were required to form a partnership was a matter of first impression for the Court. In adopting the "totality of the circumstance" test, the Court noted the difficulty in uniformly applying the test. *Id.* at *898. The Court did provide some guidance for applying the test, holding that the absence of any evidence of the factors would preclude recognition of a partnership and conclusive evidence of all the factors would establish the existence of a partnership as a matter of law. Furthermore, the Court held that "conclusive evidence of only one factor normally would be insufficient to establish the existence of a partnership." *Id.* The Court acknowledged the challenge of the test will be in its application between these far ends of the spectrum.

In this case, Deere, a board certified psychiatrist, sued Ingram, a licensed psychologist, claiming they formed a partnership for the purpose of creating an interdisciplinary pain clinic. Deere asserted claims for breach of contract, specific performance, breach of fiduciary duty, declaratory judgment, fraud, and attorney fees. The jury found that a partnership was formed. The trial court, however, eventually granted Ingram's motion for judgment notwithstanding the verdict and entered a take-nothing judgment. The court of appeals reversed in part, reinstating the jury verdict. The Court held that Deere did not provide legally sufficient evidence of any of the five TRPA factors to prove the existence of a partnership. *Id.* at 904. Accordingly, the Court reversed the court of appeals' judgment and reinstated the trial court's take-nothing judgment.

The reign of the Texas Revised Partnership Act expired this year. As of January 1, 2010, the Texas Business Organizations Code (TBOC) went completely in force. Partnerships formed after January 1, 2006, are governed by the Texas Business Organization Code. Tex. Bus. Orgs.Code § 402.001; See also *Ingram v. Deere*, 288 S.W.3d 886, 894 n. 4 (Tex. 2009). The Texas Revised Partnership Act (TRPA) governs partnerships formed on or after January 1, 1994, but before January 1, 2006.

The BOC defines the duty of care as the duty to act in the conduct (and the winding up) of the partnership business with that of a prudent person under similar circumstances. Tex. Bus. Org. Code § 152.206. The Texas Business Organization Code maintains the efforts of the TRPA, but it remains to be seen whether courts will follow its standards.

Importantly, however, the BOC also contains express language indicating that partners do not breach either duty by merely pursuing their own interests. §152.204(c)-(d). In this light, partners might be considered *quasi-fiduciaries* of one another – they must maintain a "do no harm" approach toward one another and toward the partnership, but they need not necessarily hold their partners' interests ahead of their own.

Recently, in *Hoss v. Alardin*, 338 S.W.3d 635, 650 (Tex. App.—Dallas 2011), the Dallas court of appeals held that the evidence failed to establish that Hoss and Alardin had a business partnership. The court focused its inquiry on the evidence pertaining to each of the five TRPA factors and concluded that the record contained no evidence of four of the five factors. Alardin's testimony that business expenses were paid by a credit card, in and of itself, was not evidence that he contributed money or property as capital to the business. Alardin had only weak evidence relating to an agreement to share profits. Under the totality of the circumstances test prescribed by *Ingram*, the court concluded that the evidence of a partnership was less than a scintilla, and thus was legally insufficient to support the jury's finding of a partnership. *Id.* at 650.

7. Limited Partnerships

In *Noell v. Crow-Billingsley Air Park Limited Partnership*, 233 S.W.3d 408, 414 (Tex. App.—Dallas 2007, pet. denied), the Dallas Court of Appeals held that appellant Noell failed to show that appellee, Crow-Billingsley Air Park Limited Partnership and its general partner, owed him a fiduciary duty as a limited partner. Noell brought suit asserting that the trial court erred in granting summary judgment because Crow-Billingsley Air Park Limited Partnership and its general partner breached their fiduciary duties to him. Noell asserted that a formal fiduciary relationship existed between him and the partnership because he was a limited partner. Noell cited no authority showing that a limited partnership itself was the fiduciary of a limited partner; as a result, the court held that no fiduciary duty existed between the parties. *Id.* at 414.

8. Employer/Employee

A key employee of a trucking company started a new competing trucking company. Before leaving his job, he incorporated the new company, bought insurance, obtained hauling permits and talked with drivers about leaving the old company to join his new company. The trucking company sued the key employee for breach of fiduciary duty. *Abetter Trucking Company v. Arizpe*, 113 S.W.3d 503 (Tex. App.—Houston [1st Dist.] 2003, no pet.). In an opinion that appears contradictory, the Houston Court of Appeals acknowledged that an agent has a fiduciary duty not to compete with the principal and that an employee has a duty to deal openly with an employer and to fully disclose information affecting the company's business. After citing this established law, the Houston Court then concluded "there is nothing legally wrong in engaging in such competition or in preparing to compete before the employment

terminates." *Id.* at 510. The Court was influenced by the fact that the employee was an at-will employee, not subject to a non-compete clause.

In *Daniel v. Falcon Interest Realty Corp.*, 190 S.W.3d 177 (Tex. App.—Houston [1st Dist.] 2005, no pet.), Falcon hired Guy Daniel to serve as project manager and on-site superintendent of a construction project. Part of Daniel's job included soliciting bids. Unknown to Falcon, Bell hired B&L, a subcontractor run by his wife's parents. Moreover, Daniel and his wife personally received approximately $200,000 from B&L for Falcon-related operations. The court held that Daniel breached his fiduciary duties of loyalty, fair dealing, and full disclosure to Falcon. *See Id.* at 185-86. "Regardless of whether Falcon was satisfied with the quality of B&L's work, information that Guy would be required to disclose to Falcon would necessarily include that he and his wife were heavily involved in the creation and operation of B&L, including the preparation of bids and proposals for work to be performed on the project, and, more significantly, that he and his wife were reaping a substantial profit from such work." *Id.* at 186.

In *Speedemissions, Inc. v. Capital C Enterprises, Ltd.*, 2008 WL 4006748 (Tex. App.—Houston [1st Dist.] 2008, no pet.), Speedemissions appealed a summary judgment rendered in favor of Capital C Enterprises. Cobb, the manager of Speedemissions, formed Capital entities to acquire the property where Speedemissions was located to open up his own business. Unbeknownst to Speedemissions, Cobb purchased the property, thereafter, Speedemissions brought suit against Cobb for breach of fiduciary duty. Cobb argued that he was free to purchase the location he was managing for Speedemissions and that he had no duty to Speedemissions to disclose his intent to purchase the location because his duties as a manager did not include negotiating leases. *Id.* at *7-8. The court held that Cobb had a duty to deal openly and to fully disclose to Speedemissions his intent to purchase one of their most profitable properties, given that one of his managerial duties included looking for new locations. *Id.* Thus, a fact issue existed regarding whether Cobb violated any fiduciary duties owed to Speedemissions.

Similarly, in *Navigant Consulting, Inc. v. Wilkinson*, 508 F.3d 277, 283, 288 (5th Cir. 2007), Navigant brought a diversity action against its former employees alleging breach of fiduciary duty, breach of contract, and misappropriation of trade secrets. Wilkinson and Taulman managed the operations of Navigant's claims administration practice in Dallas. Although they were at-will employees, they were bound by noncompete, nonsolicitation, and confidentiality agreements. The jury in this case found that Wilkinson and Taulman each had an informal relationship of trust and confidence with Navigant. *Id.* at 283. The Fifth Circuit found that the jury had sufficient basis to conclude that they breached their fiduciary duties; including failing to disclose their plans to sell the claims practice to Navigant's competitors before Navigant committed to a four year lease for office space in downtown Dallas. The court found it significant that Wilkinson and Taulman were the top two employees in the Dallas office, and they had active roles in negotiating, recommending, and signing the lease. *Id.* at 288.

9. Damages

Norwood v. Norwood, 2008 WL 4926008 (Tex. App.—Fort Worth 2008, no pet.), involved a divorce that included litigation between not only the husband and wife, but also a closely-held corporation owned solely by the husband and wife and a competing corporation for which the wife went to work after the divorce proceedings began. Nor Dubois was the catering company Kimberly and Tracy Norwood formed before marrying. The trial court awarded Nor Dubois $235,000 in damages, but did not specify which of Nor Dubois's claims supported the damage award. Kimberly Norwood appealed the trial court's granting of Tracy Norwood and Nor Dubois, Inc.'s motion for sanctions and the entry of a directed verdict in Nor Dubois's favor on its claims for breach of fiduciary duty, conspiracy to breach fiduciary duty, and tortious interference with contracts.

Evidence was presented at trial that Nor Dubois was worth $236,773 in December 2004 and $0 in January 2005 when Kimberly resigned. Tracy Norwood testified that Kimberly took all of Nor Dubois's customers, supplies, employees, including the chef, with her when she left. Therefore, he was unable to continue operating the business on his own.

On appeal, Kimberly challenged the legal sufficiency of the evidence to support the damage award of $235,000 to Nor Dubois under either a breach of fiduciary duty or tortious interference theory. She contended that the damage award was based solely on the diminution in value of Nor Dubois as a result of appellants' actions. Relying on *Texas Instruments Inc. v. Teletron Energy Mgmt.*, 877 S.W.2d 276 (Tex. 1994) and *Duncan v. Lichtenberger*, 671 S.W.2d 948 (Tex. App.—Fort Worth 1984), she claimed that a plaintiff may only recover out-of-pocket losses or lost profits for breach of fiduciary duty. The court of appeals disagreed, holding that those cases did not stand for the proposition that those measures of damages were the exclusive remedies for breach of fiduciary duty. *Id.* *9. The court found nothing in either case which restricted the types of damages that can be awarded on a breach of fiduciary duty claim. Thus, appellate court held that the evidence was sufficient to support the $235,000 damage award to Nor Dubois.

10. Statute of Limitations

In re *Estate of Fawcett*, 55 S.W.3d 214 (Tex. App. – Eastland 2001, pet. denied), stated that both fraudulent concealment and "inherently undiscoverable" injuries have been referred to as discovery rule cases. The Court of Appeals reasoned that injuries occurring in a fiduciary relationship would seem to be in the first type of case (fraudulent concealment), but have instead been categorized as "inherently undiscoverable." The Eastland Court pointed out that the result is the same: the issue is when the plaintiff knew or should have known, with the exercise of reasonable diligence, of the injury. In this case, the Court of Appeals ruled that the trial court erred in granting the summary judgment. *See also Yazdchi v. Washington Mut.*, 2005 WL 2276886, *3 (Tex. App.—Houston [14th Dist.] Sept. 20, 2005, no pet.) ("Their breach of fiduciary duty claim accrued when the Yazdchis knew, or should have known with the exercise of reasonable diligence, that the Bank paid the checks.").

III. TRADE SECRETS

A. Background

In Texas, the cause of action for misappropriation of trade secrets has four elements: (1) existence of a trade secret; (2) obtaining the secret through a confidential relationship or by other improper means; (3) unauthorized use or disclosure of the trade secret; and (4) damage caused to the owner of the trade secret by its use. *K & G Oil Tool & Serv. Co. v. G & G Fishing Tool Serv.*, 314 S.W.2d 782 (Tex. 1958*), cert. denied sub nom*, 358 U.S. 898 (1958*); General Universal Sys., Inc. v. Lee*, 379 F.3d 131, 149-50 (5th Cir. 2004) (applying Texas law); *Avera v. Clark Moulding*, 791 S.W.2d 144, 145 (Tex. App.—Dallas 1990, no writ). A trade secret can be any formula, pattern, device, or compilation used in business which provides an advantage over competitors who do not know or use it. *Hyde Corp. v. Huffines*, 314 S.W.2d 763, 776 (Tex. 1958), *cert. denied*, 358 U.S. 898 (1958); *Evans World Travel, Inc. v. Adams*, 978 S.W.2d 225, 231 (Tex. App.—Texarkana 1998, no pet.).

In order to qualify for trade secret protection, however, the information must be kept secret and dissemination must be restricted. *Furr's, Inc. v. United Specialty Advertising Co.*, 385 S.W.2d 456, 459 (Tex. Civ. App.—El Paso 1964, writ ref'd n.r.e.), *cert. denied*, 382 U.S. 824 (1965). Adequate measures must be taken by one claiming the trade secret to prevent its disclosure to anyone not under a duty to keep it secret. *Id.* A trade secret cannot be publicly known in the trade or business. *Wissman v. Boucher*, 240 S.W.2d 278, 280 (Tex. 1951); see also *McClain, Jr. v. State of Texas*, 269 S.W.3d 191 (Tex. App.—Texarkana 2008) (Defendant's seven year sentence for theft of trade secrets reversed. Defendant was acquitted because evidence conclusively established that backsheets had been released into the public domain and were not trade secrets). Similarly, matters completely disclosed by the goods themselves cannot be trade secrets. *Id.* Other relevant factors include the value of the information to the plaintiff and its competitors and the amount spent on developing the information. *See Lee*, 379 F.3d at 150 (citing *In re Bass*, 113 S.W.3d 735, 739-40 (Tex. 2003).

Misappropriation occurs when trade secrets are acquired through breach of a confidential relationship or by other improper means, including theft, wiretapping, and even aerial espionage. *E.I. DuPont de Nemours & Co. v. Christopher*, 431 F.2d 1012, 1016 (5th Cir. 1970, *cert. denied*, 400 U.S. 1024 (1971)); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 474-75 (1974). When evaluating whether a misappropriation has occurred, the question is not "how could the knowledge have been obtained" but instead "how was it obtained?" *American Precision Vibrator Co. v. National Air Vibrator Co.*, 764 S.W.2d 274, 277 (Tex. App.—Houston [1st Dist.] 1988, no writ), *as modified* 771 S.W.2d 562 (Tex. App.—Houston [1st Dist.] 1989, no pet.). Although "reverse engineering" is a proper means of gaining access to a competitor's secret process, obtaining trade secret information without spending the time and money to discover it independently is improper unless the holder of the trade secret discloses it voluntarily or fails to take reasonable precautions to ensure its secrecy. *Id.* at 278; *Weightman v. State*, 975 S.W.2d 621, 627 (Tex. Crim. App. 1998).

Employees have a duty not to use confidential, proprietary or trade secret information acquired during their employment in a manner adverse to their employer. *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 21-22 (Tex. App. – Houston [1st Dist.] 1998, pet. denied); *Welex Jet Services, Inc. v. Owen*, 325 S.W.2d 856, 858 (Tex. Civ. App. – Fort Worth 1959, writ ref'd n.r.e.); *Crouch v. Swing Machinery Co.*, 468 S.W.2d 604, 605-607 (Tex. Civ. App. – San Antonio, 1971, no writ); *Johnston v. American Speedreading Academy, Inc.*, 526 S.W.2d 163, 166 (Tex Civ. App. – Dallas 1975, no writ); *Jeter v. Associated Rack Corp.*, 607 S.W.2d 272, 276 (Tex. Civ. App. – Texarkana 1980, writ ref'd n.r.e.); *Reading & Bates Construction Co. v. O'Donnell*, 627 S.W.2d 239, 242-243 (Tex. Civ. App. – Corpus Christi 1982, writ ref'd n.r.e.); *Dannenbaum, Inc. v. Brummerhop*, 840 S.W.2d 624, 632 (Tex. App. – Houston [14th Dist.] 1992, writ denied). This duty owed by employees is an implied duty arising out of the confidential relationship with their employer not to disclose information received during employment, "if the employee knows that his employer desires such

information kept secret, or if, under the circumstances, he should have realized that secrecy was desired." *Lamons Metal Gasket Co. v. Traylor*, 361 S.W.2d 211, 213 (Tex. Civ. App.—Houston, 1962, writ ref'd n.r.e.). The duty arises from the employment relationship regardless of whether a written employment contract exists. *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 600 (Tex. App. – Amarillo 1995, no writ); *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 21-22 (Tex. App. – Houston [1st Dist.] 1998, pet. dismissed); *Texas Shop Towel, Inc. v. Haire*, 246 S.W.2d 482, 485 (Tex. Civ. App. – San Antonio 1952, no writ). *See also Lamons Metal Gasket Co. v. Traylor*, 361 SW.2d 211, 213 (Tex. Civ. App.—Houston, 1962, writ ref'd n.r.e.).

Courts do uphold the rights of former employees to use the general knowledge, skill and experience acquired in their former employment in competition with their former employer. *Johnston v. American Speedreading Academy, Inc.*, 526 S.W.2d 163, 166 (Tex. Civ. App.—Dallas 1975, no writ). Absent special circumstances, once an employee resigns, he may actively compete with his former employer. *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503, 510 (Tex. App.—Houston [1st Dist.] 2003, no pet.). "In Texas, to resign from one's employment and go into business in competition with one's former employer is, under ordinary circumstances, a constitutional right." *Id.* There is nothing legally wrong with engaging in competition or in preparing to compete before the employment terminates. *Id.* The possibility of crippling, or even destroying, a competitor is inherent in a competitive market. *Id.* An employer who wants to restrict the post-employment competitive activities of a key employee should use a non-competition agreement. *Id*.

Texas law also recognizes a cause of action for common law misappropriation. This cause of action prohibits "the appropriation and use by the defendant, in competition with the plaintiff, of a unique pecuniary interest created by the plaintiff through the expenditure of labor, skill and money." *Universal City Studios, Inc. v. Kamar Indus., Inc.*, 217 U.S.P.Q. 1162, 1168 (S.D. Tex. 1982). The elements of common-law misappropriation are: (1) the creation of a product through extensive time, labor, skill and money; (2) the defendant's use of that product in competition with the plaintiff, thereby gaining a special advantage or "free ride" because the defendant has borne none of the expense incurred by plaintiff; and (3) damages. *United States Sporting Prod., Inc. v. Johnny Stewart Game Calls, Inc.*, 865 S.W.2d 214, 218 (Tex. App. – Waco 1993, writ denied) (citing *Synercom Technology, Inc. v. University Computing Co.*, 474 F. Supp. 37, 39 (N.D. Tex. 1979)); *Gilmore v. Sammons*, 269 S.W. 861, 863 (Tex. Civ. App. – Dallas 1925, writ ref'd); *Aldridge v. The Gap, Inc.*, 866 F. Supp. 312, 313 (N.D. Tex. 1994). The difference between this claim and the cause of action for misappropriation of trade secrets is two-fold. First, trade secret law protects intellectual property and requires the existence of a trade secret. Common-law misappropriation requires no secrecy and protects a fully disclosed product or other tangible property. Second, common-law misappropriation requires the use of the stolen information or product in competition with its creator. With trade secret misappropriation, any use of an improperly acquired trade secret will suffice. *United States Sporting Prod., Inc. v. Johnny Stewart Game Calls, Inc.*, 865 S.W.2d 214, 218 (Tex. App. – Waco 1993, writ denied); *Gilmore v. Sammons*, 269 S.W. 861, 863 (Tex. Civ. App. – Dallas 1925, writ ref'd).

