Trends in Commercial Litigation

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I. Case Filings, Generally

The decline in the number of newly commenced civil lawsuits has been an ongoing phenomenon in the nation's courts for several years. As discussed below, that trend includes both federal and Texas state courts, although Texas federal courts in many respects represent a notable exception to the trend. A number of factors have been cited for the cause of the decline, including the growing use of arbitration, the availability of pre-litigation dispute resolution procedures, and tort and other legal forms that have impacted the medical malpractice, class action, and securities fields. Views on the desirability of the trend are widely diverse, with some seeing a positive economic and social impact from the elimination of frivolous litigation while others seeing a systematic elimination of individual rights.

A. Texas State Courts

An overall trend of fewer filings is unmistakable in Texas state courts. According to a study by the Texas Office of Court Administration, the number of new civil lawsuits dropped by 17% during the ten-year period from 2005-15, falling from 610,355 cases in 2005 to 505,104 in 2014. The trend was especially notable in county-level courts, which saw a decline from 150,735 newly-filed cases in 2005 to 96,954 cases, a decrease of 36%. The decline in district court filings, including both civil and family courts, was more modest, with new filings falling from 459,620 cases in 2005 to 408,150, a decline of 11%. By way of comparison, the Texas population swelled by over 22% during that same ten-year period, meaning that even as the size of the state's population increased considerably, the number of civil lawsuits fell.

Focusing just on civil district courts for the past five years, the decline in new cases filed is consistent with the downward trend noted above, with 12% fewer cases filed in 2015 as opposed to 2011 (108,729 versus 123,033). That aggregate number masks a number of other interesting trends. For example, the number of new motor vehicle cases has increased by nearly 25%, rising from 19,188 new cases in 2011 to 23,923 in 2015. Likewise, cases involving real property claims rose 35%, from 4,172 new cases in 2011 to 5,620 cases in 2015. These significant gains, however, were offset by more substantial decreases in other categories. Most notably, the number of contract actions, including consumer debt claims, fell by 29% during the period (60,537 to 42,918), and tort actions not involving a vehicle fell nearly 10% (10,469 to 9,458).

The same trends are discernible in statistics for both district courts and county courts covering the ten-year period from 2005 to 2014. During that time, the combined number of new motor vehicle cases in Texas state district and county courts rose 13%, from 31,152 cases in 2005 to 35,202 in 2014. On the other hand, new non-motor vehicle tort cases in those same courts decreased from 20,051 cases in 2005 to 12,441 cases in 2014, a decline of 38%. There was also a significant decrease in the number of new contract-type actions during the same period, which fell from 93,707 new cases in 2005 to 64,640 cases in 2014, a decrease of nearly 26%.

B. Federal Courts

According to reports available from the Federal Court Management Statistics, filings in the federal judiciary also have decreased in recent years, although more modestly than its Texas state court counterparts. *See* www.uscourts.gov/statistics-reports/analysis-reports/federal-court-management-statistics.

For the twelve-month period ending June 15, 2015, there were 374,791 new filings made in the federal district courts, including both civil and criminal matters. That represents a 5.5% decrease from the comparable period ending six years earlier on June 15, 2010, when 396,652 new actions were initiated. Looking only at civil filings in the nationwide federal courts, the number of new actions fell 7% (down 22,212 cases) to 281,608 from the previous year. With respect to private civil actions (i.e., excluding actions in which the United States is a party), new filings fell more modestly, from 242,482 in the 2010 period to 238,204 for 2015, representing a decrease of 1.9%.

Although some of these trends are replicated in caseload statistics available for the Fifth Circuit, many are not. In addition, results among Texas federal courts are somewhat uneven.

- There was a nearly 10% decline in the number of new civil and criminal cases filed in the Fifth Circuit from 2010 to 2015, falling from 56,300 new cases in 2010 to 50,722 cases in 2015, or some 5,578 fewer cases. The number of new cases spiked in 2013 to 57,536, caused in large part by a 77% increase in new filings in the Eastern District of Louisiana.

- The number of new civil and criminal cases filed in Texas federal courts declined by a more modest 6% in the same period, falling from 41,269 new cases in 2010 to 38,794 in 2015. As was the case for the Fifth Circuit as a whole in 2013, the number of new cases surged in Texas federal courts in that year, driven by modestly increased filings in all districts, other than the Western District.

- In contrast, the number of new civil actions commenced in the Fifth Circuit during the 2010-15 timeframe (i.e., excluding criminal cases) increased slightly from 29,759 cases in 2010 to 30,330 cases in 2015, a 1.9% increase. At the same time, there was a more robust growth in the number of private civil actions, which rose from 23,652 newly commenced cases in 2010 to 26,846 cases in 2015, representing a 13.5% increase.

- The increase in newly-commenced civil actions in Texas federal courts was even more pronounced than the Fifth Circuit as a whole during the 2010-2015 timeframe. New civil actions rose from 16,636 cases in 2010 to 20,220 in 2015, a 21.5% increase. New private civil actions in Texas federal courts rose by a slightly greater margin, increasing from 13,414 cases to 17,586 in 2015, or 23.7%.

- Among Texas federal courts, the increase in private civil actions was especially notable in the Eastern District and the Northern District. During the 2010-15 timeframe, new filings in the Eastern District rose from 2,542 to 4,115 (a 62% increase), while in the Northern District, new filings increased from 3,531 to 5,577 (a 58% increase). The

Western District also experienced an increase in new private action filings, rising from 2,244 in 2010 to 2,677 in 2015, representing a 19% increase. In the Southern District, the increase was muted, rising 2.3% from 5,097 new filings in 2010 to 5,217 filings in 2015.

The Statistical Tables also provide information concerning the nature of the claims asserted in federal actions. An examination of this data reveals a number of notable trends with respect to newly filed private civil cases:

- Most significantly, there has been a steady rise in the number of intellectual property suits filed in nationwide federal district courts in the past six years, rising from 8,458 in the period ending June 2010 to 14,131 in the period ending June 2015, representing an increase of over 67%.

- In contrast, the number of personal injury suits fell by 23% during that same period, starting from 78,210 filings in the period ending June 2010 and dropping to 60,466 filings in the period ending June 2015.

- Newly-filed contract actions also decreased during that period, falling from 28,263 suits to 24,261 suits, a decrease of 14.2%.

- Finally, new filings alleging civil rights violations rose from 32,626 cases in 2010 to 35,481 cases in 2015, an 8.7% increase.

- Labor suits were essentially unchanged, increasing from 18,464 new cases in 2010 to 18,651 in 2015.

These national trends concerning the nature of claims asserted in federal court are also seen in Texas federal courts, although their impact among the districts is uneven:

- Like other district courts across the country, Texas federal courts have experienced a sharp increase in the number of new lawsuits involving intellectual property claims. For the period ending June 2015, 2,450 intellectual property suits were filed in Texas federal courts, an increase exceeding 200% over the 810 suits filed in the period ending June 2010.

- That growth was almost entirely concentrated in the Eastern District, where newly-commenced intellectual property suits rose from 336 to 1,975 during the six-year period, an increase of over 480%.

- Newly filed contract actions decreased in Texas federal courts, as they also did at the national level, falling from 2,705 to 2,495 during the period, a decrease of nearly 8%. That decrease was largely felt in the Southern District, where new contract actions fell from 1,479 to 1,090, a decrease of over 25%. The Eastern District also experienced a decrease of roughly 25%, as new contract actions fell from 345 to 258 during the period.

- On the other hand, the Northern District and Western District recorded gains in the number of contract actions (33% and 25%, respectively), although on a smaller volume of cases than the Southern District.