In *General Universal Systems, Inc. v. Hal, Inc.*, 500 F.3d 444, 451, 453 (5th Cir. 2007), the Fifth Circuit held that the continuing tort concept did not apply to common law claims for trade secret misappropriation under Texas law. General Universal Systems (GUS) sued HAL, Inc. (HAL) for numerous state and federal claims for stealing proprietary software. A two year statute of limitations applies to claims for trade secret misappropriation. The court in this case had to decide whether trade secrets misappropriation claim against HAL was barred by the statute of limitations. GUS initially filed its complaint on May 23, 1995. Therefore, the court's task was to determine whether all of GUS's claims accrued before May 23, 1993. GUS argued that trade secret misappropriation is a continuing tort and that because HAL continued to use their trade secret after May 23, 1993, HAL's wrongful conduct continued into the period covered by the statute of limitations. *Id.* 451. Texas courts had never directly addressed the question of whether trade secret misappropriation was a continuing tort prior to the 1997 legislation-legislation that explicitly precluded treating trade secret misappropriation as a continuing tort. Tex. Civ. Prac. & Rem.Code § 16.010(b). The court found that trade secret misappropriation should not be treated as a continuing tort. Thus, the court declined to apply the concept of a continuing tort to the Texas common law claim of trade secret misappropriation. *Id.* at 453. Consequently, GUS's claim of trade secret misappropriation was time barred. *Id.*

Finally, there are also criminal liabilities – both state and federal – for misappropriation of trade secrets. Theft of trade secrets is a felony in Texas. TEXAS PENAL CODE sec. 31.05. (Vernon's 2000) *Shalk v. State*, 823 S.W.2d 633 (Tex. Crim. App., 1991, pet. denied). *See also Weightman v. State*, 975 S.W.2d 621 (Tex. Crim. App. 1998). Federal criminal liability may also attach for trade secret misappropriation under the federal Economic Espionage Act of 1996, 18 U.S.C. §§ 1831-1839.

B. Remedies

At the outset, a plaintiff may obtain temporary and permanent injunctive relief against misappropriation of its confidential information or trade secrets. A good example of the former is the case of *Rugen v. Interactive Business Systems, Inc.*, 864 S.W.2d 548 (Tex. App. – Dallas 1993, no writ). IBS employed Rugen and required her to sign a noncompete agreement. Rugen later left IBS, set up her own firm, and began competing against IBS. IBS sued Rugen for breaching the noncompete agreement and misappropriating its trade secrets. IBS contended that the identity of its consultants and customers were trade secrets. It sought a temporary injunction prohibiting Rugen from calling upon, soliciting, or transacting business with these consultants and customers. The district court found that the noncompete agreement was unenforceable. But it nevertheless granted temporary injunctive relief under IBS's misappropriation claim.

The Dallas court of appeals affirmed. It held that even without an enforceable noncompete agreement, an employer could enjoin a former employer from using the employer's own trade secrets to compete against it. *Id.* at 551. For example, "[a]n injunction is appropriate when necessary to prohibit an employee from using confidential information to solicit his former employer's clients." *Id.* It further held that when the former employee possesses the employer's confidential information and later directly competes against the employer, a presumption arises that "it is probable that [the former employee] will use the information for her benefit and to the detriment of [her former employee]." *Id.* Moreover, injunctive relief may be "the only effective relief an employer has when a former employee possesses confidential information." *Id.*

In addition to injunctive relief, a misappropriation plaintiff may recover actual damages, the benefit to the defendant (*i.e.* unjust enrichment), or a reasonable royalty. *See generally American Precision Vibrator Co. v. National Air Vibrator Co.*, 764 S.W.2d 274, 279 (Tex. App. – Houston [1st Dist.] 1988, no writ) (affirming jury award based on either the plaintiff's loss or benefits received by the defendant; "'benefit' is a measurement of the financial result directly attributable to American's having sold the nine equivalent competing models of vibrators"); *Taca Cabana Int'l. v. Two Pesos, Inc.*, 932 F.2d 1113, 1128 (5th Cir. 1991) ("Trade-secret misappropriation damages typically embrace some form of royalty."); *Rorie v. Edwards*, 48 Fed. Appx. 102 (5th Cir. 2002) ("A reasonable royalty is the appropriate measure of damages of the misappropriation of the trade secret in this case.").

When the plaintiff seeks to recover its actual loss, the measure of damages is the value of the lost trade secrets – usually, its lost profits. *Jackson v. Fontaine's Clinics, Inc.*, 499 S.W.2d 87, 89-90 (Tex. 1973); *DSC Comm. Corp. v. Next Level Comm.*, 107 F.3d 322, 329-30 (5th Cir. 1997) (using lost profits measure of damages in misappropriation case); *Astoria Indus. Of Iowa, Inc. v. SNF, Inc.*, 223 S.W.3d 616, 637-38 (Tex. App. – Fort Worth 2007, pet. filed).

Recently, in *Rusty's Weigh Scales & Serv., Inc. v. N. Texas Scales, Inc.*, 314 S.W.3d 105, 111 (Tex. App.—El Paso 2010), the appellate court affirmed the trial court's denial of lost profit damages for misappropriation of trade secrets. Rusty's claim for lost profits was based on its assumption that it lost customers based on NTS's alleged use of Rusty's software. However, Rusty was not under any contracts with its clients once the systems were sold. Moreover, the evidence showed that at least three of Rusty's former customers switched to NTS because of dissatisfaction with Rusty's customer service, that NTS simply outbid Rusty for jobs, or that NTS bought the company that previously provided service to the client. Rusty did not negate this evidence, nor did it offer any evidence that it actually lost any business because NTS had copied, sold, or used Rusty's software. The court made it clear that lost profits must be non-speculative and corroborated. *Id.* at 111. Because there was no reliable, non-speculative evidence on lost profits, Rusty failed to present legally sufficient evidence of the same. Therefore, the court found that the trial court correctly concluded that Rusty was not entitled to lost profits on his claim for misappropriation of trade secrets. *Id.*

Under the "benefit to the defendant" measure of damages, a plaintiff can recover the defendant's actual profits from using the trade secrets. *See Elcor Chem. Corp. v. Agri-Sul., Inc.*, 494 S.W.2d 202, 212 (Tex. App. – Dallas 1973, writ ref'd n.r.e.); *see also Sharma v. Vinmar International, Ltd.*, 231 S.W.3d 405, 429 (Tex. App. – Houston [14th Dist. 2007, no pet.) (a court can fashion injunctive relief "so that those who have acted wrongfully…will be effectively denied the benefits and profits flowing from the wrongdoing.") (citation omitted).

A plaintiff, however, is not necessarily limited to the defendants' profits. In *American Precision Vibrator*, the court noted that the defendants' profits "would not necessarily be an accurate reflection of 'benefits received,' but might rather reflect either good or bad business sense and management." 764 S.W.2d at 279. For example, even if the defendant did not immediately make significant profits, the trade secrets may have given it a significant "head start" in trying to compete against the plaintiff. *See, e.g., Hyde Corp. v. Huffines*, 314 S.W.2d 763, 581 (Tex. 1958) (rejecting argument that trade secret injunction should cease upon issuance of a patent; "the licensee who had abused a confidence would thus obtain a marketing advantage or

head start as compared to the patentee or any manufacturer or processor licensed by him after issuance of the patent."). A plaintiff should argue that the head start period should extend the corresponding damages period or the duration of any injunction.

A plaintiff may also recover royalties in a case involving misappropriation of trade secrets. A reasonable royalty is "a percentage of sales or profits." *Taylor Publishing Co. v. Jostins, Inc.*, 36 F. Supp. 2d 360, 374 (E.D. Tex. 1999). In reasonable royalty cases, the following factors are relevant to determining what constitutes a reasonable royalty: (1) the resulting and foreseeable changes in the parties' competitive posture; (2) the prices past purchasers or licensees may have paid; (3) the total value of the secret to the plaintiff, including the plaintiff's development cost and the importance of the secret to the plaintiff's business; (4) the nature and extent of the use the defendant intended for the secret; and (5) whatever other unique factors in the particular case might have affected the parties' agreement, such as the ready availability of alternative process. *Rorie*, 48 Fed. Appx. 102 (citations omitted); *see also Metallurgical Indus., Inc. v. Fourtek*, 790 F.2d 1195, 1208 (5th Cir. 1986) (reciting the same factors).

In an appropriate misappropriation case, the plaintiff can also recover punitive damages. *See Crutcher-Rolfs-Cummings, Inc. v. Ballard*, 540 S.W.2d 380, 387-88 (Tex. App. – Corpus Christi 1976, writ ref'd n.r.e.). According to the Fifth Circuit, punitive damages are recoverable even when the misappropriation claim arises under a contract. *Zoecon Indus. v. American Stockman Tag Co.*, 713 F.2d 1174, 1180 (5th Cir. 1983) (applying Texas law) (affirming punitive damages for misappropriation claims arising out of employment agreements).

C. Specific Case Law

1. Texas Supreme Court

The most pertinent case regarding proof of the existence of a trade secret is *In Re Bass*, 113 S.W.3d 735 (Tex. 2003). The Texas Supreme Court agreed with the Restatement (Third) of Unfair Competition and the majority of jurisdictions that a party claiming a trade secret should not be required to satisfy all six "trade secret factors" in order to establish that something qualifies as a trade secret, "because trade secrets do not fit neatly into each factor every time." *Id*. at 740. The six "trade secret factors" used by the Texas Supreme Court to determine whether a trade secret exists are: (1) the extent to which the information is known outside his business; (2) the extent to which it is known by employees an others involved in his business; (3) the extent of the measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *Id*. at 739 (citing Restatement of Torts §757 cmt. B (1939), Restatement (Third) of Unfair Competition §39, reporter's n. cmt.d, and *Hyde Corp. v. Huffines*, 314 S.W.2d 763 (Tex. 1958)). The Texas Supreme Court held that a court need only weigh these factors as relevant criteria in determining whether something qualifies as a trade secret. *Id.* at 739-40; *see also id.* at 740 (noting that it is not necessary to satisfy all six factors in every case to prove that a trade secret exists; likewise, "[w]e additionally recognize that other circumstances could also be relevant to the trade secret analysis."). The Court also held, consistent with other jurisdictions and the position of the oil and gas industry, that geologic "seismic data and its interpretations are trade secrets protected by Texas Rule of Evidence 507." *Id.* at 742.

2. Texas Courts of Appeals

In *Downing v. Burns*, 2011 WL 3196944 (Tex. App.—Houston [14th Dist.]) the Houston court of appeals concluded that Burns did not defeat Downing's recovery by conclusively proving his counterclaim for theft of trade secrets. Downing brought suit against Burns for tortious interference and defamation. Burns counterclaimed for theft of trade secrets.

Before Downing resigned from her job as an assistant to Burns, she copied several pages from the office policy and procedures manual. After learning of this, Burns and his wife told several people that Downing stole from them, and they would sue anyone who employed her if the material was not returned. Downing was fired from her two subsequent jobs. The jury found in favor of Downing on all three claims, but the trial court entered judgment in her favor only on the tortious interference and theft claims. Both sides appealed.

Downing copied four pages of the manual which contained the steps to access a website as well as steps to attach a template to an email. The court found that a reasonable jury could find that none of the pages contained trade secrets. *Id.* at *5. Downing testified that Burns never told her the manual was confidential; the material was not marked as confidential; and she was not asked to sign any confidentiality agreements. Burns took no steps to protect the material and there was testimony that the information in the manual was generally known in the industry. *Id.* The court held that Burns failed to prove that Downing stole trade secrets. Thus, the trial court did not err in denying their request for JNOV as to that claim. *Id.* at *6.

In *Gen. Insulation Co. v. King*, 2010 WL 307952 (Tex. App.—Houston [14th Dist.] 2010, no pet.), General Insulation Company ("General") appealed the trial court's summary judgment in favor of its former

employee, King. General pled common-law misappropriation of trade secrets and other confidential information. General based its claim on King's alleged disclosure or use of pricing information specific to individual clients. The pricing information at issue was "job pricing," i.e., the specific pricing information quoted to a specific customer for a specific job. King presented two summary-judgment grounds in relation to this information: (1) he did not take any customer-specific pricing information from General; and (2) the customer-specific pricing information was not confidential. Although some courts have held pricing information to be a trade secret in some circumstances, the court held that the summary-judgment proof in the present case more closely approximated evidence in cases in which the information at issue was not considered a trade secret. The summary-judgment proof showed the following in relation to the six factors. Even though pricing for an individual customer appeared in the customer's contract and customers were not required to sign confidentiality agreements, one could infer from the testimony that customer-specific pricing was not usually discussed (first and sixth factors). General had, as its only policy, practice, or procedure to protect the information, an "unspoken rule" the customer-specific pricing information was to stay in-house and General required its employees to sign a confidentiality agreement which specifically referred to "price" (third factor). General lost a job to a competitor when its bid was "within pennies" of the competitor's (fourth factor). *Id.* *6. Thus, the court affirmed the summary judgment.

In *Sharma v. Vinmar International., Ltd.*, 231 S.W.3d 405 (Tex. App.—Houston [14th Dist.] 2007), the court held that egregious misappropriation of trade secrets may justify a broad injunction. The trial court entered a temporary injunction enjoining Sharma *et al*. from "(1) using or subleasing certain chemical storage tanks in Hamina, Finland for the purpose of storing isoprene monomer purchased from Russia; and (2) purchasing, transporting, storing, marketing, selling or trading isoprene monomer that is produced in Russia or caprolactum either supplied from Mexico or Belarus or sold in China." The Houston Court of Appeals affirmed.

The evidence showed that Vinmar took steps to protect their customer information including controlled access cards, password protected computers, employee confidentiality agreements, employee manuals emphasizing the confidential nature of the business, and limiting access to a "need-to-know" basis. The trial court concluded that Vinmar's information qualified as trade secrets. The Houston Court of Appeals concluded that the evidence supported a conclusion that Vinmar had trade secret information including (1) Vinmar's sale and purchase histories that provided trend information about their customers' demands and their suppliers' product inventory; (2) the economics and margins realized in the Russian isoprene trade; (3) Vinmar's customers, suppliers, and technical data are trade secrets (the court commented that "[c]ustomer lists are routinely given trade secret protection"); and (4) Vinmar's expertise in developing, competitively pricing, and selling chemicals. According to the court, "[n]one of this institutional knowledge can be gleaned from general knowledge known outside Vinmar's business." With respect to the injunction, the court noted that "[i]njunctive relief may be employed when one breaches his confidential relationship in order to misuse a trade secret," and "[i]njunctive relief is also proper to prevent a party, which has appropriated another's trade secrets, from gaining an unfair market advantage." The court further explained that "[i]rreparable harm may also be established by evidence that disclosure of trade secret information could enable competitors to misuse the marketing plans and strategies of the applicant and avoid the less successful strategies as well as the risk and expense of developing the strategies," also noting that "[t]he misuse of trade secrets leading to the loss of an existing business is another example of irreparable harm entitling an applicant to injunctive relief."

The court concluded that "[t]he potential damage caused by the loss of Vinmar's isoprene and caprolactum business, even if not complete, cannot be easily calculated and therefore a legal remedy is inadequate." The court also concluded that the injunction, under the circumstances, was not overbroad: "the evidence demonstrates the appellants gained access to the Hamina tanks, the Russian isoprene market, and the Mexican and Belarusian caprolactum trade into China solely through the improper acquisition and use of Vinmar's trade secrets. Far from being an overbroad order that forbids lawful competition, the trial court's order is narrowly tailored to preserve the status quo by protecting the secrecy of Vinmar's trade secrets and remedying the violence to the confidential relationship through which the appellants acquired those trade secrets."

In *Matrix Network, Inc. v. Ginn*, 211 S.W.3d 944 (Tex. App.—Dallas 2007) Matrix sold digital video recorders (DVRs) and related equipment to security services companies. Matrix hired Ginn, first as an independent contractor through Ginn's company GenOmega Software Systems, Inc., and later as an employee to provide engineering and technical support services. Matrix learned in 2005 that its DVR manufacturer, Intelligent Digital Integrated Security (IDIS) had software embedded in its DVRs that allowed remote viewing using dynamic domain name service (DDNS), which IDIS called DVRNS. Matrix discussed the feature with ADT, one of its largest customers, and planned to develop a service that would

allow ADT to charge its customers for remote viewing. ADT ultimately decided not to add the service, but Matrix elected to proceed with the project, and in particular combining the DVRNS software with software Ginn would write to control access and management of remote viewing. Ginn had previously suggested modifications to IDIS, and Ginn told Matrix that those modifications were necessary before he could write the software Matrix requested. Before those modifications were ready, Ginn resigned, but continued to do work for Matrix through his company. After another contract job fell through, Ginn and his brother began focusing on the DDNS project. Ultimately Ginn developed account management software that provided remote viewing without IDIS's DVRNS or the modifications that he had earlier suggested. Ginn's product also contained additional features that Matrix's proposed product did not have. Ginn and his brother formed DVR Connections, L.L.P., to own and operate the software on its server. Matrix later told Ginn that the IDIS modifications would be ready shortly, and Ginn told Matrix that he had already completed the work. Ginn demonstrated his system to Matrix, and Matrix later sent him a letter accusing him of violating a non-disclosure agreement he had signed as an employee. Matrix also brought suit and sought a temporary injunction. The trial court denied the injunction and Matrix brought an expedited appeal.

The Court of Appeals affirmed the denial of the injunction. The court focused on whether Matrix had made a showing of irreparable harm. Matrix's president testified the delay had caused Matrix to lose $ 600,000 in revenue. The court, however, noted that was compensable through damages. Matrix's president also testified that he was concerned that Ginn would market the product to ADT, but Ginn denied any intent to do so. Although Ginn intended to market the product to the public at large, the court reasoned that did not constitute irreparable harm because Matrix had not demonstrated intent to market the product. Also, the court pointed to the additional and different features in Ginn's product. Matrix urged that harm should be presumed from the fact that Ginn had confidential information, and if Ginn was allowed to market his product before Matrix's product was ready, Matrix would lose a competitive advantage. The court was not persuaded, noting that Matrix's proposed used IDIS' DVRNS, which Ginn's product did not. Accordingly, the court concluded that Matrix had not made the requisite showing of irreparable harm.

In *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452 (Tex. App. – Austin 2004, no pet.), the court held that the employer failed to meet its burden with regard to its claim of trade secret protection for knowledge of "the difficulties inherent in implementing a compensation-management system meeting AETNA's requirements while coping with the complexities of its compensation system." *Id.* at 467. The court noted that there was no evidence that these difficulties were not readily ascertainable to someone with the employee's general knowledge, experience and skill set, and that there was uncontroverted evidence that AETNA had disclosed the inner workings of its compensation system to both the new employer and another competitor. The court found:

> [the employee's] general knowledge of the issues presented by a customer's compensation system, moreover, stands in sharp contrast to the types of customer information that have been held to comprise trade secrets, which characteristically have been compiled over long periods of time, through use of substantial resources and are shown to provide a competitive advantage.

Id. at 467, 68.

The court refused to find that trade secret status automatically attaches to any information that a company acquires regarding its customers. *Id.* at 467.

In *Fox v. Tropical Warehouses, Inc.*, 121 S.W.3d 853 (Tex. App. – Ft. Worth 2003, no pet.), the court held that a temporary injunction order granting trade secret protection does not mean the protected information is a trade secret. "When deciding whether to grant or deny a request for a temporary injunction, the trial court does not decide whether the information sought to be protected is a trade secret; rather it determines whether the applicant has established that the information is entitled to trade secret protection until a trial on the merits." *Id.* at *3. The court also held that an applicant for a temporary injunction is not required to prove that the defendant is actually using the trade secret information. *Id.* at *5. Instead, the applicant "need only prove that he is in possession of the information and is in a position to use it." *Id*.

In *Mabry v. Sandstream, Inc*., 124 S.W.3d 302 (Tex. App.—Ft. Worth 2003, no pet.), the court held that a trial court need not determine whether the information sought to be protected is, in fact and in law, a trade secret at the temporary injunction stage. "Rather, the trial court determines only whether the applicant has established that the information is entitled to trade secret protection until the trial on the merits." *Id.* at *4. The court held further that injunctive relief is proper even where an applicant has ceased to do business or to use the protected information. *Id.* at *11.

Similarly, in *Center for Economic Justice v. American Insurance Association*, 39 S.W.3d 337 (Tex. App. – Austin, 2001, no pet.), the court of appeals noted that the "use of the alleged trade secret in one's

business" part of the definition of a trade secret is not among the "six factors" required to establish trade secret protection in the preliminary stage of a temporary injunction. *Id.* at 347. The court held that: "Under Texas law, information that satisfies the six factors without more is entitled to temporary injunctive relief." *Id.*

In *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503 (Tex. App. – Houston [1st Dist.] 2003, no pet.), the court examined the extent to which employees may begin preparations to compete with their employer while still employed, and the extent to which those preparations must be disclosed to the employer. The employee in *Arizpe* had disclosed his intention to form his own company to his employer. He had not, however, disclosed that he had incorporated his company, or that he had obtained certain permits and insurance. The court held that those acts were permissible, even though they had not been disclosed to the employer. *Id.* at 511. Although the court recognized the right to prepare to compete, it cautioned that "if the nature of a party's preparation to compete is significant, it may give rise to a cause of action for breach of fiduciary duty," particularly where the employee acts as a "corporate pied piper" and lures all of his employer's personnel away, in effect destroying the employer's business. *Id*. at 511-512. The court upheld the following limitations on the conduct of an employee who plans to compete with his former employer. The employee may not: (1) appropriate the company's trade secrets; (2) solicit his employer's customers while still working for his employer; (3) solicit the departure of other employees while still working for his employer, or (4) carry away confidential information, such as customer lists. *Id*. at 512.

In *Global Water Group, Inc. v. Atchley*, 244 S.W.3d 924 (Tex. App.—Dallas 2008, pet denied), Global Water brought suit against its former president and his new company, asserting claims for breach of shareholder agreement, misappropriation of trade secrets, and conspiracy. After vacating its earlier opinion on denial for rehearing, the Dallas Court of Appeals held that Global's formula for elements used in absorption stage of water purification process was not a trade secret. The court found that the imprecise nature of the formula weighed heavily against it being a trade secret. *Id.* at 930. Global did not have an exact formula, but rather used an approximate mix of two substances commonly used together to purify the water. As a result, the court concluded that there was insufficient evidence to show misappropriation of the formula. *Id.*

3. Federal Computer Fraud and Abuse Act.

Generally, the Computer Fraud and Abuse Act (the "CFAA"), 18 U.S.C. § 1030, requires a showing of: intentional access to a protected computer without authorization or beyond authorization causing damage. This United States federal statute lists several criminal conducts committed through the use of a computer. 18 USC § 1030(a)(5)(A), punishes any person who knowingly causes the transmission of a program, information, code, or command, and as a result of such conduct, intentionally causes damage without authorization, to a protected computer. This specific computer fraud crime requires "proof that the defendant knowingly causes the transmission of a program, information, code, or command, and as a result of such conduct, intentionally causes damage without authorization, to a protected computer." 18 USC § 1030(a)(5)(A)(i).

Although the Computer Fraud and Abuse Act (CFAA) is a criminal statute, it can also create a private civil cause of action between the parties and vest federal courts with subject matter jurisdiction. In *Ennis Transportation Co., Inc. v. Richter*, 2009 WL 464979 (N.D. Tex. Feb. 24, 2009), the federal court had subject matter jurisdiction to determine private civil matters under the CFAA. Originally, Ennis filed suit in state court in Ellis County naming Judy R. Richter, Robert L. Richter, Overcomers N. Overflow, Inc., and Dynasty Transportation, Inc., and alleging that Judy and Robert Richter, former employees of Ennis, misappropriated trade secrets, *i.e.*, used confidential information obtained from Ennis's contracts, customer lists, schedules, employee files, and driver files to misappropriate business from Ennis. Ennis alleged business disparagement, wrongful use of confidential information, conversion, misappropriation of trade secrets, tortious interference with business relationships, breaches of loyalty and fiduciary duties, and finally, violation of the federal Computer Fraud and Abuse Act (CFAA). Based on the alleged violation of the CFAA, the defendants removed the action to the Northern District of Texas. The court initially remanded the case back to state court, but on a motion for reconsideration, retained jurisdiction. The court explained:

> Ennis's original petition avers Defendants accessed Ennis's confidential information by exceeding Defendants' authority without authorization. * * * Ennis continues to allege that it has consequently "suffered losses and damages by reason of the violations in excess of the statutory limits of the [CFAA] in less than a one year period of time." * * * The Court accordingly finds that it has subject matter jurisdiction over Ennis's CFAA claim. See 18 U.S.C. §§ 1030(a)(4); 1030(c)(4)(A)(i)(I). Whether Ennis's claim would satisfy a motion for failure to state a claim upon which relief can be granted is not before the Court, and is therefore

> reserved for another day. This Court is further vested with jurisdiction over Ennis's state law causes of action by virtue of its supplemental jurisdiction. See 28 U.S.C. § 1367.

It should be noted that the court was ruling on a motion to remand – not a motion to dismiss.

IV. FRAUD

A. Background

To prevail on a common-law fraud claim in Texas, a plaintiff must establish: (1) the defendant made a material representation; (2) the representation was false; (3) the defendant either knew the representation was false when made or made it recklessly without any knowledge of its truth and as a positive assertion; (4) the defendant made the representation with the intention that it be acted upon; (5) the representation was in fact relied upon; and (6) damage to the plaintiff resulted. *See DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990), *cert. denied*, 498 U.S. 1048, 111 S. Ct. 755, 112 L.Ed.2d 775 (Tex. 1991); *Trenholm v. Ratcliff*, 646 S.W.2d 927 (Tex. 1983); *Matis v. Golden*, 228 S.W.3d 301 (Tex. App.—Waco 2007); *Rogers v. Alexander*, 244 S.W.3d 370 (Tex. App.—Dallas 2007).

A fraud cause of action is generally based on a representation of fact, but it can be based on a representation of opinion when (1) the opinion is based on past or present facts, or (2) the speaker knows of the opinion's falsity. *See Trenholm*, 646 S.W.2d at 930. A representation is material if a substantial likelihood exists that a reasonable plaintiff would consider the representation important in entering into the transaction in question. *See Weatherly v. Deloitte & Touche*, 905 S.W.2d 642 (Tex. App.—Houston [14th Dist.], 1995 writ dism'd w.o.j.).

A fraud claim can be based on a promise made with no intention of performing, irrespective of whether the promise is later subsumed within a contract. *Formosa Plastics Corporation v. Presidio Engineers and Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998). *Crim Truck and Tractor Co. v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591 (Tex. 1992); *Hawkins v. Walker*, 233 S.W.3d 380 (Tex. App.—Fort Worth 2007). However, the mere failure to perform a contract is not evidence of fraud. *See Formosa*, 960 S.W.2d at 48. *See also Weinberger v. Longer*, 222 S.W.3d 557 (Tex. App.—Houston [14th Dist.] 2007); *Petras v. Criswell*, 248 S.W.3d 471 (Tex. App.—Dallas 2008).

In regard to reliance, plaintiff must show that he actually and justifiably relied on defendant's misrepresentations. *See Haralson v. E. F. Hutton Group, Inc.*, 919 F.2d 1014 (5th Cir. 1990) (under Texas law, fraud requires showing of actual and justifiable reliance). In reviewing the record on appeal, the court of appeals considers whether – given the particular plaintiff's individual characteristics, abilities, and appreciation of facts and circumstances – it is "extremely unlikely" that there was actual reliance on the plaintiff's part. *See Haralson*, 919 S.W.2d at 1026. *See also Gray v. Waste Resources, Inc.*, 222 S.W.3d 522 (Tex. App.—Houston [14th Dist.] 2007) (reliance negated by testimony that Gray did not rely on any misrepresentations, rather he could not obtain necessary financing to purchase the shares); *Grand Champion Film Production, L.L.C., Cinemark USA, Inc.*, 257 S.W.3d 478 (Tex. App.—Dallas 2008) (no evidence that Cinemark made any representation to movie producers that they relied upon in making their decision to allow their film to be used).

Texas recognizes two measures of direct damages for common law fraud: the out-of-pocket measure and the benefit-of-the-bargain measure. *Arthur Anderson & Co. v. Perry Equipment*, 945 S.W.2d 812 (Tex. 1997); *W. O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127 (Tex. 1988); *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369 (Tex. 1984). The out-of-pocket measure computes the difference between the value paid and the value received, while the benefit-of-the-bargain measure computes the difference between the value as represented and the value received. *Arthur Anderson*, 945 S.W.2d at 817. The benefit-of-the-bargain measure does not include lost profits on a "bargain that was never made." *Formosa Plastics Corporation*, 960 S.W.2d at 50. In addition, the benefit-of-the-bargain measure of damages is barred by the statute of frauds when the claim arises from a contract that has been held to be unenforceable. *Baylor University v. Sonnichsen*, 221 S.W.3d 632, 636 (Tex. 2007). However, when properly pleaded and proved, consequential damages that are foreseeable and directly traceable to the fraud and result from it may be recoverable. *Arthur Anderson*, 945 S.W.2d at 817. Consequential damages could include foreseeable profits from other business opportunities lost as a result of the fraudulent misrepresentation. *Formosa Plastics Corporation*, 960 S.W.2d 49 at fn.1.

B. Specific Application

1. Fraudulent Inducement

a. A valid contract is necessary for benefit of the bargain damages.

In *Quigley v. Bennett*, 227 S.W.3d 51 (Tex. 2007), the Texas Supreme Court considered a fraud case brought by Bennett, a geologist, against Quigley, who was the seller of interests in oil and gas leases for quantum meruit, conversion, and fraud. Bennett alleged that Quigley sold the interests using maps prepared by him for Quigley, for which he was not paid. The jury awarded Bennett $2,500 on quantum meruit, $1 million on his fraud claim, and $1 million

on his conversion claim. Quigley appealed and the San Antonio Court of Appeals affirmed. The Supreme Court held that allowing recovery of the value of a royalty interest in an oil and gas lease, when the interest itself could not be recovered because the statute of frauds bars recovery, would circumvent protections of the statute of frauds; the value of overriding royalty interests could not be considered, when assessing the legal sufficiency of Bennett's evidence of fraud damages; and the evidence was legally insufficient to support the jury's award of fraud damages. *Id.* at *2.

In *R. E. Haase and PRH Investments v. Glazner*, 62 S.W.3d 795 (Tex. 2001), the Texas Supreme Court considered a fraudulent inducement case brought by a potential franchisee against the franchisor. The specific issue considered by the Supreme Court was whether a party can maintain a claim based on either fraud or fraudulent inducement when the claim is premised on a contract that is unenforceable under the Statute of Frauds. The trial court granted summary judgment against the plaintiff and the Court of Appeals reversed, holding that the fraud and fraudulent inducement claims alleged a breach of duty independent of the contract claims. The Court of Appeals relied heavily on the Supreme Court's opinion in *Formosa Plastics Corporation v. Presidio Engineers and Contractors*, 960 S.W.2d 41 (Tex. 1998). The Texas Supreme Court reversed the Court of Appeals, holding that the franchisee could not maintain an action for fraudulent inducement if the contract was barred by the Statute of Frauds. The Supreme Court conceded that language in the *Formosa* opinion suggested that there was a distinction between fraud and fraudulent inducement, but stated that reliance was still an element of fraudulent inducement, and without a binding agreement there could be no reliance. The Court went on further to hold that the plaintiff could recover on an "out-of-pocket theory." In other words, plaintiff could not assert a fraudulent inducement claim without a contract, but could assert a fraud claim based on out-of-pocket damages.

b. "Merger" and "as is" clauses

In *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008), the Supreme Court of Texas held that a waiver of reliance disclaimer in a contract did not automatically preclude a fraudulent inducement claim. The Court found the disclaimer language in *Forest Oil* to be virtually identical to the language in *Schlumberger*. In this case, the Court clarified that the relevant facts courts should examine when determining whether a waiver-of-reliance provision is binding are: 1) the terms of the contract being negotiated, rather than boilerplate, and during negotiations the parties specifically discussed the issue which had become the topic of the subsequent dispute; 2) the complaining party was represented by counsel; 3) the parties dealt with each other in an arm's length transaction; 4) the parties were knowledgeable in business matters; and 5) the release language was clear. *Id.* at *5. However, the Court stated that "parties who contractually promise not to rely on extra-contractual statements-*more than that, promise that they have in fact not relied upon such statements*- should be held to their word." *Id.* The Court ultimately held that the parties' broad disclaimer of reliance in this particular settlement agreement defeated the fraudulent inducement claim.

Recently, in *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of America*, 341 S.W.3d 323, 336-337 (Tex. 2011), the Supreme Court declined to extend *Schlumberger* and *Forest Oil*. Italian Cowboy, a restaurant tenant and its owners, filed suit against the landlord and the property manager for fraud, negligent misrepresentation, breach of warranty of suitability, and other clams based on the defendants' misrepresentations regarding the condition of the premises. This case involved a standard merger clause in a commercial lease. The Court differentiated the merger language found in *Schlumberger* and *Forest Oil*, which included clear and unequivocal language expressly disclaiming reliance on representations, and representing reliance on one's own judgment, from the generic merger language found in the contract at issue in this case. The Court found the contract language was not clear or unequivocal about disclaiming reliance. The provision in the lease agreement stated, "Tenant acknowledges that neither Landlord nor Landlord's agents, employees or contractors have made any representations or promises ... except as expressly set forth herein." The Court held, as a matter of law, the lease agreement at issue did not disclaim reliance, and thus did not defeat Italian Cowboy's claim for fraudulent inducement. *Id.* at 337.

In *GYM-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 914, 50 Tex. Sup. Ct. J. 634 (Tex. 2007), the Texas Supreme Court addressed whether an "as is" clause in a commercial lease prevented a tenant from suing a landlord for breach of warranty, fraud, and other claims based on the property's condition. The Court held that the "as is" clause negated the causation element which was essential to each of Gym-N-I's causes of action including fraud. *Id.* at 914.

In *Garza v. CTX Mortgage*, 285 S.W.3d 919, 927 (Tex. App.—Dallas 2009), the Dallas Court of Appeals reversed the summary judgment in favor of CTX Mortgage because their motion did not identify or offer evidence of any of the *Forest Oil or Schlumberger* factors. The Garzas contracted with Royal Custom Homes (the Builder) for the purchase of a lot and construction of a new home in DeSoto, Texas. The total contract price was $800,000 and included $70,000 for the lot and $730,000 for the construction costs. The

Garzas financed the construction by borrowing $400,000 from CTX Mortgage and using their personal funds for the remainder. In August 2005, the Garzas sued the Builder and CTX Mortgage asserting contractual and tort claims against CTX relating to the management and administration of the loan proceeds and their personal funds. CTX moved for summary judgment arguing that the Loan Agreement governed the parties' entire relationship and that it had no obligations to the Garzas apart from those contained in the Loan Agreement. CTX moved for summary judgment on the claims of fraud and misrepresentation on the ground that "as a matter of law there can be no 'oral misrepresentations,' as such a claim is precluded by the terms of the integrated agreement." *Id.* 927. The court agreed that a party's disclaimer of reliance on representations, if the intent is clear and specific, can defeat claims for fraud, fraudulent inducement, and negligent misrepresentation, because reliance is a necessary element of each of those claims. *Id.* However, the court held that based on the record, they could not conclude that the Garzas disclaimed reliance on CTX's alleged representations as a matter of law because CTX's motion for summary judgment failed to identify or offer any evidence of any of the factors enunciated in *Forest Oil* and *Schlumberger*. Consequently, the court concluded that summary judgment in favor of CTX on the Garzas' claims of fraud, fraudulent inducement, and negligent misrepresentation was improper. *Id.* In the past, Courts of Appeals have gone back and forth on this issue.[2]

c. Intent to Deceive

In *Dynegy v. Yates,* 2011 WL 646571 (Tex. App.—San Antonio, no pet.), the court concluded that the evidence was legally insufficient to support the judgment based on fraud because there was no evidence that supported a reasonable inference that Cracraft had the intent not to perform at the time she made the June 2003 oral fee agreement. Yates argued that the fraud was "in the misrepresentation that Dynegy would pay the legal bills directly to him as incurred." Dynegy argued there was "no evidence" of fraudulent inducement in connection with the June 2003 oral fee agreement because: (1) the same corporate speaker must make the promise and possess the intent not to perform for the corporation to have committed fraud; (2) subsequent events may not be used to prove intent not to perform at the time of the promise; (3) mere inferences and speculation, without more, are not evidence of fraud; and (4) Yates did not prove his actual, justifiable reliance on the misrepresentation.

Dynegy argued that there is "no 'mix and match' theory of fraud" in which one corporate actor of Dynegy could make the oral promise and another corporate actor could possess the intent not to perform. Dynegy stressed that the record contained no evidence that Cracraft made the oral promise on June 20, 2003 with a conscious intent not to perform as promised. Dynegy argued the only possible evidence of an intent not to perform by a Dynegy agent is the CEO Williamson's July 2003 statement that he had wanted to modify Dynegy's fee advancement policy for the past six months. It argued the jury's fraud finding against Dynegy cannot be supported by "mixing and matching" the oral promise by Cracraft and the intent not to perform by Williamson. *Id.* at *11. The court held that Dynegy was correct that the same corporate agent must commit all the elements of fraud before the corporation may be held liable for the fraud. Yates could not point to any actions by Cracraft herself after June 20 from which an intent not to perform the oral fee agreement may be inferred. *Id.* Yates' theory of fraud was mere inference stacking and thus could not support the verdict. *Id.* at *14.

In *Kelly v. Rio Grande Computerland Group*, 128 S.W.3d 759 (Tex. App.—El Paso 2004, no pet.), a terminated corporation president sued the corporation and new investors to the corporation for fraud, breach of contract, and other causes of action. Summary judgment was granted for defendants, and on appeal, the issue on fraud was whether a fact issue existed on intent to defraud. The defendants claimed that the representations to the president did not involve representations of past or then-existing fact, but promises of future performance. The representations included promises to make the plaintiff a director and that he would maintain his position as president. The El Paso Court of Appeals held that this was sufficient evidence to raise a fact issue, since 'a promise to act in the future is actionable if made with no intention of performing at the time the promise is made." *Id*. at 771.

In *Wedgeworth v. Christus Spohn Health Systems Corp.*, 2008 WL 963173 (Tex. App.—Corpus Christi), the Court of Appeals in Corpus Christi affirmed the summary judgment in Spohn's favor as to appellant's fraud claim. Appellant Wedgeworth, a registered nurse, was placed on administrative leave after she completed a colonoscopy without the doctor's presence or supervision pursuant to what she understood to be the hospital's delegation policy. Spohn argued that the

[2] *DRC Parts & Accessories, L.L.C. v. VM Motori*, 112 S.W.3d 854 (Tex. App. – Houston [14th Dist] 2002, pet. denied), *Shell Oil Products v. Main Street Ventures*, 90 S.W.3d 375 (Tex. App. – Dallas 2002, pet. dism'd by agr.),*Ikon Office Solutions, Inc. v. Eifert*, 125 S.W.3d 113 (Tex. App.—Houston [1st Dist.] pet. denied), *Playboy Enters., Inc. v. Editorial Caballero, S.A. De C.V.*, 202 S.W.3d 250, 258 (Tex. App. – Corpus Christi 2006, no pet. hist.).

appellant lacked any evidence that Spohn (1) falsely represented its delegation policy, (2) intended to deceive her, or (3) knew that the alleged representations regarding its policy were false. The court concluded that appellant presented no evidence of intent to deceive her in communicating the delegation policy. *Id.* at *3.