- In an anomalous finding, new personal injury actions rose sharply in Texas federal courts during the period, increasing from 1,224 to 2,806, an increase of nearly 130%. The source for that increase is concentrated almost entirely in the Northern District, where large numbers of personal injury lawsuits were filed in 2013, 2014, and 2015 (2,892, 2,184, and 1,725, respectively).

- New filings in civil rights and labor actions also deviated from national norms. While civil rights actions rose nationwide by 8.7%, they decreased by 6% in Texas federal courts, as the number of new actions fell from 1,706 in 2010 to 1,605 in 2015. On the other hand, while the number of labor suits at the national level was essentially unchanged, they rose by 29% in Texas federal courts, with 1,276 actions filed in 2015 as compared to 989 in 2010.

Recently available information for the entire calendar year 2015 further underscores the role of the Eastern District as an epicenter of patent and intellectual property litigation. According to statistics compiled by Law360, there were 5,549 new patent cases filed in U.S. federal courts last year, with 2,543 of those being commenced in the Eastern District, or nearly 46% of the national total. The new 2015 filings in the Eastern District represent a 77% increase over calendar year 2014, when 1,427 new patent suits were commenced. Of the eight judgeships in the Eastern District, there are three vacancies. In 2015, the second busiest federal jurisdiction for newly filed patent suits was the District of Delaware, where 533 suits were initiated. No other district had more than 267. *See* "Patent Suit Pressuring East Texas Bench, Chief Says," *Law360*, Feb. 9, 2016.

With respect to all of the foregoing statistics, it should be noted as a precautionary matter that the number of filings in any given year can be subject to marked fluctuations based on anomalous events. For example, the number of new personal injury suits spiked to 75,505 filings in 2014, which was driven in large part by the filing in West Virginia federal court during that year of over 25,000 multidistrict cases involving pelvic repair system products. Likewise, the spike in personal injury lawsuits in the Northern District of Texas during the years 2013-2015 should be seen in the same light. As Mark Twain once quipped, "Facts are stubborn things, but statistics are pliable."

II. Agreements to Agree

A. Background

Recent Texas courts have examined the ability of parties to enter contracts to make future contracts—that is, to form "agreements to agree." In general, parties will create an enforceable agreement to enter a future contract where they have agreed as to all material and essential terms of the future contract. *Radford v. McNeny*, 129 Tex. 568, 578 (1937); *Fort Worth Ind. School Dist. v. City of Fort Worth*, 22 S.W.3d 831, 856 (Tex. 2000).

Conversely, if an agreement to agree fails to include a material and essential term, leaving it to future negotiations, it cannot be enforced. *Radford*, 129 Tex. at 578. The materiality of terms will be determined on a "case-by-case basis." *McCalla v. Baker's Campground, Inc.*, 416 S.W.3d 416, 418 (Tex. 2013).

The test for whether a missing term is "material and essential" is more strict when examining agreements to make future contracts, as compared to standard contracts. For instance, "[w]here a final contract fails to express some matter, as, for instance, a time of payment, the law may imply the intention of the parties," but this is not the case for an agreement to agree. *Radford*, 129 Tex. at 475. Rather, "where a preliminary contract leaves certain terms to be agreed upon for the purpose of a final contract, there can be no implication of what the parties will agree upon." *Id.* The latter is only an agreement to enter non-binding negotiations, and no more. *Id.* The Texas Supreme Court later restated this concept as requiring "*reasonably certain*" material terms in standard contracts, "[b]ut an agreement to make a future contract is enforceable only if it is *specific* as to all essential terms." *Fort Worth Ind. School Dist.*, 22 S.W.3d at 846 (emph. added). This distinction between "reasonably certain" and "specific" terms places a high burden for clarity and precision on agreements to agree.

In some instances, courts have gone so far as to indicate that every detail of the future contract must be determined in advance. *Fort Worth Ind. School Dist.*, 22 S.W.3d at 846 ("[N]o terms of the proposed agreement may be left to future negotiations."); *Foster v. Wagner*, 343 S.W.2d 914, 920-21 (Tex. App.—El Paso 1961, writ ref'd n.r.e.) (same). This strong language, however, has been paired with statements that the future contracts must be "specific as to all *essential* terms," *Fort Worth Ind. School Dist.*, 22 S.W.3d at 846 (emph. added), and that parties must agree to "all of [the] *essential* terms." *Foster*, 343 S.W.2d at 921 (emph. added). This emphasis on "essential terms" implies that parties could, perhaps, leave non-essential terms vague. However, case law is clear that material and essential terms must be included to create an enforceable agreement to enter a future contract.

B. Recent Developments

A recent case out of the Texas Supreme Court puts a new spin on agreements to agree. *Fischer v. CTMI, LLC*, -- S.W.3d --, 2016 WL 83477 (2016). Through adding an analysis disfavoring forfeiture—albeit under a specific set of facts—the Court moves towards a position that is more enforcement-friendly.

1. Factual Background

Fischer involves a nuanced set of facts. Ray Fischer owned a tax consulting business, and he entered negotiations to sell it to CTMI, LLC in 2007. In a written employment agreement, Fischer contracted to work as a CTMI employee until the end of 2010. The parties also signed an asset-purchase agreement, which identified the assets CTMI would acquire, including accounts receivable on projects that were not completed by the sale's closing date. In the case of projects started but incomplete on the closing date, Fischer would receive a percentage of subsequent payments "equal to the percentage by which Fischer had completed the project before closing." That is, payment on a project that was approximately 25% complete at closing would be divided, with going 25% to Fischer and 75% to CTMI. An exhibit to the agreement listed pending projects and stated the percentage of work completed by the closing date. *Id.* at *1.

CTMI agreed to pay $900,000 for the business assets, broken into a series of payments. These payments included adjustments equal to 30% of that year's business revenue in excess of $2.5 million, "calculated on an accrual/calendar year basis (*as mutually agreed to by [Fischer] and [CTMI]*)." *Id.* at *2 (emph. in original). The final payment was to be made in 2011, and it included a percentage of payments CTMI collected for projects that were pending but not completed at the end of 2010 (the "pending-projects payments"). Fischer's cut of these payments would be based on the percentage of each project completed at the end of 2010. But unlike the exhibit detailing the percentage completion rates of projects at the sale closing, the parties could not predict in 2007 what projects would be pending in 2010. As a result, this clause stated, "By January 31, 2011, a list of projects that were in-progress as of December 31, 2010 will be generated with a percentage of completion assigned to each project as of December 31, 2010. The percentage of completion will have to be mutually agreed upon by [CTMI] and [Fischer]." *Id.*

A dispute arose between the parties in 2008, with CTMI seeking a declaratory judgment that Fischer did not have the right to payments on certain accounts receivable and that Fischer had breached his employment contract. Fischer counterclaimed for breach of purchase agreement and employment agreement. CTMI then argued that none of the remaining payments were enforceable because they were mere "agreements to agree." Specifically, the payment adjustments depended on agreements as to how to calculate (1) business revenue; and (2) the percentage completion of projects at the end of 2010. The parties settled most of their claims during trial, however, the settlement specifically excluded CTMI's challenge to the final 2010 adjustment, and that claim was severed to proceed. The trial court entered judgement that the 2010 adjustment was not an unenforceable agreement to agree, but the court of appeals reversed. *Id.* at *3.