Recently, *Dana Corp. v. Microtherm, Inc.*, 2010 WL 196939 *21 (Tex. App.—Corpus Christi Jan. 21, 2010), the court reviewed Dana's challenge to the sufficiency of the evidence supporting the jury's finding of fraud. Microtherm manufactures and sells the Seisco electric tankless water heater. Microtherm bought thermistors (component parts used in its water heaters) from Dana. Microtherm filed suit against Dana for knowingly selling defective thermistors. Dana contended that there was no evidence that it made representations with the intent to deceive and with no intention of performing its contract as represented. *Id.* at *21. Moreover, Dana asserted that there was no evidence that Dana made a material misrepresentation with knowledge of its falsity, or recklessly without any knowledge of truth, with the intention that it be acted on by Microtherm. Dana also asserted that there was no evidence that Microtherm acted in reliance on any such misrepresentation and thereby suffered injury. The jury agreed with Microtherm and found that Dana committed fraud. Considering all the record evidence in a light most favorable to Microtherm, the appellate court found more than a scintilla of evidence to support the fraud finding. Thus, the court concluded that Microtherm presented legally sufficient evidence that Dana made representations with no intention of performing as represented in order to induce Microtherm into continuing to purchase thermistors from Dana.

2. Ratification

In *Fortune Production Co., et al v. Conoco, Inc.*, 52 S.W.3d 671 (Tex. 2000) the Texas Supreme Court considered the issue of how and when a party can ratify a fraudulent transaction. In *Fortune Production Co.*, several natural gas producers sued Conoco, claiming that they were defrauded into accepting a lower price for their gas due to misrepresentations made by Conoco. The jury found fraud, but also found that each of the plaintiffs had ratified the contracts with Conoco after they became aware of the fraud. The trial court did not award any damages for fraud in the judgment, but rendered judgment on an unjust enrichment finding and both sides appealed. The Court of Appeals affirmed the trial court's judgment in all respects.

The Texas Supreme Court affirmed the Court of Appeals in part and reversed in part, holding that (1) only some of the producer's claims for fraud damages were foreclosed, and (2) the evidence was legally insufficient to support the total amount of fraud damages found by the jury. *Id.* The Supreme Court distinguished some of the producer's claims from others, finding that there may be circumstances under which a party who was induced to enter a contract by fraud could ratify the contract after they learned of the fraud. *Id.* at 5. In this case, the plaintiffs who simply continued to sell gas under their existing contracts after they learned of the fraud did not waive their right to sue for damages, although they did waive the right to rescission. *Id.* at 6. However, the plaintiffs who continued to perform after the existing contracts expired did waive the right to seek damages for the post-contract period. *Id.* The Court distinguished new or executory contracts from existing contracts, stating that parties who entered into new contracts or decided to perform under executory contracts after learning of the fraud had ratified the fraud and could no longer sue for damages.

See also Cordero v. Tenet Healthcare Corp., 226 S.W.3d 747 (Tex. App.—Dallas 2007). In *Cordero*, the Dallas Court of Appeals held even though Cordero had been induced by fraud to enter into the agreement, she engaged in conduct that recognized the agreement as binding after she became aware of the fraud. Therefore, she ratified the agreement and waived any right to assert fraud as a ground to avoid the agreement. Cordero was Vice President of Human Resources for Tenet when she decided to take early retirement. Her resignation agreement provided that her stock options would continue to vest and she could exercise them during a salary continuation period in which she remained on the payroll as a consultant. Cordero continued to exercise her stock options even after learning of the corporation's allegedly illegal billing practices which caused the corporation's stock to plummet. Thus, the alleged ratifying conduct occurred after she had full knowledge of the fraud. *Id.*

3. Failure to Read a Contract

In *Amouri v. Southwest Toyota, Inc.*, 20 S.W.3d 165 (Tex. App. – Texarkana 2000, pet. denied), the Texarkana Court of Appeals reviewed a summary judgment in which plaintiff claimed that he had been fraudulently induced into signing a car lease, alleging that he was told it was an agreement to sell the car, rather than lease it. The trial court granted a summary judgment for the defendant car dealership on the grounds that the contract clearly stated it was a car lease and plaintiff was under an obligation to read and understand the agreement he had signed. The Texarkana Court reversed, holding that "the failure to read a contract will be excused where the execution of the contract has been fraudulently induced." *Id.* at 170. The affidavit of the plaintiff stating the misrepresentations and his reliance was sufficient to raise a fact issue precluding summary judgment.

Recently, in *Athey v. Mortgage Elec. Registration Sys., Inc.*, 314 S.W.3d 161, 162 (Tex. App.—Eastland 2010), review denied (Sept. 3, 2010), the court declined to extend the holding in *Amouri v. Southwest Toyota, Inc.*, 20 S.W.3d 165. In this case the Athey's sued Mortgage Electronic Registration Systems (MERS) for fraud in connection with their home equity loan. MERS filed a motion for summary judgment. The trial court granted that motion and found that the Atheys were in default on a promissory note, that MERS was the beneficiary of a deed of trust securing their note, and that MERS was entitled to proceed with nonjudicial foreclosure. Despite the clear contract language, the Atheys contended that an unnamed representative of Decision One told them at closing that the note had a fixed interest rate. The Atheys reason that, because the Decision One representative's statement induced them to sign the note, they could rely upon it even if it was contradicted by a conspicuous note provision. The court found that Atheys' evidence did not establish the trickery, artifice, or device necessary to void a promissory note. The oral representation upon which they rely is directly, clearly, and conspicuously contradicted by the note's heading and introductory paragraph. The court did not go so far as to hold that a fraudulent inducement cause of action can never lie merely because the operative oral representation is contradicted by a provision within the contract. In this instance, however, the court held that the Atheys could not reasonably rely upon an oral representation that was so plainly contradicted. The trial court did not err by granting MERS's motion for summary judgment.

4. Accountant Liability – "Reason to Expect" Intent

In *Ernst and Young & Co. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573 (Tex. 2001), the Texas Supreme Court reviewed a summary judgment on behalf of the defendant accounting company on a common law fraud claim. The defendant had submitted affidavits of accounting experts that stated that it had followed generally accepted auditing standards (GAAS) and that there was no evidence that it had made representations intending for the plaintiffs or other investors to rely on them. The trial court granted the summary judgment. On appeal, the Dallas Court reversed, holding that (1) affidavits of plaintiff's experts raised a fact issue on the GAAS standards, and (2) it was only necessary for plaintiff to prove that defendant intended that a particular class of persons rely on its representations and that plaintiff was a member of that class. *Id.* at 804. The Court cited Section 531 of the Restatement (Second) of Torts in reaching its decision:

> One who makes a fraudulent representation is subject to liability to *the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation*, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

The Court summarized Section 531 by stating that a "maker of a misrepresentation is liable if he has information that would lead a reasonable man to conclude that an especial likelihood exists that it will reach certain persons and will influence their conduct. *Id.* at 805. In this case, the evidence raised a fact issue whether Ernst and Young had "reason to expect" its representations would be relied on by investors to the company it was auditing.

The Texas Supreme Court reversed the Court of Appeals, holding that the Court of Appeals was correct on the law, but had misapplied the standards to the fact of this case. The Supreme Court agreed with the plaintiffs that Texas fraud jurisprudence was consistent with Section 531 of the Restatement, and held that the "reason to expect" standard was appropriate for Texas fraud claims. However, the Supreme Court also held that the plaintiffs had not met their burden under the expert's affidavits, because they only cited to "commonly accepted practices in the investment community," and did not specifically show that Ernst and Young had reason to expect that the plaintiffs would rely on their audit report. General industry practice may show foreseeability, but did not raise a fact issue on whether the maker of the representation had a reason to expect that it would reach people in the industry and influence their conduct. *Id.* at 581. *See also Tara Capital Partners v. Deloitte & Touche,* 2004 WL 1119947 (Tex. App. – Dallas, pet. denied)

5. Duty to Disclose

In *Bradford v. Vento*, 48 S.W.3d 749 (Tex. 2001), created doubt on whether a cause of action exists in Texas for a "partial disclosure":

> Several courts of appeals have held that a general duty to disclose information may arise in an arm's length business transaction when a party makes a partial disclosure that, although true, conveys a false impression. *See e.g.*, *Hoggett v. Brown*, 971 S.W.2d 472, 487 (Tex. App. – Houston [14th Dist.] 1997, no writ); *Ralston Purina*, 850 S.W.2d at 636. The *Restatement (Second) of Torts* section 551 also recognizes a general duty to disclose facts in a commercial setting. *Restatement (Second) of Torts* section 551 (1977). In such cases, a party does not make an affirmative misrepresentation, but what is

> said is misleading because other facts are not disclosed. We have never adopted section 551. *SmithKline Beecham*, 903 S.W.2d at 352. But even if we were to adopt such a general duty, there is no evidence to support the jury's liability finding under the submitted jury charge.

See also Samedan Oil Corp. v. Intrastate Gas Gathering, Inc., 78 S.W.3d 425 (Tex. App. – Tyler 2001, judgment vacated); *Anderson, Greenwood & Co. v. Martin*, 44 S.W.3d 200 (Tex. App. – Houston [14th Dist.] 2001, pet. denied). In *Samedan*, as discussed earlier, the Court of Appeals held that a partial disclosure could be fraud in the absence of a special relationship. In *Greenwood*, the Houston Court of Appeals held the same in regard to partial disclosure as a defense. The *Greenwood* case has an excellent discussion regarding the use of fraud as a defense to breach of contract.

In *Fleming v. Texas Coastal Bank of Pasadena*, 67 S.W.3d 459 (Tex. App.—Houston [14th Dist.] 2002, pet. denied), the 14th Court of Appeals again stated their view that a partial disclosure could be fraud in the absence of a special relationship.

In *Pellegrini v. Cliffwood-Blue Moon Joint Venture, Inc.*, 115 S.W.3d 577 (Tex. App.—Beaumont 2003, no pet.) the Beaumont Court of Appeals closely followed *Bradford v. Vento* in a case that involved a geophysicist contractor who was seeking to recover on an overriding royalty on an oil well under terms of a contract. The issue in regard to fraud was whether the defendant had the obligation to disclose prior well development that the plaintiff believed was hid from him during the negotiations. The Beaumont Court stated that the negotiations involved an arms-length transaction with experts on both sides of the contract, that the parties had an interest in identifying the prospects prior to execution of the contract, and the plaintiff could have made an investigation to protect his own interests. Given these facts, no duty arose on the part of the defendant.

In *Citizens National Bank v. Allen Rae Investments, Inc.*, 142 S.W.3d 459 (Tex. App.—Fort Worth 2004, no pet.), a borrower brought a fraud cause of action and other claims against a bank and bank officer that financed, administered, and foreclosed on a construction loan for a motel that the borrower was building. After a jury verdict for the borrower, the bank appealed. The issue regarding fraud on appeal was whether the bank had a duty to disclose to the borrower his misgivings concerning the motel franchisor and whether his statements were actionable statements of fact, as opposed to mere opinions. In discussing the law on duty to disclose, the Fort Worth Court of Appeals stated the following:

> A duty to disclose may arise in a commercial context in four situations: 1) when there is a fiduciary relationship between the parties; 2) when one voluntarily discloses information, the whole truth must be disclosed; 3) when one makes a representation, new information must be disclosed when that new information makes the earlier representation misleading or untrue; or 4) when one makes a partial disclosure and conveys a false impression.

Although the Court recognized no fiduciary duty existed, the Court still found that the banker had a duty to disclose under the second scenario ("whole truth") and that he breached that duty. In regard to the issue of fact v. opinion, the Court cited the Texas Supreme Court case of *Transp. Ins. Co. v. Faircloth*, 898 S.W.2d 269 (Tex. 1995), and analyzed the circumstances regarding the speaker's knowledge, the comparative levels of knowledge, and whether the statement related to the present or future to hold that the statements were statements of fact.

In *Playboy Enters., Inc. v. Editorial Caballero, S.A. De C.V.*, 202 S.W.3d 250, 259-260 (Tex. App.—Corpus Christi 2006, no pet. hist.), the court essentially held that *Bradford* did not preclude fraud claims based on partial disclosures. The Fifth Circuit has aptly summed up the current state of Texas law as follows: "it would be fair to say that courts after *Bradford* (including this court)…have instead continued to find that a duty to disclose can exist in Texas absent a confidential or fiduciary relationship." *United Teacher Assocs. Ins. Co. v. Union Labor Life Ins Co.*, 414 F.3d 558, 566 (5th Cir. 2005). Such duties, if they continue to exist, include duties arising from partial disclosures. Absent further clarification from the Texas Supreme Court, this remains an open question. Recent intermediate cases have held that these duties continue to exist even after *Bradford*. *See also McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007); *County of El Paso, Tex. v. Jones*, 2009 WL 4730237 (W.D. Tex. Dec. 4, 2009) (The county's allegations that the officer of company and others bribed a County Commissioner to secure her vote in their favor supported an inference of conspiracy to commit fraud by material omission).

6. Vicarious Responsibility

In *Millan v. Dean Witter Reynolds, Inc.*, 90 S.W.3d 760 (Tex. App.—San Antonio 2002, pet. denied), the San Antonio Court of Appeals reviewed a case in which a mother sued her son and the brokerage firm in which he worked, alleging conversion, fraud, breach of fiduciary duty, and other claims. The trial judge directed a verdict on the fraud claim on the issue of vicarious liability, finding that the acts in question went beyond the normal brokerage duties, including

stealing checks from his mother's bathroom drawer, writing checks on his mother's account, forging his mother's signature, and sending bogus statements to his mother. The Court of Appeals affirmed, finding that the acts were not within his general scope of authority. Justice Stone wrote a dissenting opinion, finding that the acts were not "utterly unrelated" to his duties. *Id.* at 8.

In *Zarzana v. Ashley*, 218 S.W.3d 152, 161 (Tex. App.—Houston [14th Dist.] 2007), the Houston Court of Appeals affirmed the trial court's ruling that appellee Ashley, who owned and operated Meineke Car Care #10, was not vicariously liable for their employee who allegedly sold counterfeit safety inspection stickers to customers. After having his car serviced and inspected at Meineke Car Care #10, Zarzana was arrested for possessing a counterfeit safety inspection sticker. Zarzana brought suit against Ashley for vicarious fraud for their employees conduct. The court held that Ashley conclusively established that their employee acted outside the scope of his employment and the trial court properly granted summary judgment in favor of Ashley on the claim for vicarious fraud. *Id.* at 161.

7. Agency

In *III Forks Real Estate*, the Dallas Court of Appeals affirmed the trial court's summary judgment for guarantor's wife because she did not substantially assist her husband, the guarantor, in providing an allegedly fraudulent financial statement in connection with a lease guaranty. *III Forks Real Estate, L.P. v. Cohen*, 228 S.W.3d 810, 817 (Tex. App.—Dallas 2007). III Forks claims against the wife were not based on misrepresentations by her made directly to III Forks. Instead, III Forks claimed that the wife was liable for her husband's fraud because he was her agent. The court rejected III Forks argument; thus, the wife was not held liable for her husband's alleged fraud under an agency theory. *Id.* at 817.

8. Fraud and the Single Business Enterprise Theory

In *SSP Partners* v. *Gladstrong Investments (USA) Corporation*, the Texas Supreme Court rejected the single business enterprise theory as "inconsistent" with veil piercing principles under Texas law. 275 S.W.3d 444, 456 (Tex. 2008). In reaching its decision, the court examined the historical development of the single business enterprise theory over the last twenty years. *Id.* at 450-56. The court acknowledged that during that time period, the court refrained from adopting or rejecting the single business enterprise theory as a means of imposing liability. *Id.* at 452 (citing *Southern Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87 (Tex. 2003); *National Plan Administrators, Inc. v. National Health Ins. Co.*, 235 S.W.3d 695, 704 (Tex. 2007); *PHC-Minden, L.P. v. Kimberly-Clark Corp*, 235 S.W.3d 163, 173 (Tex. 2003).

The court noted that, in all the circumstances in which the separate existence of a corporation can be disregarded, there is "an element of abuse of the corporate structure" or injustice in "holding only the corporation liable." *Id.* at 454 (citing the six factors outlined in *Castleberry*, 721 S.W.2d at 271-72). Examples of such abuse include "fraud, evasion of existing obligations, circumvention of statutes, monopolization, and criminal conduct." *Id.* at 455. Conversely, the court found that abuse and injustice are not components of the business enterprise theory. *Id*. at 451 (sharing of names, offices, accounting, employees, services, and finances are not abusive or unjust practices).

Next, the court looked to the Texas Legislature's "stricter approach to disregarding the corporate structure" in article 2.21 of the TBCA. *Id.* at 455-56. The court noted that the Texas Legislature's amendment to article 2.21 of the TBCA, restricted the ability of courts to disregard the separate existence of a corporation solely to situations where there was evidence of actual fraud. *Id.* at 451-52, 455-56. After surveying what it considered to be the appropriate methods of imposing liability by disregarding the corporate structure, the court concluded, "The single business enterprise liability theory is fundamentally inconsistent with the approach taken by the Legislature in article 2.21." *Id.* at 456. As a result, the court held that one corporation's obligations cannot be imposed on another on the theory that the corporations are part of a single business enterprise. *Id.* at 455-56.

V. TORTIOUS INTERFERENCE

A. Background

Parties to a contract may sue each other for breaching the contract and obtain the contractual benefits and possibly attorneys fees. If, however, the contract is breached or impaired because of the conduct of someone other than the contract parties, a tort cause of action may exist, allowing the damaged party to seek "tort" damages including punitive damages. This broader avenue of recovery makes the claim for tortious interference an attractive theory.

Texas recognizes a cause of action for tortious interference with a contract if the following elements can be proved: (1) the existence of a contract; (2) a willful and intentional act of interference, (3) proximate causation; and (4) actual damage or loss to the plaintiff. *Powell Industries v. Allen*, 985 S.W.2d 455 (Tex. 1998); *ACS Investors, Inc. v. McLaughlin*, 943 S.W.2d 426 (Tex. 1997); *Fluorine On Call, Ltd. v. Fluorogas Ltd.*, 380 F.3d 849, 864 (5th Cir. 2004).

Although a Plaintiff may prove all four elements, a defendant may prevail by pleading and proving a privilege or a legal justification for the interference.

Such justification may be based on the exercise of either (1) one's own legal rights or (2) a good-faith claim to a colorable legal right, even though that claim ultimately proves to be mistaken. *Prudential Insurance Company of America v. Financial Review Services, Inc.*, 29 S.W.3d 74 (Tex. 2000).

B. Specific Application

1. Parent Company and Subsidiaries

Recently, in *Cleveland Reg'l Med. Ctr., L.P. v. Celtic Properties, L.C.,* 323 S.W.3d 322 (Tex. App.—Beaumont 2010, no pet.) the court held that a parent company of a tenant had complete identity and unity of interest with tenant, its wholly-owned subsidiary, and thus, the parent company could not tortiously interfere with tenant's lease agreements with landlord. In this case, there was undisputed evidence that CRMC was a wholly owned subsidiary of CHS. The Beaumont court agreed with the courts of appeals in Houston, Corpus Christi, and Dallas, concluding that as a matter of law, a parent company cannot tortiously interfere with the contracts of its wholly owned subsidiary.

2. Intentional Interference

The defendant must take action to induce the breach of contract in order to be liable for tortious interference. A defendant must do more than enter into a contract with a party, knowing that the party had contractual obligations to another. The defendant must have interfered or persuaded the party to breach for tort liability to arise. *Davis v. HydPro* 839 S.W.2d 137 (Tex. App. – Eastland 1992, writ denied).