2. Texas Supreme Court Analysis

Without a doubt, the settlement of certain claims left the Texas Supreme Court with an unusual situation in examining the remaining, severed claim. As the Supreme Court recognized, "[A] finding that the pending-projects clause is unenforceable could render the entire asset-purchase agreement unenforceable, yet the parties have agreed through their settlement and in their briefing that the remainder of the purchase agreement is enforceable." *Id.* at *3. Perhaps it is unsurprising that the Supreme Court ultimately concluded that the pending-projects clause at issue in the 2010 adjustment was enforceable, but its analysis contained some marked differences from prior case law on the subject.

In broad strokes, the Supreme Court agreed with the general background principles of agreements to agree. "It is well settled law that when an agreement leaves material matters open for future adjustment and agreement that never occur, it is not binding upon the parties and merely constitutes an agreement to agree." *Id.* at *4 (citing *Fort Worth Indep. Sch. Dist.*, 22 S.W.3d at 846). "Conversely, '[a]greements to enter into future contracts are enforceable if they contain all material terms.'" *Id.* (citing *McCalla*, 416 S.W.3d at 418). The Supreme Court reasoned that "when an agreement to enter into a future contract already contains all the material terms of the future contract, courts can determine and enforce the parties' obligations, and concerns about indefiniteness and reasonable certainty do not arise." *Id.* (internal quotations omitted). The Supreme Court framed the ultimate question as "whether the pending-projects clause, which states that 'the percentage of completion will have to be mutually agreed upon,' is sufficiently definite as to all of its essential and material terms." *Id.*

In coming to its decision, the Supreme Court explicitly relied on several guiding principles. First, a court may not "rewrite the parties' contract nor add to its language." *Id.* at *5. "Second, because the law disfavors forfeitures, we will find terms to be sufficiently definite whenever the language is reasonably susceptible to that interpretation." *Id.* "Third, when construing an agreement to avoid forfeiture, we may imply terms that can reasonably be implied." *Id.* Although this principle seems to risk contradicting the first principle, the Supreme Court noted that "courts often imply a term setting a reasonable time of payment, or a reasonable time during which the contract will remain effective." *Id.* (internal citation and quotations omitted). "Fourth, a term that appears to be indefinite may be given precision by usage of trade or by course of dealing between the parties." *Id.* (internal quotations omitted). Last, "part performance under an agreement may remove uncertainty and establish that a contract enforceable as a bargain has been formed."

Based on these principles, the Supreme Court determined that the pending-projects clause was "sufficiently definite" to be enforceable. Although noting that a lack of specificity as to price sometimes indicates there was "no meeting of the minds," the Supreme Court found that the language in the agreement (CTMI "shall pay," the total price "will be paid," and the adjustment "will include" certain revenue) indicated the parties intended to be bound. *Id.* Further, where it is impossible to specify an amount, in this case because the parties would have to predict project completion years in the future, it is sufficient for parties to include a "description of the input to be supplied later." *Id.* at *7. The use of a standard to determine payments—here, the completion percentages of projects—leads to a presumption "that the parties intended a reasonable price," even when "a court cannot determine from the agreement's language the actual amount that CTMI owes." *Id.*

Further supporting its decision, the Supreme Court pointed out that (1) the parties had gone through a similar procedure to go determine completion percentages of projects before closing the sale; and (2) the parties had either substantially or fully performed other obligations under the agreement. *Id.*

The Supreme Court did give some thought to whether its decision rewrites the contract terms by implying a reasonable price and forcing agreement where there is none. On this point, the Supreme Court observes that the pending-projects clause "says nothing about any 'additional negotiations' over the completion proceedings," nor does it indicate CTMI can avoid payment if no agreement is reached. *Id.* at *8. Therefore, "CTMI expressly agreed to pay Fischer for the pending projects, and in light of the parties' prior conduct regarding the 2007 accounts receivable, the parties' substantial performance of their contractual obligations, and the law's preference to avoid forfeiture, we conclude that a court could determine CTMI's obligations and provide a remedy by implying a reasonable price based on objective facts and the specific standard to which the parties agreed, without rewriting the clause's language." *Id.* at *9.

3. New Directions in *Fischer*

The holding and analysis in *Fischer* may bring a more pro-enforcement slant to agreements to agree than many previous cases. To take one example, the *Fischer* Court cites *Radford* for the principle that terms such as time of payment may be implied when a contract is incomplete. *Radford*, however, held that this is only the case in a final contract, and not an agreement to agree. *Radford*, 129 Tex. at 475. *Fischer*'s application of *Radford*'s holding seems to gloss over the fact that the contract between Fischer and CTMI relies on a future agreement—an agreement to agree—as to payment terms.

In another example, the Supreme Court's citation to *McCalla* implies that the *Fischer* holding is a straightforward application of existing case law. *Fischer*, 2016 WL 83477, at *9 ("We conclude that the language providing that the completion percentages 'will have to be mutually agreed upon' is more akin to the language in the agreement we recently addressed in *McCalla*."). Yet *McCalla* was a much easier case, in that it did not actually require any future agreement as to terms. *McCalla* involved a contract where the parties had agreed to the sale of property for a specific price. The only dispute was over a handwritten notation stating, "I will agree to $470,000 purchase price above," and "I agree to enter an agreement as discussed above." *McCalla*, 416 S.W.3d at 417. In fact, the case was simple enough that the *McCalla* Court "assumed arguendo" that the facts involved an agreement to agree, based solely on the language "I will agree" and "I agree to enter an agreement," not based on any missing terms. *Id.* In contrast, *Fischer* had key payment terms that were explicitly left to future agreement. The *Fischer* Court's citation to *McCalla* understates the gap in the *Fischer* contract.

In *Fischer*, the Supreme Court seems comfortable in supplying the missing terms based on a "guiding principle" disfavoring forfeiture. 2016 WL 83477 at *5. But the forfeiture principle is primarily relevant based on *Fischer*'s procedural posture, and may not be applicable to other cases. Indeed, there is no mention of the forfeiture principle in any of the other leading cases on agreement to agree. *Fischer*, of course, starts from a posture that assumes the contract as a whole is enforceable. *Id.* at *3 ("This unique procedural status complicates our analysis, because a finding that the pending-projects clause is unenforceable could render the entire asset-purchase agreement unenforceable, yet the parties have agreed through their settlement and in their briefing that the remainder of the purchase agreement is enforceable."). It is conceivable that if the parties had not agreed on the enforceability of the purchase agreement, the entire agreement could have been tossed as unenforceable, and the parties would have been returned to their starting points. As the Supreme Court seemed to assume that option was unavailable, it is perhaps unsurprising that it came down on the side of enforcing the remainder of the agreement.

In the same vein, this may be the first case where the Supreme Court has applied a "sufficiently definite" standard in approving the terms in an agreement to agree. Previous cases, such as *Radford*, had noted, "[W]here a preliminary contract leaves certain terms to be agreed upon for the purpose of a final contract, there can be no implication of what the parties will agree upon." 129 Tex. at 475.Similarly, the Supreme Court later restated this concept as requiring "*reasonably certain*" material terms in standard contracts, "[b]ut an agreement to make a future contract is enforceable only if it is *specific* as to all essential terms." *Fort Worth Ind. School Dist.*, 22 S.W.3d at 846 (emph. added). The move from "specific" to "sufficiently definite" is hard to gauge on words alone, but prior cases looking at agreements to agree certainly disapproved of missing terms in the future contract, especially if they are material and essential. *See, e.g.*, *Fort Worth Ind. School Dist.*, 22 S.W.3d at 846 ("[N]o terms of the proposed agreement may be left to future negotiations."); *Foster v. Wagner*, 343 S.W.2d 914, 920-21 (Tex. App.—El Paso 1961, writ ref'd n.r.e.) (same). *Fischer*'s willingness to fill in missing terms suggests "sufficiently definite" may be a more lenient standard.

Going forward, courts will have to consider whether the ruling in *Fischer* is a guiding principle for increased enforcement of agreements to agree, or whether it is a fact-specific holding that future courts may decline to apply in other cases with more typical procedural postures.

III. Texas Trade Secrets Act

A. Background

The Texas Uniform Trade Secrets Act ("TUTSA"), TEX. CIV. PRAC. & REM. CODE ANN. §§134A.001-.008, applies to claims alleging misappropriation of trade secrets occurring on or after September 1, 2013. *See* Adoption of Uniform Trade Secrets Act, 2013 TEX. SESS. LAW SERV. Ch. 10 (S.B. 953). To establish a claim under TUTSA, a plaintiff must establish: (1) the existence of trade secrets; (2) its ownership of those trade secrets; (3) that defendant acquired those trade secrets by improper means; and (4) that defendant used or disclosed those trade secrets or threatened to do so. *See* §134A.002(3); *St. Jude Medical S.C., Inc. v. Janseen-Counotte*, 2014 WL 7237411, *14 (W.D. Tex. Dec. 17, 2014).

In general terms, TUTSA provides for injunctive relief in the event of an actual or threatened misappropriation, as well as damages, which may be in addition to or in lieu of injunctive relief. Id. §§134A.003 & 134A.004. Damages can include both the actual loss caused by misappropriation and any unjust enrichment that is not taken into account by computing actual loss. *Id.* §134A.004(a). An award of punitive damages, in an amount not exceeding twice the any award of monetary damages, is available if a "willful and malicious misappropriation is proven by clear and convincing evidence." *Id.* §134A.004(b). TUTSA "displaces conflicting tort, restitutionary, and other law of this state providing civil remedies for misappropriation of a trade secret. §134A.007(a). TUTSA does not affect contractual remedies, criminal remedies, or other civil remedies not based upon misappropriation of a trade secret. §134A.007(b).

B. Recent Developments

Case law construing TUTSA is in its infancy, so identifying emerging trends rests on a small sample. An important case currently pending before the Texas Supreme Court, however, may provide insight into those future trends and issues. That case—*In re M-I L.L.C. d/b/a M-I SWACO*, No. 14-1045 (Tex. 2014)—concerns §134A.006, which requires that trial courts take "reasonable measures" to protect the secrecy of trade secrets in pending TUTSA actions. In the case, plaintiff M-I SWACO sought injunctive relief under TUTSA against a former employee and his new employer National Oilwell Varco (NOV) for misappropriation of trade secrets related to M-I SWACO's mesh screens used in the filtering of drilling fluid, which it said was the company's technology roadmap and its strategy for competing with NOV. At the injunction hearing, M-I SWACO asked the trial court to clear the courtroom of everyone except the parties' counsel, their experts, and the former employee defendant, so that it would not disclose its trade secret information to NOV. The trial court denied the request and instead stated that it would order NOV's in-house counsel from disclosing or using the trade-secret information. Concerned that the trial court's instruction to the in-house counsel would be ineffective, M-I SWACO discontinued the hearing and sought mandamus relief. Upon appeal to the Texas Supreme Court after the appellate court denied relief, the Supreme Court requested full briefing, and oral argument was heard on January 13, 2016.

As revealed by the parties' briefing and the oral argument before the Supreme Court (both available from the Court's website at www.txcourts.gov/supreme.aspx), the appeal presents something of a conundrum. On the one hand, as M-I SWACO argued, allowing defendant's corporate representatives to attend evidentiary hearings presents a TUTSA plaintiff with a Hobbesian choice: either risk disclosure of its trade-secret information to its competitor or discontinue its efforts to protect those trade secrets altogether. Instead, according to M-1 SWACO, it was sufficient that it disclose its trade secrets in the presence of NOV's attorneys and experts, and in front of the defendant employee but not in front of NOV itself. On the other hand, as NOV contended, excluding corporate representatives and allowing the presence of only outside counsel and experts could deprive of information about the trade secret at issue, thus prejudicing its ability to contest key factual and legal issues. Based on questions during oral argument, an important factor may be the protective order agreed to by the parties in the case, which restricted certain materials to outside counsel only.

Texas courts have not addressed how trade secrets should be in evaluated in a misappropriation suit, and decisions from other jurisdictions are scant and contradictory. *See, e.g.*, *Newark Group, Inc. v. Sauter*, 2004 WL 5623944 (S.D. Ohio 2004) (defendants in trade secret misappropriation were "entitled to have a natural person designated as a representative of each corporation present during court proceedings"); *Air Prods. & Chems., Inc. v. Johnson*, 442 A.2d 1114, 1129 (Pa. Super. 1982) (excluding defendant representative because defendant's "desire to fully participate in any hearing could result in their obtaining knowledge of [the plaintiff's] trade secrets if in fact they were found to exist"). The Supreme Court's resolution of how to handle trade secrets in the context of an injunction also may provide guidance concerning the related issue of appropriate procedures at trial on the merits.

Another issue that courts have grappled with is the requirement under TUTSA's definition of "misappropriation" that the defendant "acquire" knowledge of the trade secret at issue through "improper means." §134A.002(3)(A). Under TUTSA, "improper means" includes "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, to limit use, or to prohibit discovery of a trade secret, or espionage through electronic or other means." §134A.002(2). At least three federal courts have held that a defendant does not acquire a trade secret through "improper means" where the defendant acquires the trade secret pursuant to an ongoing employment arrangement or valid license or other agreement, which the defendant subsequently breaches by disclosure of the trade secret. *See*, *Capstone Associated Services, Ltd. v. Organizational Strategies, Inc.*, 2015 WL 3919239 (S.D. Tex. Dec. 23, 2015) (allegation that defendant acquired trade secrets in connection with a valid license, but later breached the license and related service agreement, did not state cause of action under TUTSA); *Education Management Services, LLC v. Tracey*, 102 F.Supp.2d 906, 914-15 (W.D. Tex. Apr. 9,

2015) (no showing that defendant acquired trade secrets through breach of contractor agreements that imposed obligation not to disclose confidential information on plaintiff); *Education Management Services, LLC v. Cadero*, Civ. No. 5:14-CV-587-HLH, Dkt. #26 (W.D. Tex. Dec. 23, 2014) (trade secret not acquired by defendant's breach of a duty to maintain secrecy, thus negating TUTSA's "acquired by improper means" requirement). These federal court decisions seem to suggest that TUTSA does not apply when the initial disclosure of trade secrets is deemed to be voluntary pursuant to a contractual agreement or otherwise, even if the receiving party subsequently breaches that undertaking. It is an open question whether a disclosing party could rely on the "misrepresentation" element of the "improper means" definition to contend that a trade secret recipient is subject to liability under TUTSA because on the basis of false representations made in connection with their acquisition of the trade secrets at issue. Texas state courts have not yet chimed in on these issues.

IV. Economic Loss Rule

A. Background

In broad terms, the economic loss rule in Texas limits the recovery of purely economic damages that are unaccompanied by injury to the plaintiff or its property in actions for negligence. *LAN/STV v. Martin K. Eby Constr. Co.*, 435 S.W.3d 234, 235 (Tex. 2014). "Parties may be barred from recovering in negligence or strict liability for purely economic losses." *Sharyland Water Supply Corp. v. City of Alton*, 354 S.W.3d 407, 415 (Tex. 2011). "Economic losses" has been defined as "damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits—without any claim of personal injury or damage to the property." *A&H Properties Partnership v. GPM Engineering*, 2015 WL 9435974 (Tex. App.—Austin 2015, no pet.) (quoting *Thomson v. Espey v. Huston & Assocs.*, 899 S.W.2d 415, 421 (Tex. App.—Austin 1995, no writ). As the Supreme Court has noted, however, "there is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law." *Sharyland*, 354 S.W.3d at 415. (quoting Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 534-35 (2009)).