In an Austin Court of Appeals Case, the court affirmed a trial court's decision to enter a JNOV and render a take-nothing judgment despite the jury's award of $15,000,000. *John Paul Mitchell Systems v. Randall's Food Markets*, 17 S.W.3d 721 (Tex. App. – Austin 2000, pet. denied). The jury found that Randall's Food Markets was selling Paul Mitchell hair products and in so doing was tortiously interfering with Paul Mitchell's exclusive distribution contracts. The distributor, Jade Drug Company, sold the products to Randall's and the president of Jade testified that he knew that Paul Mitchell had contracts with various salons to sell its products exclusively through the salons. He testified that Jade was not an authorized dealer of Paul Mitchell products and that for his company to obtain the product, "somebody broke their agreement". 17 S.W.3d at 730. Despite this testimony, the Court held that:

> Here, although there is evidence that Jade purchased products when it knew of Paul Mitchell's closed distribution system, there is no evidence that Jade "induced" anyone to breach its exclusive distribution agreement with Paul Mitchell…. If one of Paul Mitchell's dealers or salons breached its obligations of its own volition, and Jade merely participated in the transaction, this does not constitute the "knowing inducement" required under Texas law to impose liability for tortious interference with Paul Mitchell's distribution network.

17 S.W.3d at 731.

Contrast this case with *Graham v. Mary Kay, Inc*., 25 S.W.3d 749 (Tex. App.—Houston [14th Dist.] 2000, pet denied) to find a successful approach to the "exclusive dealership" type case. In *Graham*, the evidence showed that Mary Kay had an exclusive distribution agreement with its sales people who agreed to sell the products exclusively at home visits to customers. The defendant Graham was obtaining Mary Kay products from these sales people and selling the products at a flea market. Mary Kay sued to obtain an injunction to stop these flea market sales. Graham contended that there was insufficient evidence of improper interference. The Court found:

> The evidence shows that Graham actively sought current Mary Kay salespersons who were willing to breach this clause in their agreement and sell their products to Graham. Graham knew of this restriction because she had been a beauty consultant, signed an agreement and was terminated for selling cosmetics at a retail location. The summary judgment evidence showed that Graham cajoled these beauty consultants into continuing to sell to her, even after they knew that dealing with Graham was in breach of their agreements. Thus, we find there was ample evidence of willful and intentional interference by Graham, that these acts were essential to Graham's conduct of her business….

25 S.W.3d at 753.

The contrast between these two cases shows that it is not enough that a Defendant knew that a contract was being breached; the defendant must be the one interfering with the contract and causing the breach. Conversely, it is not enough that the Defendant interfered with the contract. The Defendant must also ***know*** about it. *See, e.g. Mark III Sys., Inc. v. Sysco Corp.*, 2007 WL 529960, *5-6 (Tex. App. – Houston [1st Dist.] Feb. 22, 2007, no pet.) (affirming no-evidence summary judgment for Sysco; Mark III failed to present any evidence that Sysco knew about Mark III's contract with BI).

In 2003, the Austin Court of Appeals wrote again on tortious interference in *New York Life Insurance Company v. Miller*, 114. S.W.3d 114 (Tex. App.—Austin 2003, no pet.). In *New York Life*, a life insurance agent brought suit for tortious interference against another insurance agent for interfering with his contract with New York Life. After finding that New York Life had not breached its contract with the plaintiff, the Austin Court found that the evidence was insufficient to support a tortious interference finding. Since the contract was not breached, the defendant could not have "interfered" with it. *Id*. at 125.

In *Nova Consulting Group, Inc. v. Engineering Consulting Services, Ltd.*, 290 Fed. Appx. 727, 735-736 (5th Cir. 2008), the court held that there was a sufficient basis for a reasonable jury to find that ECS tortiously interfered with Nova's employment agreements. *Id.* at 736. At trial, the jury returned a verdict for Nova on their claims for misappropriation of trade secrets and tortious interference with contractual relations and awarded actual (past and future lost profits) and exemplary damages. The evidence showed that former Nova employees who were hired away by ECS were instructed by ECS's president and general counsel to disregard Nova's employment agreement which prohibited former Nova employees from using, or disclosing, any of Nova's confidential information. *Id.* at 735-736. In addition, there was evidence that every former Nova employee hired by ECS was expected to immediately begin entering all of the contact information into the ECS contact database. *Id.* Thus, the court held that a reasonable jury could find from the evidence that ECS tortiously interfered with Nova's employment agreements.

In *Downing v. Burns*, 2011 WL 3196944 (Tex. App.—Houston [14th Dist.]), Burns argued the evidence was legally insufficient to support the jury's finding the he tortuously interfered with Downing's employment. Downing was Burns' former assistant. Before resigning from her job, Downing copied four pages of the office policy and procedures manual. After discovering this, Burns told several people that Downing stole from him, and that he would sue anyone who employed her if the material was not returned.

Relying on *Sterner v. Marathon Oil Co.*, 767 S.W.2d 686 (Tex. 1989), Burns argued that since he did not "direct" Downing's subsequent employers to fire her the evidence was insufficient. The court found Burns' reliance on *Sterner* misplaced. Burns admitted to telling Downing's subsequent employer that if she did not return the allegedly stolen policy and procedures manual, then they would sue anyone that employed her. *Id.* *8. Downing's employer testified without contradiction that she fired Downing only to avoid this threatened litigation. Downing presented evidence that the termination harmed her financially. *Id.* Therefore, the court held that the trial court did not err in denying Burns' motion for JNOV as to this claim.

3. Proving Damages

The plaintiff must further prove that the tortious interference proximately caused damages. In *Richardson-Eagle, Inc. v. William M. Mercer, Inc.*, 213 S.W.3d 469 (Tex. App.—Houston [1st Dist.] 2007, pet. denied), Richardson-Eagle failed to meet this burden. Richardson-Eagle claimed that Mercer tortiously interfered with its right to recover commissions arising out of securing contracts for its clients Standard and American Heritage with the Houston Independent School District. The HISD, however, would have rejected the contract proposals, in part because Richardson-Eagle's proposed commission was too high. Instead, HISD directed Mercer to negotiate directly with Standard and American Heritage. These negotiations resulted in a standard contract with a much lower commission for Richardson-Eagle. The negotiations with American Heritage failed to result in a contract at all. The court held that HISD's rejection of Richardson-Eagle's requested commission, and not anything Mercer did, caused Richardson-Eagle to lose the commissions. *Id.* at 474-75.

Recently, in *Glattly v. Air Starter Components, Inc.* 332 S.W.3d 620, 633-34 (Tex. App.—Houston [1st Dist.] 2010), the court of appeals analyzed lost profits due to tortious interference. The amount of lost profits must be proved "by competent evidence with reasonable certainty" (quoting *Holt Atherton*, 835 S.W.2d at 84). Air Starter had the burden of "providing evidence supporting a single complete calculation of lost profits." *See id.* The court held that the evidence was insufficient to show any amount of reasonably certain lost profits, based on objective facts, figures, or data, caused by the tortious interference. *Id.* at 635. Air Starter had no evidence showing it lost any particular sales from tortious interference. Further, Air Starter's accounting expert's opinion on lost profits assumed that 100 percent of Specialized's sales would have been made by Air Starter. However, there was no evidentiary basis for that assumption. In addition, the expert based her lost profits calculation on an average of all of Air Starter's business, not the profit associated with the customers or products at issue in this case. *Id.* Thus, the court found that the evidence was insufficient to support the jury award of any amount of lost profit damages on the tortious interference claim.

4. Interference by Corporate Agent

Generally, a party cannot interfere with its own contract. *Holloway v. Skinner*, 898 S.W.2d 793 (Tex. 1995). However, when the defendant serves the dual roles of corporate agent and the third party who allegedly induces the corporation's breach, the

"interference" issue can become complicated. In that event, a plaintiff must generally prove that the corporate agent's alleged interference was in furtherance of the agent's personal interests, not the corporation's. *Id.*

This issue came up in two opinions in 2003, *Ed Rachel Foundation v. D'Unger*, 117 S.W.3d 348 (Tex. App.—Corpus Christi 2003, pet. filed) (reversed by *Ed Rachal Foundation v. D'Ungeron*, 207 S.W.3d 330 (Tex. 2006) on other grounds), and *Swank v. Sverdlin*, 121 S.W.3d 785 (Tex. App.—Houston [1st Dist.] 2003, pet. denied). In *Ed Rachel Foundation*, a former officer of a non-profit corporation brought claims against the foundation for wrongful termination, breach of contract, and brought claims against the CEO of the foundation for tortious interference. After a jury verdict for plaintiff, the foundation and CEO appealed. The issue on appeal in regard to tortious interference was two-fold: 1) whether an at-will employment agreement could be the subject of tortious interference, and 2) whether the CEO had acted "solely" in furtherance of his interests, as opposed to the corporation's interest. The Court first held that an at-will employment agreement could be the subject of tortious interference, consistent with prior precedent. *See Sterner v. Marathon Oil*, 767 S.W.2d 686 (Tex. 1990). In considering the second issue, the Corpus Christi Court focused on the foundation's view of the CEO's conduct:

> A principal is a better judge of its own best interests than a jury or court. If a principal does not complain about its agents' actions, the agent cannot be held to have acted contrary to the principal's interests.

Id. at 16.

Evidence was presented that the CEO benefited by use of a ranch and an increased salary, but the Court held that the plaintiff had to prove more than "the fact that Altheide (the defendant) had benefited personally from firing D'Unger (the plaintiff)." *Id.* at 16. The plaintiff basically had to prove that the defendant acted willfully or intentionally to serve his personal interest *at the expense of the foundation*. Further, since the foundation had not complained about the CEO's conduct, this was further evidence that the CEO had not acted contrary to its interests. *See also COC Services, Ltd. v. CompUSA*, 150 S.W.3d 654 (Tex. App.—Dallas 2004, no pet.).

In *Swank*, the First Court of Appeals in Houston faced similar issues and reached a similar conclusion. The plaintiff had sued for tortious interference on an employment agreement and claimed that several directors/investors in the corporation had interfered with his employment contract. The jury agreed, and on appeal one of the issues was whether the evidence had shown they acted "solely" in their own interests. The First Court reversed the jury finding, holding that "mixed" motives were not sufficient, and even stating that corporation complaints were not "conclusive" evidence that the agents were acting solely in their own interests. *Id*. at 17.

More recently, a federal district court applied the *Holloway* rule in another case involving allegedly mixed motives. In *Bisong v. University of Houston*, 493 F.Supp.2d 896 (S.D. Tex. 2007) (applying Texas law), Dr. Voskuil, a professor, accused Bisong of plagiarism. Bisong sued Dr. Voskuil, alleging that she had tortiously interfered with a contract between Bisong and the university. Bisong argued that personal animus motivated Dr. Voskuil's charges against her. The court rejected this argument and granted Dr. Voskuil a summary judgment. It essentially found that whatever Dr. Voskuil's personal feelings against Bisong, she brought the plagiarism claim in good faith and was also acting in the university's best interest. *Id.* at 917-918.

5. Justification as Defense

Justification is an affirmative defense to tortious interference with contract, based either on: (1) one's own legal rights; or (2) a good faith claim to a colorable legal right, even though that claim ultimately proves to be mistaken. *Tex. Beef Cattle Co. v. Green*, 921 S.W.2d 203 (Tex. 1996). In *Vingcard v. Merrimac Hospitality Systems*, 59 S.W.3d 847 (Tex. App. – Fort Worth 2001, pet. denied), the Fort Worth Court of Appeals considered the use of justification as a defense in a case in which a computer workstation manufacturer brought a tortious interference action against a buyer and another manufacturer. After a verdict in plaintiff's favor, defendant appealed on several grounds, including the failure of the jury to find justification. The Court of Appeals pointed out that the issue of whether a defendant has a legal right or colorable legal right is a question of law, which did not need to be submitted to the jury. The only issue that goes to the jury is whether there is evidence of good faith, which is after the court has concluded that no legal right exists. In this case, the Court of Appeals found that the evidence supported the jury's failure to find good faith.

In *C.M. Asfahl Agency v. Tensor, Inc., et al*, 135 S.W.3d 768 (Tex. App.—Houston [1st Dist.] 2004, no pet.), a commissioned sales agent sought to recover unpaid and continuing commissions under sales agreements with the manufacturer after the manufacturer sold the company assets to a new company, also a defendant. The case was submitted to the jury on a breach of contract theory only after the trial court directed a verdict on the tortious interference claim. Both sides appealed after a jury verdict in

plaintiff's favor. On appeal, the new company argued that it had no liability as a matter of law because it had acquired the assets of the company pursuant to the Texas Business Corporation Act and, therefore, had no liabilities that it had not expressly assumed. Without ruling on whether the plaintiff had established the elements of tortious interference, the 1st Court of Appeals ruled that justification was established as a matter of law.

In *Roof Systems, Inc. v. Johns Manville Corporation*, 130 S.W.3d 430 (Tex. App.—Houston [14th Dist.] 2004, no pet.), a roofing subcontractor for the construction of two schools brought a claim against the general contractor for breach of contract and against the manufacturer of the roofing materials for tortious interference with contract. Summary judgment was granted for the defendants. On appeal, the issue on tortious interference was whether the manufacturer was entitled to a defense of justification as a matter of law because the statements that allegedly interfered with the contract were "true." The 14th Court reviewed the Restatement (Second) of Torts and prior cases arising out of the 14th Court and held that truth could establish a defense of justification, but in this particular case a fact issue was present and summary judgment was inappropriate.

In *De Mino v. Chu*, 2005 WL 2123537 (Tex. App. – Houston [1st Dist.] 2005, pet. denied), De Mino (a nontenured lecturer) and Chu (a student) had a brief affair. After it ended, Chu complained to the university about De Mino stalking and harassing her and pressuring her to resume their relationship. De Mino subsequently sued Chu, alleging among other things that he did not receive an appointment for the next academic year because of her complaints. The court affirmed a summary judgment for Chu on her defense of justification. "Alverez Chu conclusively established, under the first alternative for proving the affirmative defense of justification, that, in stating her complaints concerning De Mino to the university officials, Alvarez was exercising the legal rights accorded her under the university's sexual harassment policy and therefore established her affirmative defense of justification as a matter of law." *Id.* at *9.

In *Worldpak Int'l, LLC v. Diablo Valley Packaging, Inc.*, 2010 WL 3657335 (E.D. Tex. Aug. 26, 2010) report and recommendation adopted, 2010 WL 3657142 (E.D. Tex. Sept. 14, 2010), WorldPak asserted that Diablo intentionally interfered with WorldPak and SMC's business relationship so that Diablo could remove and replace WorldPak from the distribution chain and purchase product directly from SMC and sell that product to Dibalo and WorldPak customers. Diablo contended that the summary judgment evidence conclusively established that any alleged interference was justified or privileged as a matter of law because he acted in the bona fide exercise of his own rights by going straight to the source, SMC, when the middleman, WorldPak was not meeting its obligations. The trial court held that Diablo had not established its justification defense as a matter of law. Diablo argued that Worldpak's claim failed "because the ongoing business relationship that is the subject of the claim of interference with a prospective business relationship cannot be one that has already been reduced to contract." The Court agreed with Diablo based on the finding that WorldPak failed to provide any evidence that there was a reasonable probability that WorldPak would have entered into another contractual or business relationship with SMC. WorldPak supplied no evidence, outside of a hearsay statement, that SMC planned to continue the exclusivity agreement with WorldPak or to renew the agreement if it had expired. The evidence simply did not rise to a level showing a "reasonable probability" that WorldPak and SMC would enter "into a business relationship."

6. Effect of Void or Unenforceable Contract

In *Long Distance International v. Telefonos de Mexico*, 18 S.W.3d 706 (Tex. App.—San Antonio 2000, rev'd on other grounds) 49 S.W.3d 347 (Tex. 2001), the Court determined that the contract in question was illegal under Mexican law, and, therefore, tortious interference was not available as a cause of action. Since the Plaintiff was suing to obtain damages for the interference with its contract to illegally provide phone service in Mexico, the Court concluded that

> [a] contract made with a view of violating the laws of another country, though not otherwise obnoxious to the laws either of the forum or of the place where the contract was made, is illegal and will not be enforced.

18 S.W.3d at 713. This is consistent with the general rule that a contract that is void cannot be the basis for a claim for tortious interference. *Juliette Fowler Homes v. Welch Associates*, 793 S.W.2d 660 (Tex. 1990). On appeal, the Supreme Court reversed on the ground the contract was not illegal under Mexican law.

In *COC Services, Ltd. V. Compusa, Inc., et al*, 150 S.W.3d 654 (Tex. App.—Dallas 2004, no pet.), the plaintiff brought a breach of contract action and a tortious interference action under a proposed master franchise agreement against the contemplated franchisor (CompUSA) and a subsequent purchaser of the contemplated franchisor (Carso parties). The plaintiff claimed that they had partially performed under the franchise agreement and it was enforceable. After a jury verdict in plaintiff's favor, defendants appealed on multiple grounds. The Court found that no enforceable contract existed between the parties, so that no tortious interference was possible. *See also*

Overton v. Bengel, 139 S.W.3d 754 (Tex. App.—Texarkana 2004, no pet.). *But cf. The York Group, Inc. v. Horizon Casket Group, Inc.*, 2007 WL 2120419 (S.D. Tex. Jul. 10, 2007) (applying Texas law) (holding that York could base a tortious interference claim on Horizon's interference with an unenforceable "best efforts" clause in York's distribution agreements.).

7. Interference with Prospective Contracts

Although the Texas Supreme Court has repeatedly affirmed that a claim for tortious interference requires proof of the "existence of a contract," the courts of appeal have, in the past, expanded this cause of action to include tortious interference with prospective contracts. *See Milam v. National Insurance Crime Bureau*, 989 S.W.2d 126 (Tex. App. – San Antonio 1999, no pet.); *Bradford v. Vento*, 997 S.W.2d 713 (Tex. App. – Corpus Christi 1999, aff'd in part, rev'd in part, 48 S.W.3d 749 Tex. 2001).

Creating some speculation about the long term future of this cause of action, the Texas Supreme Court noted in *Prudential*:

> We have never enumerated the elements of a cause of action for tortious interference with prospective contracts, although we have concluded that justification is an affirmative defense to tortious interference with prospective business relations as well as to tortious interference with an existing contract. (Citing *Calvillo v. Gonzalez*, 922 S.W.2d 928, 929 (Tex. 1996).

Prudential, 29 S.W.3d at 78.

The Court declined to address the point because neither the parties nor the courts had addressed the issue.

In *Wal-Mart v. Sturges*, 52 S.W.3d 711 (Tex. 2001), the Texas Supreme Court again addressed tortious interference with prospective relations with the express intent of bringing "some measure of clarity to this body of law." *Id.* at 713. However, the Supreme Court still did not identify the specific elements of the cause of action. In *Wal-Mart*, the Supreme Court reviewed a case in which the plaintiffs sued for tortious interference with prospective relations, claiming that *Wal-Mart* interfered with their contract to purchase some real estate next to one of the *Wal-Mart* stores. The Supreme Court looked at the historical development of the interference tort in Texas and other jurisdictions and reached the conclusion that plaintiff must prove that it was harmed by conduct that was either independently tortious or unlawful. The plaintiff is not required to prove an independent tort; intead, the plaintiff need only establish that the defendant's conduct would be actionable under a recognized tort. *Id.* at 726. The Supreme Court stated that conduct that is merely "sharp" or "unfair" cannot be the basis for the action, specifically disapproving a line of cases in Texas such as *Light v. Transport Ins. Co.*, 469 S.W.2d 433 (Tex. Civ. App. – Tyler 1971, writ ref'd n.r.e.). In regard to justification as a defense, the Court held that the concept was "subsumed" in plaintiff's proof, and was only a defense to the extent that it is a defense to the "tortiousness of the defendant's conduct." "Justification and privilege are not useful concepts" in assessing interference with prospective relations. *Id.* at 727.