One limited area applies to products liability. In Texas, "[t]he economic loss rule applies when losses from an occurrence arise from failure of a product and the damage or loss is limited to the product itself." *Equistar Chems., L.P. v. Dresser-Rand Co.*, 240 S.W.3d 864, 867 (Tex. 2007). In such a case, a plaintiff cannot recover in tort, as damages are "more appropriately recovered through the UCC's thorough commercial warranty framework." *Sharyland*, 354 S.W.3d at 416. On the other hand, a plaintiff may pursue a products liability action in tort where the defective product causes either personal injury to a user, or it damages the property of the user. *Equistar*, 240 S.W.3d at 867.

Texas also applies the economic loss rule in certain cases involving a contractual relationship between the parties. *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986). As the Supreme Court recently summarized, Texas law is "fairly clear that one party to a contract cannot recover from another party, in an action for negligence, an economic loss to the subject of the contract." *LAN/STV*, 435 S.W.3d at 243. In order to determine whether the economic loss rule applies in a case where a contract exists between the parties, courts will consider two tests:

(1) First, where the acts of one person appear to breach both tort and contract duties, the court will look to the nature of the injury. *Jim Walter Homes*, 711 S.W.2d at 618 ("The nature of the injury most often determines which duty or duties are breached. When the injury is only the economic loss to the subject to a contract itself, the action sounds in contract alone."). Thus, where a builder negligently constructed a house, but the homeowner had no damages besides the reduced value of the house, the injury was entirely economic. *Id.*

(2) Second, the court considers whether a party has a breached a duty independently imposed by law. Where a party breaches a contract, causing economic loss, but has breached no duty independently imposed by law, the economic loss rule governs the case. *Southwestern Bell Telephone Co. v. DeLanney*, 809 S.W.2d 493, 494 (Tex. 1991) (where defendant's conduct "would give rise to liability because it breaches the parties' agreement," plaintiff's claim sounds only in contract).

The Supreme Court has noted that both tests should be considered in determining whether a claim sounds in contract or tort. *DeLanney*, 809 S.W.2d at 494. Where the results of the two tests diverge, however, it appears that Texas courts will focus on the second test, i.e., the existence of a legal duty, rather than the nature of the injury That dichotomy can be seen in *Formosa Plastics Corp. USA v. Presidio Engr's & Contractors, Inc.*, 960 S.W.2d 41 (1998). There, the Supreme Court found that the economic loss rule does not apply to fraudulent inducement claims, because "the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself." *Id.* at 46. This independent legal duty controlled, and "accordingly, tort damages are recoverable for a fraudulent inducement claim irrespective of whether the fraudulent representations are subsumed in a contract or whether the plaintiff only suffers from an economic loss related to the subject matter of the contract." *Id.* at 47. Under *Formosa*, therefore, where the two tests produce conflicting results, the existence of an independent legal duty will control.

B. Recent Developments

1. Parties Lacking Contractual Privity

In two recent decisions, the Texas Supreme Court has addressed the extent to which the economic loss rule applies in cases where parties are not in privity.

In *Sharyland*, 354 S.W.3d 407, plaintiff Sharyland, a non-profit water supply corporation, sued the city of Alton and the city's contractors after the contractors installed defective sewer lines above portions of Sharyland's water system, threatening contamination of its water supply. After a jury verdict in favor of Sharyland against the contractor, the appellate court reversed. According to the appellate court, Sharyland had suffered only economic loss, as its water system had not been physically damaged. *Id.* at 415. It further held that because Sharyland was not a party to the contract between Alton and the contractor, it was prevented from recovering in tort under the economic loss rule. *Id.* at 418.

The Supreme Court disagreed and reversed, noting at least two grounds for permitting Sharyland's recovery in tort. First, the Court noted that while the economic loss rule may apply in a products liability case where parties are not in privity, the Court has "never held that it precludes recovery completely between contractual strangers in a case not involving a defective product." *Id.* at 418. Rather, under current law, a "contractual stranger" may recover for the breach of an independent duty. *Id.* at 419. As a second basis for reversal, the Court determined that Sharyland had suffered property damage, as evidenced by the fact that the negligent installation of the sewer required Sharyland to remediate its own water lines, by either moving or encasing them. *Id.* at 420. Thus, the fact that Sharyland's water system may not have been physically touched by the sewer system was immaterial. *Id.*

In *LAN/STV*, 435 S.W.3d 234, the Court tackled an issue previously unaddressed in its economic loss rule jurisprudence; namely, the extent to which Texas law precludes recovery of economic damages in a negligence suit between contractual strangers. In that case, plaintiff Eby contracted with the Dallas Area Rapid Transit ("DART") for the construction of a rail line extension owned by DART. Separately, as part of the same project, DART contracted with LAN/STV, a project engineering firm, to provide plans and specifications. Typical of construction projects, no contract existed between Eby and LAN/STV, both of whom contracted with the owner DART. During the construction process, Eby suffered delay and disruption damages of nearly $14 million which it alleged were caused by changes required to LAN/STV's drawings. Eby sued DART for breach of contract, which ultimately settled. Eby also brought a separate suit against LAN/STV alleging negligence and negligent misrepresentation based on its allegedly error-ridden plans, drawings, and specifications upon which Eby claimed it relied. After a jury trial, the trial court entered a $2.25 million judgment in Eby's favor, representing LAN/STV's apportioned responsibility for Eby's damages. The Dallas Court of Appeals affirmed. 350 S.W.3d 675.

While this was apparently the court's first opportunity to address whether economic losses may be recovered in negligence actions between contractual strangers, it nevertheless stopped well short of laying down any broad pronouncements. Instead, reversing the lower court and denying any recovery to Eby, the court adopted a nuanced approach, observing that the economic loss rule "does not lend itself to easy answers" and that its application "depends on an analysis of its rationales in a particular situation." *LAN/STV*, 435 S.W.3d at 245. Those rationales, according to the court, include avoiding the "indeterminate and disproportionate liability" that economic damages tend to impose on tortfeasors and giving deference to the parties contractual agreements, under which the "[r]isks of economic loss" have been bargained for and allocated between the parties themselves. *Id.* at 240-41. Applying these principles to the particular circumstances of construction contracts, the Supreme Court concluded that the contractor's reliance should be on the owner, with whom it would enter into an agreement, not the designer with whom it had no contractual arrangement. In support of that conclusion, the Supreme Court noted the risk of "magnified and indeterminate" liability if participants on a construction project, such as roofing subcontractor and a foundation subcontractor, could recover from each other. *Id.* at 246.

2. Post-*LAN/STV* Decisions

After *Sharyland* and *LAN/STV*, courts have continued to grapple with the boundaries of the economic loss doctrine. In the construction contract context, there are some indications that these decisions may promote greater certainty. For example, in *A&H Properties Partnership v. GPM Engineering*, 2015 WL 9435974 (Tex. App.—Austin 2015, no pet.), the Austin Court of Appeals addressed a "vertical chain of contracts" where a warehouse/office project owner entered into a contract with a designer for the design and installation of energy-efficient improvements who in turn contracted with a second designer for the design of a component part of the improvements. *Id.* at *1. When the component part caused damages in "the amounts it cost to construct the system," the owner brought suit against the second designer. Noting the absence of any direct privity between the owner and the second designer, the absence of any personal injury or property damage separate from the owner's economic loss, and the fact the contracting parties had allocated liability risks in their respective contracts through indemnification provisions and bonding requirements, the court found that the owner's suit was foreclosed by the *LAN/STV* decision. *Id.* at **2-3.