In *Baty v. Protech Insurance Agency*, 63 S.W.3d 841 (Tex. App. – Houston [14th Dist.] 2001, pet. denied), the Houston 14th Court of Appeals had a chance to apply the Supreme Court's opinion in *Wal-Mart*. In *Baty*, the plaintiffs brought suit for tortious interference against the two of their former officers who had formed a competing business, along with four insurance companies who were former clients. The trial court granted summary judgment for the insurance companies. On appeal, the Houston Court of Appeals considered *Wal-Mart* and how it fit within the context of the defendants' summary judgments. The Court set out what it considered the elements of the cause of action to be in light of *Wal-Mart*:

> In light of *Sturges* and *Bradford*, the elements of a claim for tortious interference with a prospective business relationship appear to be: (1) a reasonable probability that the plaintiff would have entered into a business relationship; (2) an independently tortious or unlawful act by the defendant that prevented the relationship from occurring; (3) the defendant did such act with a conscious desire to prevent the relationship from occurring or the defendant knew the interference was certain or substantially certain to occur as a result of the conduct; and (4) the plaintiff suffered actual harm or damages as a result of the defendant's interference. *Ash v. Hack Branch Distrib. Co.*, 54 S.W.3d 401, 414-15 (Tex. App. – Waco 2001, pet. denied).

The Court of Appeals then found that, using the new standard, three of the four insurance companies had not "intentionally" prevented the formation of the relationships and, therefore, summary judgment was proper. In regard to the fourth, the court reversed on procedural grounds, finding that its summary judgment had not raised the issues properly. *See also Axcess Broadast Servs., Inc. v. Donnini Films*, 2006 WL 2679982, *5-6 n.6 (N.D. Tex. Sept. 18, 2006) (applying Texas law) (listing essentially these same

elements); *Texas Disposal Sys. Landfill, Inc. v. Waste Management Holdings, Inc.*, 219 S.W.3d 563, 590 (Tex. App. – Austin 2007, pet. filed) (same, but adding that the plaintiff must show that the interference was not privileged or justified).

The case of *Suprise v. Dekock*, 84 S.W. 3d 378, 379 (Tex. App.—Corpus Christi 2002, no pet.), illustrates a practical litigation tip regarding pleadings in a cause of action for tortious interference with prospective contract. This case involved a group of hunters who owned a hunting property and brought suit against neighboring land owners for alleged tortious interference with use and enjoyment of land. *Id*. The trial court granted the neighboring owners summary judgment, and the hunters appealed. *Id*. The issue on appeal was whether the hunters had failed to state a claim for tortious interference when they did not specifically mention the terms "prospective contract" or "business relationship" in their pleadings. *Id*. at 380. The hunters did specifically mention in their pleadings that the neighboring owners had interfered with their efforts to the sell the property by posting signs and calling prospective buyers. *Id*. at 381. Accordingly, the court said, the hunters did sufficiently state a claim for tortious interference with prospective contract because the wording of the petition made apparent the gist of the complaint. *Id*. at 382.

A case decided by the Corpus Christi Court of Appeals in 2002 addressed the issue of what constituted an "independent tort" such that it would form the basis of a claim for tortious interference with prospective business relationship. *See Allied Capital Corporation v. Cravens*, 67 S.W. 3d 486 (Tex. App. – Corpus Christi 2002, no pet.). In *Allied*, the Cravens owned two properties secured by a deed of trust and were late in their note payments, resulting in foreclosure proceedings. *Id*. at 488. Allied advertised the foreclosure sale and the Cravens obtained a temporary restraining order. *Id*. In support of their motion, the Cravens presented testimony that a prospective purchaser was deterred by the advertising. On appeal, Allied argued that the trial court erred in granting the TRO because movants failed to show a likelihood of success on the merits. *Id*. Specifically, Allied contends that the Cravens would not win at trial because their actions in advertising the foreclosure are not an independent tortious act or a violation of law which would allow recovery for tortious interference. *Id*. at 489. The Court of Appeals agreed, holding that because the Cravens did not assert any independent cause of action such as fraud, but rather, asserted that the conduct was unfair because it provided detailed foreclosure information only to a few people before the sale was posted.

Several cases have elaborated further on what constitutes a prerequisite independent tort under *Sturges*. In *Renewdata Corp. v. Strickler*, 2006 WL 504998, *10-11 (Tex. App. – Austin Mar. 3, 2006, no pet.), the court held that a breach of fiduciary duty claim was an independent tort that could support a claim for tortious interference with a prospective business relationship. In *Video Ocean Group LLC v. Balaji Management Inc.*, 2006 WL 964565, *6 (S.D. Tex. Apr. 12, 2006), the court listed additional examples, including fraudulent statements to a third person, threatening a person with physical harm if he does business with the plaintiff, and engaging in an illegal boycott. In *CSTM Corp. v. AM General LLC*, 2005 WL 1923605, *4 (S.D. Tex. Aug. 10, 2005), the court held that neither quantum meruit, promissory estoppel, nor unjust enrichment qualified as independent torts under *Sturges.* I*n Astoria Industries of Iowa, Inc. v. SNF, Inc.*, 223 S.W.3d 616 (Tex. App. – Fort Worth 2007 pet. filed), the independent tort was misappropriating Brand FX's trade secrets. This misappropriation allegedly enabled Astoria to compete more effectively against Brand FX. In *Labor v. Warren, M.D.*, 268 S.W.3d 273, 278 (Tex. App.—Amarillo 2008, no pet.), the court held that because Labor did not appeal the summary judgment rulings or jury findings that Warren did not defame him, there was no requisite independent tortious or unlawful act to support his tortious interference claim.

In addition to showing an independent tort or unlawful act, a plaintiff must prove that a "reasonable probability" existed that the prospective business relationship would have otherwise resulted. In *Axcess Broadcast Services*, Donnini Films had sent letters to some of Axcess's former clients. These letters essentially warned that using certain Axcess videos might infringe Donnilli's copyrights. Axcess alleged that these letters tortiously interfered with its prospective business relationships with these former clients. Axcess alleged that it expected its past relationships to lead to additional future business with these clients. The court held that this was not enough. Such evidence showed only a "mere possibility," not a reasonable probability, that the alleged tortious interference prevented plaintiff from establishing business relationships. 2007 WL 2679982, *6.

In *SP Midtown, Ltd. v. Urban Storage, L.P.*, 2008 WL 1991747 (Tex. App.—Houston [14th Dist.]), review denied (Oct 03, 2008), the court held that mere phone calls from potential customers did not reach the level of a reasonable probability. *Id.* at *9. In this case, Space Place relied on evidence that phone calls from people inquiring about its business were diverted to a competitor and that Space Place suffered a significant drop in business as a result. The court found it was not reasonably probable that, considering all the facts and circumstances, that Space Place would have entered into a business relationship with those callers. *Id.* Therefore, the trial court did not err in granting summary judgment on this cause of action.

In *Smith v. Royal Seating, Ltd*, the court held that a claim for tortious interference with a prospective business relationship does not necessarily require a direct contractual relationship. *Smith v. Royal Seating, Ltd*, 2009 WL 3682644 *5 (Tex. App.—Austin 2009, no pet.). The court held that Royal Seating, a distributor in a sales transaction with three churches, was not required to prove the existence of a prospective *direct* sale between Royal and the churches to satisfy the element of a reasonable probability of a business relationship element of their claim against Smith. *Id.* at *5 (emphasis added).

In *Faucette v. Chantos*, 322 S.W.3d (Tex. App.—Houston [14th Dist.] 2010), the court held that Chantos' claim was for tortious interference with prospective relations rather than with existing contracts and Chantos did not demonstrate that Faucette engaged in an independently tortious or unlawful act that interfered with its business relation, as required to support his tortious interference with prospective relations claim. Chantos did not allege or show that Faucette induced two customers to breach their contracts with Chantos. *Id.* 915. Chantos' real complaint on appeal was the loss of the continuing business relationship with two of its most profitable customers, which had existed for over twenty years. *Id.*

8. Statute of Limitations

The two-year statute of limitations applies to claims for tortious interference with a contract. V.T.C.A., Civil Practice & Remedies Code § 16.003(a). The determination of when a cause of action accrues is a question of law for statute of limitations purposes. A cause of action for tortious interference with prospective business relations accrues when "existing negotiations which are reasonably certain of resulting in a contract, are interfered with such that the negotiations terminate and harm to the plaintiff results." *Hill v. Heritage Res., Inc.*, 964 S.W.2d 89, 116 (Tex. App.—El Paso, 1997, pet. denied).

In *Burke v. Union Pacific Resources Company, et al*, 138 S.W.3d 46 (Tex. App.—Texarkana 2004, pet. filed), an owner of a feedlot brought suit against a seismic company and a water well drilling company after the blasting from the seismic ruined his water well and killed many of his cattle. The water well drilling company cross claimed against the seismic company for tortious interference with its contract with plaintiffs. On appeal, one of the issues before the Texarkana Court of Appeals was the statute of limitations. The jury found, in response to a "discovery rule" jury question, that the owners of the feedlot knew or should have known of the damage on January 1, 1998. The cross claim was filed on August 28, 2000, more than two years after the date found by the jury. The water well company argued that tortious interference should be governed under the residual statute of limitations, Section 16.051, which provides for four years, instead of 16.003, which provides for two years. The Texarkana Court responded as follows:

> In *Dickson Construction, Inc.*, this court noted that the Texas Supreme Court may have erred in *First National Bank of Eagle Pass v. Levine. Dickson Constr., Inc.*, 960 S.W.2d at 849; *see First Nat'l Bank of Eagle Pass v. Levine*, 721 S.W.2d 287, 289 (Tex. 1986) (holding that tortious interference with business relations was within the meaning of trespass in Section 16.003). In our opinion, we criticized the Texas Supreme Court's interpretation of the statute to require a tortious interference cause of action to be brought within two years. *Dickson Constr., Inc.*, 960 S.W.2d at 849. As we held in *Dickson Construction*, we adhere to the application of Section 16.003 to tortious interference claims until the Texas Supreme Court changes its interpretation.

No other courts of appeal have followed the Texarkana Court's lead on this issue. *See, e.g., Texas Disposal Sys Landfill*, 219 S.W.3d 563, 586 (Tex. App.—Austin 2007, pet. denied) (noting simply that the statute of limitations is two years for tortious interference claims).

VI. COVENANTS NOT TO COMPETE

A. Background

The Texas Supreme Court in 1987 created new precedent by holding that "covenants not to compete which are primarily designed to limit competition or restrain the right to engage in a common calling are not enforceable." *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 172 (Tex. 1987). This common law holding was soon contravened by Texas statute when the legislature passed the Covenant Not to Compete Act in 1989. This legislation was amended in 1993 and 1999 and now allows the enforceability of covenants not to compete under certain circumstances. TEX. BUS. & COM. CODE 15.50 (Vernon's 2000). Section (a) provides the general rule and Section (b) provides statutory provisions specific to physicians. The general rule is as follows:

> (a) Notwithstanding Section 15.05 of this code, and subject to any applicable provision of Subsection (b) a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area and scope of activity to be restrained that are reasonable and do not impose a

> greater restraint than is necessary to protect the goodwill or other business interest of the promisee.

Procedures and remedies are set out in TEX. BUS. & COM. CODE §15.51 (Vernon's 2000). This statutory provision allows monetary damages, injunctive relief, or both. TEX. BUS. & COM. CODE 15.51(a). The statute also allows the court to reform a contract to limit the time, geographical area or scope of activity that are restrained by a covenant not to compete.

The statutory scheme provides that it is the exclusive mechanism for determining the enforceability of covenants not to compete and that the statutory remedies are the only ones allowed by law. This preemption provision was added in 1993. TEX. BUS. & COM. CODE §15.52 (Vernon's 2000). Prior to the 1993 amendment, the courts were presumably allowed to rely on the common law theories in addition to the statutory provisions. After 1993, the statutory language became the starting and ending point for analysis of such contractual provisions.

B. The Texas Supreme Court's Evolving Acknowledgement of the Statutory Scheme

The Texas Supreme Court has been clarifying and fine-tuning the requirements of the statutory scheme for the past two decades. The Court identified two initial inquiries required by the language of Section 15.50. These are as follows:

(a) Is there an otherwise enforceable agreement, to which
(b) The covenant not to compete is ancillary to or a part of at the time the agreement is made.

Light, 883 S.W.2d at 644. In the *Light* case, the Court was presented with an employee contract that provided at-will employment for Ms. Light to sell cellular phones for the Centel company. The Court acknowledged that as a general rule an at-will contract would not provide an otherwise enforceable agreement but noted that "at-will employees may contract with their employers on any matter except those which would limit the ability of either the employer or employee to terminate the employment at will." Reviewing the contract in this case the Court found that Centel had agreed to provide Ms. Light with specialized training and that this obligation was enforceable even if they fired her. Furthermore, they found that Ms. Light had agreed to give 14 days' notice before she terminated her employment and subject to such termination, she further agreed to provide an inventory of her employer's property in her possession. These agreements, the court deemed to be enforceable agreements.

Addressing the second part of the statutory test, the Court determined that a covenant not to compete is not ancillary to a contract unless it is designed to enforce a contractual obligation of one of the parties. The Court set out a two part test which says that in order for a covenant not to compete to be ancillary to an otherwise enforceable agreement between employer and employee:

(1) the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interest in restraining the employee from competing; and
(2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement.

Light, 883 S.W.2d at 647. This two part test seems to require some nexus between the enforceable agreement and the necessity of the restraint of trade. In the *Light* case, the Court determined that the promises of 14 day notice and an inventory did not have any connection to the covenant not to compete. Therefore, the covenant was not designed to enforce the employee's consideration in the otherwise enforceable agreement.

The Texas Supreme Court reaffirmed its prior holding that the enforceability of a covenant not to compete, including the question of whether a covenant not to compete is a reasonable restraint of trade, is a question of law for the court. (Citing *Martin v. Credit Protection Ass'n*, 793 S.W.2d 667 (Tex. 1990).

The Texas Supreme Court overruled part of the *Light* case in *Alex Sheshunoff Management Services, L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006). In *Sheshunoff* the Court overruled a footnote in *Light* to the effect that a unilateral contract could not comply with the Act because it was not enforceable at the time it was made. *Id.* at 650-51. Instead, such a contract complies with the Act once it becomes enforceable by performance. *Id.* at 651. "[I]f, as in the pending case, the employer's consideration is provided by performance and becomes non-illusory at that point, and the agreement in issue is otherwise enforceable under the Act, we see no reason to hold that the covenant fails." *Id.* As the Court stated, "We now conclude, contrary to *Light*, that the covenant need only be 'ancillary to or part of' the agreement at the time the agreement was made. Accordingly, a unilateral contract formed when the employer performs a promise that was illusory when made can satisfy the requirements of the Act." *Id.*

In 2009, the Texas Supreme Court again revisited *Light* in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 848-49 (Tex. 2009), this time, although not overturning *Light per se*, nevertheless seems to have returned the law to the pre-

Light era. The Court concluded that a non-compete agreement is enforceable if the nature of the contemplated employment will reasonably require the employer to furnish the employee with confidential information because, in such an instance, an employer impliedly promises to provide confidential information. *Id.* at 850.

Mann Frankfort was an accounting and consulting firm. Fielding was hired as a CPA in 1992 as a staff accountant in the tax department. Fielding resigned in 1995, but was rehired later that year. A condition of being rehired was that Fielding was required to sign an "at will" employment agreement that included a "client purchase provision": If at any time within one (1) year after the termination or expiration hereof, Employee directly or indirectly performs accounting services for remuneration for any party who is a client of Employer during the term of this Agreement, Employee shall immediately purchase from Employer and Employer shall sell to employee that portion of Employer's business associated with each such client. The agreement defined the types of "business" Fielding would purchase and the purchase price. The agreement also contained a non-disclosure provision. Fielding further signed a limited partnership agreement that contained a similar "client purchase provision."

The Houston Court of Appeals held that the "client purchase provision" was an unenforceable covenant-not-to-compete because it was not ancillary to an "otherwise enforceable agreement, as required by TEX. BUS. & COMM. CODE § 15.50(a). The Houston Court reasoned that Mann Frankfort had failed to provide any consideration to support that covenant because it had made no promise to provide Fielding access to confidential information, citing *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson* and *Light v. Centel Cellular Co. of Tex.* and because Fielding never acknowledged that he had received or would receive confidential information. The Houston Court reasoned that there was no implied promise by Mann Frankfort to disclose confidential information to Fielding.

The Court explained that the present case differed from *Sheshunoff* because Mann Frankfort had made no express promise to provide Fielding with access to confidential information. Fielding however, had promised not to disclose confidential information. The Supreme Court rejected the Houston's Court's rationale, and held that "[w]hen the nature of the work the employee is hired to perform requires confidential information to be provided for the work to be performed by the employee, the employer impliedly promises confidential information will be provided."
The Court further explained that "[r]egardless of whether a contract is based on express or implied promises, mutual assent must be present.… In the case of an implied contract, however, mutual assent is inferred from the circumstances." Furthermore, according to the Court, "if one party makes an express promise that cannot reasonably be performed absent some type of performance by the other party, courts may imply a return promise so the dealings of the parties can be construed to mean something rather than nothing at all." "In other words," the Court explained, "when it is clear that performance expressly promised by one party is such that another party must act, the law will deem the second party to have impliedly promised to perform the necessary action." The Court reasoned that the circumstances of Fielding's employment indicated that his employment necessarily involved access to confidential information – *i.e.*, Mann Frankfort's client database which contained clients' names, billing information, and tax and financial information. The Court also noted that Mann Frankfort's summary judgment evidence indicated that it had provided Fielding with confidential information on the first day of his work in 1995, or shortly thereafter. Further, the Court reasoned, Fielding could not have fulfilled his promise to refrain from disclosing confidential information unless Mann Frankfort had provided the same.

The Supreme Court further discussed the holding in *Light* in *Marsh USA Inc. v. Cook*, 2011 WL 2517019 *9-12 (Tex. 2011). After a detailed exposition of how the Texas Covenants Not to Compete Act's purpose was to expand rather than restrict the enforceability of non-competes, the Court held that § 15.50's requirement that a covenant be "ancillary" to an otherwise enforceable agreement simply means that it must be "supplementary" to that agreement, and that the consideration given by the company in the otherwise enforceable agreement need not "give rise" to the interest in restraining the individual from competing, but need only be "reasonably related" to that interest. *Id.* *3-4, 8-9. In other words, § 15.50's 'ancillary' requirement is satisfied when there is a "nexus between the otherwise valid transaction and the interest worthy of protection . . . ." *Id*. at *9.

In this case MMC filed suit against Cook, a former employee and his new employer, alleging breach of non-solicitation agreement. Cook filed a motion for partial summary judgment, on the ground that agreement was unenforceable. MMC contended that the consideration provided by it, the transfer of stock in return for Cook's covenant not to compete, was sufficient to render the covenant enforceable under Texas law. The trial court and the court of appeals held that the non-solicitation agreement Cook signed in exchange for receipt of stock options was not enforceable. Citing *Light*, the trial court and the court of appeals held that Texas law required that the consideration provided by an employer *give rise* to the company's interest in restraining competition.

The Supreme Court held that adding more stringent requirements on top of those in the Act was

unnecessary to prevent naked restraints on trade and would thwart the Legislature's attempt to enforce reasonable covenants under the Act. Further, consideration for a noncompete that is reasonably related to an interest worthy of protection, such as trade secrets, confidential information or goodwill, satisfied the statutory nexus. Cook's exercise of the stock options to purchase MMC stock at a discounted price provided a reasonable nexus between the noncompete and the company's interest in protecting its goodwill. *Id.* *9. Thus, the non-solicitation was ancillary to an otherwise enforceable agreement.

The Court also addressed whether a timing requirement existed. Marsh argued that the court of appeals imposed a new timing requirement, where the employer's interest in restraining the employee cannot exist before the employer's consideration is given. The Court found this requirement inconsistent with the ruling in *Sheshunoff. Id.* at *12. The Court held there is no requirement under Texas law that an employee receive consideration for the noncompete agreement prior to the time the employer's interest in protecting its goodwill arises. *Id.*

C. Specific Application

1. Whether the Promise is Illusory and Whether the Covenant is Ancillary to an "Otherwise Enforceable Agreement"

Several appellate courts have had the opportunity to apply the newer Supreme Court cases. In *York v. Hair Club For Men, L.L.C.*, 2009 WL 1840813 *4 **(**Tex. App.—Houston [1st Dist.], June 25, 2009), the Houston court of appeals held that the trial court did not abuse its discretion in granting Hair Club for Men a temporary injunction prohibiting stylists, York and Reynolds, formerly employed by the company and now working for a competitor, and the competitor from soliciting the company's clients. Hair Club provided client names and limited client information to York and Reynolds, as it was necessary for their work as stylists. The testimony of Hair Club's CEO, Darryl Porter, established that Hair Club invested significant amounts of money in generating clients, thus supporting the trial court's finding that Hair Club had an interest in keeping its client information confidential. York and Reynolds could not have acted on their promises not to disclose confidential information unless Hair Club actually provided them with it, sufficient to find that an implied promise existed. Under Section 15.50(a), the non-compete agreement must be "ancillary to or part of" an otherwise enforceable agreement, meaning that (1) the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interest in restraining the employee from competing, and (2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement. (quoting Tex. Bus. & Com.Code Ann. § 15.50(a)). Applying *Mann Frankfort*, the court found that an employer's implied promise of access to confidential information satisfied the first requirement because the promise and provision of confidential information generates the employer's interest in preventing the later disclosure of such information. The employee's promise not to disclose confidential information satisfied the second requirement. The court held that the non-solicitation and non-disclosure agreements were enforceable, and thus Hair Club had a probable right to relief under them. The trial court therefore did not abuse its discretion in granting a temporary injunction on this ground.

The holding in *Mann Franfort* makes the holdings in several of the cases decided under the *Shesunoff* standard uncertain. For example, in *TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29 (Tex. App. – Houston 2005, no pet.) which was decided under the *Shesunoff* standard, the court concluded that because "there was no contemporaneous exchange of consideration for the contract – the confidential information was not provided close to the time that the agreement was made – Champions' promise was illusory and, thus, could not be the basis of an otherwise enforceable contract ancillary to the covenant." The court affirmed the trial court's refusal to enforce a non-compete clause in an employment contract. Gray, the employee, was employed at will. TMC promised to give Gray confidential information in consideration for the non-compete clause. However, Gray did not receive this information for over a year. Under *Shesunoff*, the court found former employer's promise to provide confidential information was illusory, and thus was not an otherwise enforceable contract necessary for a valid non-compete covenant.

The *Shesunoff* case did not otherwise affect the requirement that the covenant not to compete be ancillary to an otherwise enforceable agreement. In *31-W Insulation Co., Inc. v. Dickey*, 144 S.W.3d 153 (Tex. App. – Fort Worth 2004, no pet.), the court held that the employer's promises to give the employee two weeks' notice of termination and to compensate him during that two week period were not promises that "give rise to an interest worthy of protection by a covenant not to compete." *Id*. at 159. Thus, the court held that the noncompete agreement was not ancillary to or part of an otherwise enforceable agreement and was therefore not enforceable. *Id.*

Even prior to *Shesunoff*, courts were applying its holding in cases not involving at-will employees. For example, in *Pearson v. Visual Innovations Co., Inc.* 2006 WL 903736 (Tex. App.—Austin 2006, no pet. hist.), an employment agreement provided that Visual Innovations would not terminate Person for six months

unless it determined that his performance was unsatisfactory. This determination was at Visual Innovation's "sole discretion." The agreement further provided that Visual Innovations would provide Pearson with confidential information, specialized training, stock options, and other consideration. And it included a non-compete provision. The Court held that the non-compete provision was enforceable and rejected Pearson's argument that he was merely an at-will employee. *See id.* at *4-5. In addition, the other consideration given to Pearson, including confidential information, "gave rise to the employer's interest in restraining the employee from competing…" *Id.* at 5 (citations omitted).

2. Scope and Reasonableness of a Covenant not to Compete

The *Sheshunoff* court further emphasized that "the statute's core inquiry is whether the covenant 'contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.'" 209 S.W.2d 644, 655.

In *Wood v. Reserve First Partners, Ltd.*, 2007 WL 2199901 (Tex. App.—Beaumont 2007), the court affirmed a summary judgment enforcing a covenant not to compete. Wood's employment agreement acknowledged and stipulated that the restrictions were reasonable. He testified that he agreed to these restrictions as part of signing his employment agreement. He did not otherwise challenge their reasonableness. *See id.* at *4.

The Houston Court in *Curtis v. Ziff Energy Group, supra*, enforced a covenant that restricted the employee from working for any oil and gas company in North America. 12 S.W.3d at 118. The Court noted the general rule:

> Generally, a reasonable area for purposes of a covenant not to compete is considered to be the territory in which the employee worked while in the employment of his employer. (Citing *Zep. Mfg. Co. v. Harthcock*, 824 S.W.2d 654 (Tex. App. – Dallas 1992, no writ).

The Court relied on Mr. Curtis' job description, which stated that he was the Vice President of Pipelines and Energy Marketing, hired to build up the U.S. practice.

Note that the non-solicitation (of customers) and non-disclosure (of confidential information) may effectively amount to covenants not to compete and therefore be subject to the Act. *See, e.g., Oxford Global Resources, Inc. v. Weekley Cessnum*, 2005 WL 350580, *4 (N.D. Tex. Feb. 8, 2005) ("Provisions restricting solicitation of former employees and customers restrain trade and constitute covenants not to compete.").

The court in *Rimkus Consulting Group, Inc. v. Cammarata*, 255 F.R.D. 417, 436, 28 IER Cases 345 (S.D. Tex. 2008), held that an employment agreement that covered multiple counties in Texas, Mississippi, Alabama, and Florida was broader in geographical scope than necessary to protect Rimkus's legitimate business interest when Cammarata worked primarily in Louisiana while employed by Rimkus. This case also involved a nonsolicitation covenant. Texas courts have held that nonsolicitation covenants that apply to clients with whom the employee had no contact while working for the employer are overbroad and not reasonably necessary to protect the employer's legitimate business interest in maintaining its client. base. *See Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 387-88 (Tex. 1981). In *Rimkus* the covenant not to solicit applied to all of Rimkus customers. The record showed that Cammarata solicited few clients and solicited no Rimkus employees outside of Louisiana. *Id.* at *23. Thus, the court held the covenant was broader than necessary and was unenforceable. *Id.*

Similarly, in *Cobb v. Caye Publishing Group, Inc.*, 322 S.W.3d 780, 784, 786 (Tex. App.—Fort Worth 2010), the court found the noncompete covenant overbroad and unenforceable because the geographical scope included areas where Cobb never worked for Caye Publishing. During his employment with Caye, Cobb only worked in Johnson County. However, Caye argued that it was reasonable to include Aledo and Weatherford in the geographical scope of the covenant not to compete because Caye had already targeted Parker County for expansion by the time Cobb resigned. *Id.* As an issue of first impression, the court held that a reasonable geographical limitation of parties' covenant not to compete could not include areas where Cobb never worked for Caye, but where Caye intended to distribute publications at some point in the future. *Id.* at 784. The court of appeals found that the trial court abused its discretion by determining for purposes of the temporary injunction that Caye had a probable right to recover for breach of a covenant not to compete in a geographical area that included Aledo and Weatherford. *Id.* at 786. Therefore, the court modified the geographical area to include only Johnson County. The court held that a geographical limitation which included areas where an employer did not currently operate, but had targeted for future potential expansion was unreasonable. *Id.*

3. Attorneys' Fees

In *Gage Van Horn & Assoc. v. Tatom*, 26 S.W.3d 730 (Tex. App. – Eastland 2000, pet. denied), the employee filed a declaratory judgment action to void a covenant not to compete. The trial court voided the

covenant and awarded the employee attorneys' fees under the declaratory judgment statute. The employer cited the preemption provision in the Covenant Not to Compete Act, and argued that the court should provide attorneys' fees exclusively under the Act. The employer believed that the statutory language in the Covenant Not to Compete Act required the employee to meet a higher standard of proof because the statute requires an ex-employee to show that:

> [t]he promisee knew at the time of the execution of the agreement that the covenant did not contain limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and the limitations imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee, and the promisee sought to enforce the covenant to a greater extent than was necessary to protect the goodwill or other business interest of the promisee.

TEX. BUS. & COM. CODE 15.51.

The court held that this statutory provision did not apply because the preemption clause specifically stated that the Act is the exclusive procedure in "an action to *enforce* a covenant not to compete under the common law or otherwise." *Id*. at 732. The court reasoned that the employee did not bring his lawsuit to *enforce* a covenant not to compete. Therefore, the declaratory judgment act applied instead, and the employee who successfully voided the covenant was entitled to "reasonable and necessary" attorneys' fees as are equitable and just." *Id*. (citing TEX. CIV. PRAC. & REM. CODE §37.009). In *Perez v. Texas Disposal Systems, Inc.*, 103 S.W.3d 591, 594 (Tex. App. – San Antonio 2003, pet. denied), the court held that the Covenant Not to Compete Act controlled the award of attorneys' fees, and that Section 15.52 preempts an award of fees under any other law. The court held that a plaintiff's entitlement to attorneys' fees, if any, is controlled by Section 15.51 of the Act. Because the court of appeals had already held that the plaintiff was not entitled to fees under Section 15.51, court of appeals held the trial court erred in awarding the plaintiff fees under Texas Civil Practice & Remedies Code §38.001(8).

Citing *Perez*, the Houston court of appeal held in *Glattly v. Air Starter Components, Inc.*, 332 S.W.3d 620, 645 (Tex. App.—Houston [1st Dist.] 2010), the trial court properly denied Air Starter's requests for attorney's fees because the Covenants Not to Compete Act does not permit employers to recover their attorney's fees in suits to enforce their rights under the Act.

4. Injunctive Relief

Several courts have now held that the Covenant Not to Compete Act, Tex. Bus. & Com. Code Ann §§15.50-15.52, does not preempt the common law relating to temporary injunctions. *See e.g. EMSL Analytical, Inc. v. Yonker*, 154 S.W.3d 693 (Tex. App. – Houston [14th Dist.] 2004, no pet.) (December 7, 2004); *Wright v. Sport Supply Group, Inc.*, 137 S.W. 3d 289, 293 n. 1 (Tex. App. – Beaumont 2004, no pet.); *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 239 (Tex. App. – Houston [1st Dist.] 2003, no pet.) (en banc) ("Because section 15.51 (a) does not govern preliminary relief, it does not preempt the law that generally applies to preliminary relief, including the equitable rules that apply to temporary injunctions."); *NMTC Corp. v. Conarroe*, 99 S.W.3d 865 (Tex. App. – Beaumont 2003, no pet.)

In *Loye v. Travelhost, Inc.*, 156 S.W.3d 615, 620 (Tex. App. – Dallas 2004), the Court of Appeals refused to consider the issue of whether a covenant not to compete is unenforceable as a matter of law at the temporary injunction stage. The court held: "Because the issue of whether the covenant not to compete is enforceable must await a final judgment on the merits, we decline to address appellants second issue." (*Id*. at 620) (citing *Tom James of Dallas, Inc. v. Cobb*, 109 S.W.3d 877, 885 (Tex. App. – Dallas 2003, no pet.).

In *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787 (Tex. App. – Houston [1st Dist.] 2001, no. pet. hist.), the court considered whether the promisee in a covenant not to compete must prove an irreparable injury for which it has no adequate remedy at law in order to secure a permanent injunction against the promissor. The court held that unlike at common law, "a showing by the promise of an irreparable injury for which he has no adequate legal remedy, is not a prerequisite for obtaining injunctive relief under the Covenant Not to Compete Act, TEX. BUS. & COM. CODE ANN. §315.50, 15.51(a). *Id*. at 795.

The court also reversed the judgment denying attorneys' fees to the employer. The court reasoned that the employer was the prevailing party entitled to recover its reasonable attorneys' fees under Section 38.001(8) of the TEX. CIV. PRAC. & REM. CODE because the employer obtained a permanent injunction against the former employees, even though it did not recover money damages, and even though the terms of the covenant itself had been reformed by the trial court. *Id*. at 797.

The Corpus Christi Court of Appeals affirmed the denial of injunctive relief in *Shoreline Gas, Inc. v. McGaughey,* 2008 WL 1747624 (Tex. App.—Corpus Christi – Edinburg). In this case, Shoreline filed action against McGaughey, a terminated at-will employee, seeking injunctive relief under the non-compete, non-solicitation, and non-disclosure provisions of the

agreement signed by McGaughey. The testimony reflected that Shoreline only had a fear that McGaughey would go into competition with them and that they were afraid he would disclose their secrets. *Id.* at *12. The court held that this was insufficient evidence to establish a probability of irreparable injury that would support a temporary injunction. *Id.*

In contrast, the court in *In re Electro-Motor, Inc.*, 390 B.R. 859 (Bkrtcy. E.D. Tex. 2008), issued a preliminary injunction based on evidence demonstrating that EMI would suffer irreparable injury. EMI brought suit against former employee, Welborn, for breach of noncompete, nonsolicitation, and nondisclosure covenants and sought an injunction to enforce the covenants. EMI provided significant evidence that Welborn moved confidential EMI information, including the status of EMI pending business, to his home and then to his new employer's computer system. In addition, he used EMI data to inform EMI clients of his new employment and solicited their business to his new employer. Evidence showed that Welborn was able to convince at least one former client of EMI to switch to Welborn's new employer and there was an inference that other customers of EMI moved their business after Welborn's solicitation. *Id.* Based on the evidence, the court found that the threatened injury to EMI outweighed any threatened injury to Welborn and granted EMI a preliminary injunction.

Recently, in *Sadler Clinic Ass'n, P.A. v. Hart*, 2010 WL 114241 (Tex. App.—Beaumont Jan. 14, 2010), the appellate court affirmed the denial of the Clinic's request for a temporary injunction against Hart. Hart, a family practice physician, was scheduled to open a solo practice in October 2009, a few weeks after the temporary injunction hearing. The trial court denied the temporary injunction on October 2, 2009. At the time of the hearing, the Clinic had 105 physicians and 10 locations. Hart argued the Clinic did not meet its burden to demonstrate a probable, imminent, and irreparable injury. The Clinic maintains it did. The Clinic's evidence of probable, imminent, and irreparable harm was essentially its conclusion that the Clinic would "unravel" if the trial court did not grant a temporary injunction; and dissemination of the Clinic's confidential information would cause the Clinic harm. There was no specific evidence of Hart's dissemination of confidential information, of a decline in Clinic revenues since Hart left the Clinic, of Hart's solicitation of any Clinic physicians to join her in her practice, of Hart's capitalization on Clinic vendor or insurance opportunities, of any Clinic difficulty in obtaining financing, or of the exit of any other physicians from the Clinic. Thus, the Beaumont court of appeals could not conclude from the record that the trial court abused its discretion in denying the Clinic's request for a temporary injunction.

VII. PROPORTIONATE RESPONSIBILITY

A. Background

In deciding what causes of action to plead for a plaintiff, or what parties to join as a defendant, attorneys should carefully consider the ramifications of the proportionate responsibility statute.

In 1995 the Legislature amended the comparative responsibility statute, Chapter 33 of the Tex. Civ. Prac. & Rem. Code, to broaden its applicability, renaming it "proportionate" responsibility. Previously, it applied only to negligence actions that resulted in personal injury, death or property damage. It didn't apply to intentional or most business torts. In 1995 the statute was amended to apply to "all torts."

In addition, the 1995 act amended section 33.003. Previously, the jury determined only the responsibility of each "claimant, defendant and settling person." Now the jury also determines the responsibility of each "responsible third party." "Responsible third party" was initially defined in 1995 in section 33.011 as any person within the court's jurisdiction who the plaintiff could have sued, and who "is or may be liable to the Plaintiff" for all or part of the damages claimed against the named defendant or defendants."

In 2003, section 33.011 was amended so that now a "responsible third party" includes "any person who is alleged to have caused or contributed to causing in any way the harm for which recovery of damages is sought, whether by negligent act or omission, by any defective or unreasonably dangerous product, by other conduct or activity that violates an applicable legal standard, or by any combination of these.

The 2003 amendment also allows a defendant to simply designate responsible third parties without joining them as third parties. One purpose of these amendments was to eliminate the plaintiff's control over what parties might be included in the proportionate responsibility question submitted to the jury.

B. Specific Application

Cressman Tubular Products Corp. v. Kurt Wiseman Oil & Gas, Ltd., 322 S.W.3d 453 (Tex. App.—Houston [14th Dist.] 2010, pet. for review filed Dec. 8, 2010), involved a double appeal of a case in which Wiseman, the owner of a working interest in a well, asserted breach of express and implied warranties against four defendants for damages caused by the sale of goods for use in an oil well. Cressman argued that breach of express warranty sounded in tort when the breach causes damage to or loss of use of property other than the property that is the subject of the contract. The Houston court of appeals disagreed. Relying on the Texas Supreme Court's holding in *Medical City Dallas, Ltd. v. Carlisle Corp.*, 251 S.W.3d 55, 57 (Tex. 2008) the court held that express

warranty claims sound in contract. *Id.* at 460. Thus, the court of appeals concluded that the trial court did not err in granting Wiseman's request to disregard the jury's proportionate-responsibility finding in connection with the breach of an express warranty claim. *Id.*

With regard to his claims for breach of implied warranty, Wiseman argued that the trial court erred in failing to disregard the jury's proportionate responsibility finding that two other defendants were not responsible for any part of his damages arising from their breaches of implied warranties. Wiseman argued that in *JCW Electronics, Inc. v. Garza* the court recognized an exception in that "when the damages are purely economic, the claim sounds in contract." The court of appeals found that the exception applicable to implied warranty claims that result solely in economic damages did not apply in this case because the damages to the well formation was damage to an interest in real property. Thus, the court concluded that Wiseman's implied warranty claims sounded in tort and the trial court did not err in applying the jury's proportionate responsibility finding to the damages associated with those claims. *Id.* at 462.