The decision in *Trebuchet Siege Corp. v. Pavecon Commercial Concrete, Ltd.*, 2014 WL 4071804 (Tex. App.—Dallas 2014, no pet.), addressed the economic loss doctrine in similar circumstances. The Dallas Court of Appeals considered whether the doctrine allowed a property owner to sue a foundation subcontractor for negligence, where the property owner was in privity with the architect/contractor, but not the subcontractor. Relying on *LAN/STV*, the court invoked the economic loss rule on the basis that the only duty alleged to have been breached by the subcontractor was its contractual duty under its contract with the architect/contractor and that the damages suffered by the property owner was the cost to repair the damaged flooring, a classic form of economic damages. *Id.* at *7. The court further noted the policy concern of *LAN/STV* of disrupting risk allocations, which it said had been arranged by the parties in their respective contracts. *Id.*

Outside the construction context, courts have grappled with the economic loss rule when it comes to contractual strangers. In *Clark v. PFPP Limited Partnership*, 455 S.W.3d 283 (Tex. App.—Dallas 2015, no pet.), the plaintiff brought suit against a car dealership for negligent hiring, supervision, and retention of its employees after discovering that the car she had purchased in a private sale had been stolen from the dealership, while simultaneously suing the seller of the vehicle for breach of contract. On appeal after dismissal by the trial court, the Dallas Court of Appeals looked to the nature of the harm allegedly caused the dealership, which it concluded was no different than the economic harm suffered when the seller breached the contract. *Id.* at 289. Citing *LAN/STV*, the court found that the economic loss rule barred plaintiff's recovery from the dealership. *Id.* at 289-90. In reaching that result, the court noted the *LAN/STV* court's concern with the risk of indeterminate liability in cases involving contractual strangers. *Id.* at 289 n.7.

The economic loss rule also continues to receive the attention of the federal judiciary. In *McCaig v. Wells Fargo Bank, N.A.*, 788 F.3d 463 (5th Cir. 2015), a divided Fifth Circuit panel addressed whether the rule barred a claim under §392.403(a) of the Texas Debt Collection Act ("TDCA"), even if a contract between the parties had been breached. *Id.* at 474-75. In that case, the defendant entered into a settlement and forbearance agreement with the plaintiffs, but nevertheless thereafter sent repeated notices of default, made threats of foreclosure, and assessed late fees, even though plaintiffs were in compliance with the agreements between the parties. Looking to *LAN/STV*'s teaching that "application of the rule depends on an analysis of its rationales in a particular situation," *LAN/STV*, 435 S.W.3d at 245-46, the Fifth Circuit concluded that the TDCA contemplated contractual duties between a consumer and debt collector and that invocation of the rule would disrupt the TDCA's statutory scheme. *McCaig*, 788 F.3d at 475. The dissent contended that the failure to apply the economic loss rule under these circumstances was inconsistent with prior decisions involving the Texas Deceptive Trade Practices Act holding that breaches of contracts do not create statutory liability. *Id.* at 487.

V. Tortious Interference

A. Background

At Texas common law, a cause of action for tortious interference with a contract requires proof of the following elements: (1) the existence of a contract subject to interference; (2) willful and intentional interference; (3) interference that proximately caused damages; and (4) actual damage or loss. *Powell Indus. v. Allen*, 985 S.W.2d 455, 456 (Tex. 1998); *see also 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).

B. Recent Developments

1. Defenses

A defendant may defeat a claim for tortious interference by affirmatively demonstrating that his actions were privileged or legally justified. *Prudential Ins. Co. of North America v. Financial Review Services, Inc.*, 29 S.W.3d 74, 77-78 (Tex. 2000). This justification defense "can 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." *Id.* at 80. Assertion of the two defenses is not mutually exclusive. *Collins v. Sunrise Senior Living Management, Inc.*, 2012 WL 1067953, at *12 (Tex. App.—Houston [14th Dist. 2012], no pet.) (defendant may "simultaneously assert two alternative justification defenses"). Rather, justification is established as a matter of law when the defendant's acts, which the plaintiff claims constitute tortious interference with the existing contract, are merely done in the defendant's exercise of its own contractual rights. *Fitness Evolution, L.P. v. Headhunter Fitness, L.L.C.*, 2015 WL 67550047, *24 (Tex. App.—Dallas 2015, no pet.). Alternatively, if the defendant cannot prove justification as a matter of law, it can still establish the affirmative defense if the trial court determines that the defendant interfered while exercising a colorable right, and the jury finds that, although mistaken, the defendant exercised the colorable right in good faith. *Id.*

Cases that fall into the first prong of the justification defense—where a defendant is found to have a legal right to interfere with another's contract—generally share two characteristics. First, the defendant tends to have an existing relationship, often contractual with the third party that has a contractual relationship with the plaintiff. *See, e.g.*, *Prudential Ins. Co.*, 29 S.W.3d at 81 (defendant insurance company had contractual relations with policyholders who were patients of the third-party healthcare provider who had a contract with the plaintiff); *Gulf Liquids New River Project, LLC v. Gulsby Engineering, Inc.*, 356 S.W.3d 54, 76-78 (Tex. App.—Houston [1st Dist.] 2011, no pet.). Second, the nature of the defendant's existing relationship with the third party gave the defendant an implicit right to interfere with the contractual relationship between the third party and the plaintiff. *See, e.g.*, *Prudential Ins. Co.*, 29 S.W.3d at 81 (insurance policies and statues gave defendant insurance company the right to contact the plaintiff's clients and the defendant's policyholders); *Gulf Liquids*, 356 S.W.3d at 77-78 (contractual provision gave defendant to withhold certain charges, which hindered plaintiff's ability to obtain payment and ultimately led to termination of plaintiff's contract). Thus, in a recent case, where a defendant purchased oil and gas interests from a leaseholder who previously had entered into a contingency fee agreement with legal counsel involving those interests, the defendant could not claim rights under the fee agreement, nor did its right under its purchase agreement with plaintiff to waive conditions precedent create a legal right justifying interference. *Brewer v. Pritchard, P.C. v. AMKO Resources Intern., LLC*, 2014 WL 3512836 (Tex. App.—Houston [14th Dist.] 2014, no pet.).

Under the second prong of the justification defense—a good faith claim to a colorable legal right even though that claim proves to be mistaken—the court first determines as a matter of law whether the defendant had a colorable legal claim. Whether the defendant acted in good faith, however, is a question left to the jury. *Texas Beef Cattle Co. v. Green*, 921 S.W.2d 203, 211 (Tex. 1996). In a recent case, the plaintiff, a factoring company who had entered into an agreement to purchase a portion of a structured settlement, sued a competitor for tortious interference with that agreement when the competitor offered a "substantial amount" more than the plaintiff's offer, thus leading to the attempted rescission of the agreement. *Settlement Funding LLC v. RSL Funding, LLC*, 3 F. Supp. 3d 590, 599-600 (S.D. Tex. 2014) (applying Texas law). The court denied summary judgment in favor of the plaintiff, concluding that a fact issue existed as to whether the defendant acted in good faith in pursuing a colorable legal right. In particular, the court noted "contradictory rulings" on whether the existence of a transfer agreement prior to court approval (such as plaintiff's agreement) rendered the type of solicitation engaged in by the defendant a form of prohibited tortious interference. *Id.* at 611.

2. Causation

A case recently decided by the Texas Supreme Court addressed the sufficiency of evidence to prove causation in a tortious interference claim. *HMC Hotel Props. II Ltd. P'ship v. Keystone-Texas Prop. Holding Corp.*, 439 S.W.3d 910 (Tex. 2014), involved the issue of tortious interference in a real estate contract. Keystone owned a mall and land underlying a hotel in San Antonio. HMC leased the land underlying the hotel from Keystone. Under section 14.02 of the lease, "Tenant's Right of First Negotiation," Keystone was required to send notice of a potential sale to HMC and afford it a reasonable period of time, not to exceed ninety days, to negotiate a purchase of its leased premises.

In 2004, Keystone put the two properties up for sale, and New York investor Ben Ashkenazy emerged as a potential investor at a price of $166 million for both properties. HMC became aware of the proposed sale on January 7, 2005 when Keystone sent a letter informing it was selling the hotel land to Askenazy for $65 million, inviting it to make an offer for the property, and requesting that it waive its rights under section 14.02. Although it initially expressed an interest in making an offer and later represented that it was "close" to signing the waiver, HMC ultimately did neither. Instead, in an April 18 letter, HMC affirmatively told Keystone it would not waive its rights and further accused Keystone of having failed to provide HMC a first right of negotiation as required by the lease. When the sale for the hotel land did not close, Keystone and HMC brought suit against each other. At trial, the jury awarded Keystone $39 million in damages, which was affirmed by the San Antonio appellate court.

On appeal, the Texas Supreme Court reversed, finding that no evidence supported "but-for" causation, as demonstrated by the fact that title insurers for the proposed transaction insisted on a waiver from HMC of its rights under section 14.02 both before and after its April 18 letter. In reaching its result, the Supreme Court dismissed arguments by Keystone that the April 18 letter "ratched up risk" for the title insurers and effectively made it impossible that they would "insure around" lease section 14.02. According to the Supreme Court, testimony that the title insurers "could have" insured around section 14.02 did not establish that they "would have," and as such, were "bare, baseless opinions [that] will not support a judgment." *Id.* at 917. Further, even accepting testimony that the HMC letter was "really devastating" and that it "blew up the deal," this testimony at most only established that the letter was "a substantial factor in bringing about harm" to Keystone, not that it was the "but-for" cause. *Id.*

3. Prospective Contracts

Texas allows tortious interference claims for prospective as well as existing contracts. The boundaries of this rule, however, are not well-established. In *Wal-Mart Stores, Inc. v. Sturges*, 52 S.W.3d 711, 726 (Tex. 2001), the Texas Supreme Court considered a case in which the plaintiffs brought suit for tortious interference with prospective leases. The Supreme Court determined that in order for a plaintiff to recover for tortious interference in a case of a prospective business relationship, the "plaintiff must prove that the defendant's conduct was independently tortious or wrongful." *Id.* at 726. Although the behavior must be "actionable under a recognized tort," the plaintiff does not need to prove the actual tort. *Id.* By way of example, "a plaintiff may recover for tortious interference from a defendant who makes fraudulent statements about the plaintiff to a third person without proving that the third person was actually defrauded." *Id.* The *Wal-Mart* case did not expound on the specific elements for a cause of action in the case of prospective contracts.

A case from the Houston Court of Appeals later attempted to fill that gap. In *Baty v. Protech Ins. Agency*, 63 S.W.3d 841 (Tex. App.—Houston [14th Dist.] 2001, pet. denied), the plaintiff insurance agency sued two former officers and four former clients for tortious interference with prospective business relationships, where the officers had formed a competing business. The *Baty* court interpreted the *Wal-Mart* case to require four elements in a claim for tortious interference with a prospective business relationship: (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 not 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." *Id.* at 860.

Texas state and federal courts have continued to address tortious interference claims in the context of prospective contracts. Three recent cases are illustrative.

In *Alliantgroup, LP v. Solanji*, 2014 WL 1089284 (Tex. App.—Houston [1st Dist.] 2014, no pet.), plaintiff Alliantgroup brought a tortious interference claim against a group of former employees who left to start their own company. In the process, the employees contacted two companies with whom Alliantgroup had contracted for services in the past but had no current contractual relationship. Despite the absence of an ongoing relationship, Alliantgroup considered the two companies to be "continuing clients" because they had not provided notice that they wished to disengage from Alliantgroup. The trial court granted summary judgment in favor of the employees because there was no evidence of any current contracts or relationships between Alliantgroup and the two companies. On appeal, the Houston Court of Appeals affirmed that result, but went on to consider whether Alliantgroup had any action for tortious interference with prospective business relationships. While noting that Texas recognizes a cause of action for tortious interference with prospective contracts, it also noted that plaintiffs must present evidence of interference with a "specific" contract. *Id.* at *8. Alliantgroup failed to identify any specific contract, whether existing or prospective, and thus summary judgment was appropriate. *Id.*

In contrast, a plaintiff in a Dallas federal court survived a motion to dismiss where he identified with particularity the prospective contract which was the subject of defendant's tortious interference. In *Cooper v. Harvey*, 108 F. Supp. 3d 463 (N.D. Tex. 2015), the plaintiff, who had contracted with the comedian Steve Harvey to market videotaped performances by the comedian, entered into negotiations with a distributor for the purpose of marketing the videotapes. The distributor subsequently withdrew from the negotiations when Harvey's attorney falsely advised that the plaintiff did not have rights to the videotapes and that Harvey would "come after" the distributor. *Id.* at 467. The Dallas court found that based on the plaintiff's description of the proposed distribution agreement, there was "a reasonable probability" that the plaintiff would have entered into a business relationship and that knowingly false statements by Harvey's attorney constituted an "independently tortious or unlawful act" that prevented the relationship from occurring. *Id.* at 472. On that basis, dismissal was not warranted.

Where there are only a few competitors in a market, courts sometimes have not required that a specific prospective contract be alleged. For example, in *Impala African Safaris, LLC v. Dallas Safari Club, Inc.*, 2014 WL 4555659 (N.D. Tex. 2014), the plaintiff claimed that it was wrongfully excluded from an annual African safari exposition held in Dallas and asserted claims under the Sherman Act, Title II of the Civil Rights Act, and tortious interference with prospective contractual relations, among others. For purposes of the tortious interference claim, the court found that plaintiff's allegations that it held one of the largest quotas for hunting dangerous game in Zimbabwe and that its prices were lower than competitors was sufficient to show that there was a "reasonable probability" that a customer would enter into a contract with it. *Id.* at *7. Instead, plaintiff's claim failed on the requirement of showing actual harm. According to the court, plaintiff's damages stemmed from its exclusion from future expositions, and as such, amounted to "the mere prospect of competitive disadvantage" and was insufficient to show actual harm. *Id.*

VI. Arbitration

A. Background

1. TAA Standards

The Texas General Arbitration Act (TAA) provides that parties may form a valid, enforceable agreement to arbitrate a controversy where the controversy either "exists at the time of the agreement," or "arises between the parties after the date of the agreement." TEX. CIV. PRAC. & REM. CODE §171.001(a). Arbitration agreements are binding to the same extent as any other contract, and therefore "[a] party may revoke the agreement only on a ground that exists at law or in equity for the revocation of a contract." *Id.* §171.001(b).

Texas law strongly favors arbitration of disputes, and there is a presumption against the waiver of a contractual right to arbitration. *Prudential Sec., Inc. v. Marshall*, 909 S.W.2d 896, 898 (Tex. 1995). As a result, even though a party may take action that appears inconsistent with asserting its arbitration rights, such as by delay or by initially invoking the judicial process, waiver of arbitration will not be presumed in the absence of prejudice to the other party. *Id.* at 898-99.