In *Bank of Texas v. VR Electric, Inc.*, 276 S.W.3d 671, 683-4 (Tex. App.—Houston [1st Dist.] 2008, pet. denied), the court disagreed with the Bank's assertion that Chapter 33 of the Civil Practice and Remedies Code applied to this case. In this case, the Bank appealed the trial court's judgment awarding VR damages for paying VR's check that was forged. The judgment against the Bank was for breach of contract and the judgment against the co-defendant, Frank C. Mata, was for negligence. The two defendants were found jointly and severally liable for their payment of the forged check. The Bank asserted that the trial court incorrectly aggregated damages and attorney's fees to the Bank and Mata. Specifically, the Bank contended (1) that Chapter 33 of the Texas Civil Practice and Remedies Code applied to this case and (2) that, under that chapter, the trial court could not aggregate the Bank's 15% liability with Mata's 70% in assessing damages against Bank of Texas.

The Bank made no objection or exception to VR's characterization of its claim as a breach of contract claim in its pleading; however, the Bank, in its brief, refers to VR's claim as a "tort related" claim. *Id.* at 683. The court found that even if it were to characterize VR's claim as a tort claim against the Bank, Chapter 33 would still not apply because Article 3 of the UCC (as codified in the Texas Business and Commerce Code) was recently revised to create a discrete fault scheme, specifically allocating responsibility among parties to a banking relationship. *See* Tex. Bus. & Comm.Code Ann. § 3.406. *Id.* Thus, the court held that to the extent any proportionate responsibility provisions applied to VR's breach of contract claim against the Bank, it was §3.406 that applied, not the general statute in Chapter 33. *Id.* at 684.

In *JCW Elscs., Inc. v. Garza,* 257 S.W.3d 701, 705 (Tex. 2008), the Supreme Court of Texas held that a party who seeks damages for death or personal injury pursuant to a breach of implied warranty claim under Article 2 of the Uniform Commercial Code seeks damages in tort and is accordingly subject to proportionate responsibility scheme.

Garza sued the City of Port Isabel for her son's death and subsequently joined JCW as a defendant. Garza's was arrested for public intoxication and placed in the Port Isabel jail. The next day, Montez called his mother to arrange his bail. Montez made the call from his jail cell on a phone provided by JCW Electronics, Inc. ("JCW"). JCW had installed these collect-only telephones for inmate use under a 1998 contract with the Port Isabel Police Department. Tragically, on the day he was to be released, Montez was found dead in his cell, hanging from the telephone cord.

In this case, the 1995 version of Chapter 33 applied because Garza's son died on November 16, 1999. The 1995 amendments, however, deleted mention of specific theories of liability, providing instead that the chapter should apply " *to any cause of action based on tort* in which a defendant, settling person, or responsible third party is found responsible for a percentage of the harm for which relief is sought." Thus, Garza argued that a breach of implied warranty claim was not a "cause of action based on tort." The Court pointed out that they have often recognized that "[i]mplied warranties are created by operation of law and are grounded more in tort than in contract." *La Sara Grain Co. v. First Nat'l Bank,* 673 S.W.2d 558, 565 (Tex. 1984); *see also Rocky Mountain Helicopters, Inc. v. Lubbock County Hosp. Dist.,* 987 S.W.2d 50, 52 (Tex. 1998); *Melody Home Mfg. Co. v. Barnes,* 741 S.W.2d 349, 352 (Tex.1987); *Garcia v. Tex. Instruments, Inc.*, 610 S.W.2d 456, 462-63 (Tex. 1980); *Humber v. Morton,* 426 S.W.2d 554, 556 (Tex. 1968).

The Court found that the chapter's language "other conduct or activity that violates an applicable legal standard" was different but clearly broad enough to include the breach of an implied warranty under UCC article 2. The Court reasoned that when the statute was read as a whole, section 33.003 revealed that a "cause of action based on tort" includes negligence, products liability, and any other conduct that violates an applicable legal standard, such as the tort aspect of an implied warranty. Furthermore, the Court held that if Chapter 33 applied to product liability claims, it followed that the chapter applied to implied warranties because a claim for implied warranty is one basis for a products liability action. *Id.* at 705.

In *F.F.P. Oper. Partners v. Duenez*, 237 S.W.3d 680, 681 (Tex. 2007), the Supreme Court held that "the language of the proportionate responsibility statute includes claims under the Dram Shop Act. Neither the purpose nor the language of the [Proportionate Responsibility] Act makes a dram shop automatically responsible for all of the damages caused by an intoxicated patron, regardless of a jury's determination of the dram shop's proportion of responsibility. Instead, … a dram shop is responsible for its proportionate share of the damages as determined by a jury."

C. Further Issues

The scope of Chapter 33 is still uncertain in business litigation. In the past, it appeared that statutory "tort" claims were not covered by the Chapter 33. Many business lawsuits include tort, contract, and statutory claims. For example, a lawsuit involving misrepresentations in the sale of goods might give rise to claims of fraud, negligent misrepresentation, breach of contract, and UCC claims. None of these were covered by the old statute absent personal or property injuries. Now, the common law tort claims are, but not the contract or statutory fraud claims. *See, e.g., Davis v. Estridge*, 85 S.W.3d 308, 311-12 (Tex. App. 2001) (statutory fraud not subject to proportionate responsibility); *Southwest Bank v. Info. Support Concepts, Inc.* 149 S.W.3d 104 (Tex. 2004) (UCC conversion claim not subject to proportionate responsibility statute); *CTTI Priesmeyer, Inc. v. K & O Ltd. Partnership*, 164 S.W.3d 675, 684 (Tex. App.—Austin 2005, no pet.) (breach of contract claims not subject to proportionate responsibility statute).

1. Is a breach of fiduciary duty a contract or tort claim? There is some case law support for the contention that it is both. *See, e.g., Sassen v. Tanglegrove Townhouse Condominium Ass'n*, 877 S.W.2d 489, 493 (Tex. App.—Texarkana 1994, writ denied)(citing *inter alia Crutcher-Rolfs-Cummings, Inc. v. Ballard*, 540 S.W.2d 380 and RESTATEMENT (SECOND) OF AGENCY §§ 399, 400, 401 cmt. a (1958)). For agency relationships created by contract, the Second Restatement provision cited in *CTTI* includes among the remedies for a principal "an action on the contract of service."
2. Section 33.002 says that the chapter applies only to "causes of action based on tort," but the combined language of 33.003 and 33.011 means that parties, including third parties, who might be liable in contract, not tort, may now be included, and a jury is left to compare contract and tort liabilities. An example of this problem is posed by *Turner Constr. Co. v. Pharr San Juan Alamo Indep. Sch. Dist.*, 2006 WL 3317730 (Tex. App.—Corpus Christi 2006). That case involved personal injury tort claims of a plaintiff against a contractor, who then asserted a third party contract claim against the school district.
3. Is a defendant sued on a non-tort theory entitled to a settlement credit under section 33.012(b), which reads "if the claimant has settled with one or more persons, the court shall further reduce the amount of damages to be recovered by the claimant with respect to a *cause of action* by the sum of the dollar amounts of all settlements." The word cause of action is not defined in Chapter 33, but it is also used in section 33.002(a)(1), which provides that "this chapter applies to any *cause of action* based on tort." In *CTTI Priesmeyer*, the Austin Court of Appeals held that since chapter 33 does not apply to contract claims, and the "one satisfaction" rule likewise applied only to tort claims and not contract claims, that a contract defendant was not entitled to any settlement credits. *CTTI Priemeyer* at 684.

   By way of contrast, in *Galle, Inc. v. Pool*, 262 S.W.3d 564, 573 (Tex. App.—Austin 2008) (*citing AMX Enters., Inc. v. Bank One, N.A.*, 196 S.W.3d 202, 206 (Tex. App.—Houston [1st Dist.] 2006, pet denied), homeowners brought an action against Allstate, their insurance company, and Galle, a mold remediation company, for deceptive trade practices, fraud, breach of contract, negligence, and negligent misrepresentation. The homeowners reached a settlement agreement with Allstate. The trial court, however, awarded damages against Galle under a negligent misrepresentation theory and declined to apply the settlement credit. Galle appealed. The court of appeals found that the settlement agreement encompassed claims for recovery for damages that the homeowners alleged Allstate and Galle had jointly caused. Thus, the one satisfaction rule prohibited the homeowners from recovering breach of contract damages from Galle. The court held that "the application of the [one satisfaction] rule is not limited to tort claims, and where the rule may be applied depends not on the cause of action asserted, but rather the injury sustained. *Id.* 573.
4. Is "mitigation" coupled with "proportionate responsibility" double dipping for the defendant? Long before the doctrine of contributory negligence, and before the comparative and proportionate responsibility statutes were adopted, Texas courts adopted the defensive rule of mitigation. In *Walker et al v. Salt Flat Water Co.*, 96 S.W.2d 231 (Tex. 1936); the Texas Supreme Court wrote "The rule has ever been in Texas that no recovery may be had for losses or damages, whether from tort or breach of contract, which

might have been prevented, or the consequences avoided by reasonable efforts or expenditure by the person damaged. . . . Where a party is entitled to the benefits of a contract and can save himself from damages resulting from its breach at a trifling expense or with reasonable exertions." *Id.* at 232. For cases on mitigation, *see Gunn Infiniti v. O'Byrne*, 996 S.W.2d 854, 857 (Tex. 1999); *Great Am. Ins. Co. v. North Austin Mun. Util. Dist. No. 1*, 908 S.W.2d 415, 426 (Tex. 1995); *U.S. Rest. Props. Operating L.P. v. Motel Enters., Inc.*, 104 S.W.3d 284, 293 (Tex. App.--Beaumont, 2003); *Mondragon v. Austin*, 954 S.W.2d 191, 195 (Tex. App.—Austin 1997). Isn't the determination by a jury regarding the extent to which a plaintiff failed to act "reasonably" to prevent his own damages, part of the inquiry under section 33.003 as to the percentage of the plaintiff's responsibility for "causing or contributing to cause in any way the harm for which recovery of damages is sought"? In any case in which a proportionate responsibility question is submitted, a plaintiff should vigorously contest the submission of any mitigation instruction as part of the damages question, or as a separate question.

5. The new statute allows a defendant to bring in a third party that the plaintiff could not have sued, and from whom the plaintiff can never recover. One such situation is when the third party is a governmental entity that is immune. What would happen in a case like *Turner*, where the defendant sues a third party governmental entity that the plaintiff cannot sue, if the defendant settles with the governmental entity, and they designates the governmental entity as a responsible third party for submission in the charge?

VIII. THE SHAREHOLDER OPPRESSION CAUSE OF ACTION

Six Texas Courts of Appeals have recognized a cause of action for shareholder oppression. *See, e.g., Allchin v. Chemic, Inc.*, 2002 WL 1608616, at *6 (Tex. App.—Houston [14th Dist.] 2002, no pet.) (not designated for publication); *Willis v. Bydalek*, 997 S.W.2d 798 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); *Davis v. Sheerin*, 754 S.W.2d 375, 378-81 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

A. Majority and Minority Shareholder Status

A cause of action for shareholder oppression is available only to minority shareholders, and can only run against those who control a majority of the stock. *See, e.g., Allchin*, 2002 WL 1608616 at *9. *Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011) (PFR initially denied; on rehearing) provides the first discussion distinguishing between *one* majority shareholder versus *several* shareholders comprising a majority. The *Ritchie* court recognized a claim for oppression against a group of shareholders that, standing alone, are not majority shareholders:

> Appellants assert the trial court's judgment should be reversed and judgment rendered for them because shareholder oppression can only be committed by a majority shareholder, and it is undisputed that there is no majority shareholder in RIC. Appellants cite two authorities in support of their argument—article 7.05 [of the Texas Business Corporation Act] and *Allchin v. Chemic, Inc.*, No. 14–01–00433–CV, 2002 WL 1608616, at *7 (Tex.App.-Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication). Neither is persuasive.
>
> Article 7.05 authorizes equitable intervention when "the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent." Tex. Bus. Corp. Act Ann. art. 7.05(A)(1)(c) (emphasis added). This text clearly indicates *shareholder oppression claims may be brought against "directors or those in control of the corporation." Id. This negates the argument that the absence of a majority shareholder is a bar to such claims.*
>
> Appellants' other cited authority, *Allchin*, is a non-published opinion that stands only for the proposition that a plaintiff alleging shareholder oppression cannot be a fifty percent shareholder, a matter we need not

> address directly. *See Allchin*, 2002 WL 1608616, at *7.

Ritchie, 339 S.W.3d at 290 (emphasis added). Most of the other cases and treatises refer generally to actions against "majority shareholders." *See, e.g.*, *Cotton v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 700-01 (Tex. App.—Fort Worth 2006, pet. denied); *Hoggett v. Brown*, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).

B. Oppression as Wrongful Interference with Legitimate Expectations of Minority Shareholders

Courts have not defined what constitutes "oppressive" conduct with specificity. The inquiry remains very circumstance-dependent and equitable. *See Davis*, 754 S.W.2d at 381 ("Oppressive conduct has been described as an expansive term that is used to cover a multitude of situations dealing with improper conduct, and a narrow definition would be inappropriate."); *Redmon v. Griffith*, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied) ("a claim of oppressive conduct can be independently supported by evidence of a variety of conduct"). The settled Texas recitation is that oppression constitutes either of the following:

> 1. majority shareholders' conduct that substantially defeats the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or
>
> 2. burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely.

Guerra v. Guerra, 2011 WL 3715051, at *6 (Tex. App.—San Antonio 2011, no pet. h.) (mem. op.); *Allen v. Devon Energy Holdings, LLC*, 2011 WL 3208234 (Tex. App.—Houston [1st Dist.] July 28, 2011, no pet. h.); *Ritchie* 339 S.W.3d at 289; *Willis*, 997 S.W.2d at 802. "These definitions are not mutually exclusive; depending on the facts of the case, conduct could be oppressive under either or both definitions." *Ritchie*, 339 S.W.3d at 289.

The key component is interference with legitimate expectations of minority shareholders. HODGE O'NEAL AND ROBERT THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 7:13, 7:15 (2d ed. 2005). Those expectations fall into three categories:

(1) expectations of employment,
(2) expectations of a management role in the venture, and
(3) expectations of a return on their investment.

Id. at § 7:15. According to the treatises, the expectations must be both "important to the investor's participation" and "known to the other parties." *Id.* "Frustration of subjective hopes and desires will not trigger relief."

Common themes run through the Texas cases. First, Texas courts have found oppression where the evidence proved a "conspiracy to deprive [minority shareholder] of his interest in the corporation, together with the acts of willful breach of a fiduciary duty as found by the jury, and the undisputed evidence indicating that [minority shareholder] would be denied any future voice in the corporation." *Davis*, 754 S.W.2d at 382.

In dicta, the *Willis* court cited to other decisions finding shareholder oppression in the following contexts:

1) Conspiring to deprive minority of stock + wrongfully withholding of dividends that breaches fiduciary duty + wasting corporate funds on personal attorney's fees;

2) Firing + Stopping informing of corporate actions + withholding dividends (from minority only) + breach of fiduciary duty;

3) Withholding of dividends (from everyone) + removing as officer + removing as employee;

4) Withholding of dividends (from everyeone) + denial of shareholder benefits + inaccurate and inequitable bookkeeping;

5) Withholding of corporate information + denial of salary increase for minority only + removal as officer and director + cease notifiying of meetings;

Willis, 997 S.W.2d at 802. The *Willis* court held, however, that the facts before it did not constitute shareholder oppression. "

Courts have found other acts to not constitute oppression: "we hold [majority shareholder] did not oppress [minority shareholder] by firing him when (1) the jury found no wrong besides a lock-out, (2) the corporation and [majority shareholder], personally, always lost money, both before and after the lock-out, and (3) the [minority shareholders] were at-will employees." *Id.* Similarly, the *Allen* court found no wrongdoing where the minority shareholder "was not a terminated employee; he was not denied access to company books or records; and there was no allegation that [defendant] wrongfully withheld dividends, wasted corporate funds, paid himself excessive compensation, or locked [plaintiff] out of the corporate offices." *Allen*, 2011 WL 3208234, at *32.

The San Antonio Court of Appeals recently held that a plaintiff who received her shares via gift or bequest cannot recover under the expectation-focused definition of shareholder oppression. *Guerra*, 2011 WL 3715051, at *6 ("Maria received all of her shares as gifts or as a bequest from her father. Therefore, there is no evidence of shareholder oppression under this prong.").

C. The (possibly weakened) business judgment rule

When evaluating claims of shareholder oppression, courts balance the minority shareholder's reasonable expectations against some version of the business judgment rule. *Guerra*, 2011 WL 3715051, at *6 ("The minority shareholders' interests must be weighed against the corporation's need to exercise its business judgment.") (citing *Willis*, 997 S.W.2d at 801); *Ritchie*, 339 S.W.3d at 289 ("In deciding whether conduct rises to the level of oppression, courts must exercise caution, balancing the minority shareholder's reasonable expectations against the corporation's need to exercise its business judgment and run its business efficiently."); *Gibney v. Culver*, 2008 WL 1822767, at *12 (Tex. App.—Corpus Christi 2008, pet. denied); s*ee Willis*, 997 S.W.2d at 801 ("The minority shareholder's reasonable expectations must be balanced against the corporation's need to exercise its business judgment and run its business efficiently.").

Texas is employs a robust version of the business judgment rule. S*ee Willis*, 997 S.W.2d at 801 ("despite the existence of the minority-majority fiduciary duty, a corporation's officers and directors are still afforded a rather broad latitude in conducting corporate affairs"); *id.* at 802 ("We afford Willis broad latitude in conducting the club's affairs, balancing her business judgment in the face of four profitless years of operation against the Bydalek's reasonable expectations of participating in the business."); *In re White*, 429 B.R. 201 (Bankr. S.D. Tex. 2010) ("The corporation's conduct must not be protected by the business judgment rule.").

D. Remedies

Courts have much equitable flexibility in fashioning a remedy for shareholder oppression. One common remedy is a forced buy-out of the minority's shares at a fair value. Before ordering a buy-out, the court must determine if less drastic alternatives exist. *See Davis*, 754 S.W.2d at 380 ("We conclude that Texas courts, under their general equity power, may decree a "buy-out" in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties."). The recent *Ritchie* decision held that "Texas law authorizes the trial court, in an appropriate case, to order a buyout of an oppressed minority shareholder as an equitable remedy for shareholder oppression." *Ritchie*, 339 S.W.3d at 289. Where a buy-out occurs, the court determines the value of the stock. *See id.*; 2 O'NEAL & THOMPSON § 7:19.

E. Procedure

Whether certain acts constitute oppressive conduct is a question of law for the trial judge to decide. *Guerra*, 2011 WL 3715051, at *6 ("The question of whether a party's acts are oppressive is a question of law; the only questions of fact are what acts occurred."); *Ritchie*, 339 S.W.3d at 289 ("The jury determines what acts occurred (assuming those facts are in dispute), but whether

those acts constitute shareholder oppression is a question of law for the court."); *Allen*, 2011 WL 3208234, at *31 ("Whether conduct rises to the level of shareholder oppression is a question of law for the court."); *Gibney*, 2008 WL 1822767, at *16 ("Whether certain acts were performed is a question of fact, but the determination of whether such acts constitute shareholder oppression is usually a question of law for the court."); *Willis*, 997 S.W.2d at 798 ("While what acts were performed is a fact question, the determination of whether those facts constitute oppressive conduct toward a minority shareholder is a question of law for the judge."); *Davis*, 754 S.W.2d at 380 ("Although whether certain acts were performed is a question of fact, the determination of whether these acts constitute oppressive conduct is usually a question of law for the court."). Thus, the jury should not be asked about the existence of "oppression." They must, however, be asked to establish the occurrence of the factual predicates. In one case where the charge was not at issue, the court asked the jury whether or not the defendant had "maliciously or wrongfully" done the predicate acts. *Gibney*, 2008 WL 1822767, at *7.