An arbitration award has "the same effect as the judgment of a court of last resort." *CVN Group, Inc. v. Delgado*, 95 S.W.3d 234, 238 (Tex. 2002). Thus, "[a]ll reasonable presumptions are indulged in favor of the award, and none against it." *Id.* In fact, arbitration awards receive so much deference that they may not be reviewed for errors of law or fact, unless the arbitration agreement specifically states that the arbitrator has no authority to render a decision containing a reversible error of state or federal law. *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 89-97 (Tex. 2011).

2. The TAA and the FAA

If an arbitration agreement does not specify whether the TAA or the Federal Arbitration Act applies, and both are legally applicable, the agreement is subject to both state and federal law. *In re D. Wilson Const. Co.*, 196 S.W.3d 774, 778-79 (Tex. 2006); *In re L&L Kempwood Assocs., L.P.*, 9 S.W.3d 125, 127 (Tex. 1999). But there is an exception where state law actually conflicts with federal law. *Nafta*, 339 S.W.3d at 97 & n.64. Where the TAA "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the TAA is preempted. *Id.* (quoting *Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989)). Texas has determined that the FAA preempts the TAA only if four factors are met:

> 1) the agreement is in writing, (2) it involves interstate commerce, (3) it can withstand scrutiny under traditional contract defenses [under state law], and (4) *state law affects the enforceability of the agreement*.

In re D. Wilson Const. Co., 196 S.W. 3d 774, 780 (Tex. 2006) (emph. and alterations in original). Based on this test, the TAA will generally be preempted only where state law would refuse to enforce an agreement that the FAA would enforce. *Id.* If this test is not met, and the arbitration agreement does not specify whether the TAA or FAA controls, parties may avail themselves of both.

In addition, even where the FAA governs arbitration, it "does *not* apply to the determination of whether there is a valid agreement to arbitrate between the parties." *Morrison v. Amway Corp.*, 517 F.3d 248, 254 (5th Cir. 2008) (emph. added). Rather, "to determine whether an agreement to arbitrate is valid, courts apply ordinary state-law principles that govern the formation of contracts." *Carey v. 24 Hour Fitness, USA, Inc.*, 669 F.2d 202, 205 (5th Cir. 2012) (internal quotations marks and citation omitted); *see also In re Halliburton Co.*, 80 S.W.3d 566, 568 (Tex. 2002) ("Under the Federal Arbitration Act (FAA), an agreement to arbitrate that is valid under general principles of state contract law and involves interstate commerce is 'valid, irrevocable, and enforceable.'").

B. Developments

A very recent Fifth Circuit case applying Texas contract law highlights a new trend in arbitration. *Nelson v. Watch House Int'l*, -- F.3d -- , 2016 WL 825385 (5th Cir. Mar. 2, 2016), examined whether there was a valid agreement to arbitrate, where Texas law governed the formation of the agreement. Although the proposed arbitration would have been conducted in accordance with the FAA, not the TAA, Texas law was nonetheless crucial to the analysis, and the case has significant implications for Texas parties who wish form enforceable arbitration agreements.

1. Factual Background

Michael Nelson worked for Watch House as an instructor for the Federal Air Marshal Program. On the day he was offered his position, he also received a copy of the employee handbook, including Watch House's Arbitration Plan. The plan stated, in part, that both Watch House and its employees were obligated to submit all employment claims to binding arbitration. But the plan also provided that it could be changed at any point by Watch House, and the changes would be "immediately effective upon notice to Applicant/Employee of its terms," although changes would not apply retroactively. *Id* at *1.

Nelson worked for Watch House for several years before being terminated. Nelson argued his termination violated Title VII of the Civil Rights Act as well as the Texas Labor Code. When Watch House moved to compel arbitration, Nelson contended the arbitration plan was unenforceable and illusory because Watch House could change it any time, and it neither included a savings clause as to existing claims nor required advance notice of plan termination.

2. Analysis and New Directions

The Fifth Circuit started its analysis by acknowledging that although "the Federal Arbitration Act reflects a liberal federal policy favoring arbitration, that policy does not apply to the determination of whether there is a valid agreement to arbitrate between the parties." *Id.* at *2 (internal citation and quotations omitted). Here, both parties agreed that Texas law controlled whether a valid agreement to arbitrate was made, using "ordinary state-law principles that govern the formation of contracts." *Id.*

Texas law holds that arbitration agreements, like all contracts, must be supported by consideration. A mutual agreement to arbitrate will be consideration, unless the agreement is "illusory." For instance, "where one party has the unrestrained unilateral authority to terminate its obligation to arbitrate," the agreement is illusory and unenforceable. *Id.* at *2.

But Texas also has determined that an arbitration agreement is *not* illusory where one party is able to terminate the agreement, but there are limits placed on the termination. The leading case, which *Nelson* discussed, is *In re Halliburton Co*., 80 S.W.3d 566 (Tex. 2000). In *Halliburton*, which also involved an employment arbitration provision, the court held that although Halliburton was permitted to terminate or modify an arbitration agreement, the agreement was not illusory because of two key provisions. First, any changes to the agreement did not apply to a dispute of which Halliburton had actual notice; and second, any termination of the arbitration agreement could not go into effect until 10 days after reasonable notice of termination. These limits ensured Halliburton could not "avoid its promise to arbitrate by amending or terminating [the arbitration agreement] altogether." *Id.* at *3.

After *Halliburton*, the Fifth Circuit created a three-prong test to determine whether similar agreements are illusory under Texas state law: "Retaining termination power does not make an agreement illusory so long as that power (1) extends only to prospective claims, (2) applies equally to both the employer's and employee's claims, and (3) so long as advance notice to the employee is required before termination is effective." *Nelson*, 2016 WL 825385, at *3 (citing *Lizalde v. Vista Quality Markets*, 746 F.3d 222, 226 (5th Cir. 2014)). The arbitration agreement in *Lizalde* was very similar to the agreement in Halliburton, in that it required advance notice of changes, and any changes would not apply retroactively.

Nelson, however, addressed an open question in Texas law not addressed in *Lizalde*. Watch House argued that as long as the first prong is met—that is, as long as any alterations apply only to prospective claims—the agreement is not illusory, and that prongs 2 and 3 are not actually required by Texas law. And in fact, the Texas Supreme Court has not explicitly specified the *minimum* limits on a party's ability to unilaterally change an arbitration agreement. *Halliburton* identified two limits on Halliburton's power to change the arbitration agreement, but it did not explain whether either limit alone would be sufficient to create an enforceable agreement. *Halliburton*, 80 S.W.3d at 570; *see also Temp. Alts., Inc. v. Jamrowski*, -- S.W.3d --, 2014 WL 2129518, at *3 (Tex. App.—El Paso May 21, 2014, no pet.) ("The Texas Supreme Court has not explicitly defined the minimum requirements of an arbitration savings clause . . . ."). In fact, *Temporary Alternatives* points out a "split in authorities as to when a savings clause is adequate under *Halliburton*," regarding whether either notice or a ban on retroactive application, alone, would be sufficient to create an enforceable arbitration agreement. 2014 WL 2129518, at *3.

The *Nelson* court, however, takes the extra step. *Nelson* reads recent Texas appellate cases to be consistent with its three-prong test. *Nelson*, 2016 WL 825385, at *4. For instance, *Nelson* cites *Temporary Alternatives* as holding that an agreement is illusory where it provides no notice before one party may unilaterally change it—even if the change does not apply retroactively. This holding is inconsistent with Watch House's argument, and it is consistent with the Fifth Circuit's three-prong test. *Nelson* concludes, therefore, that all three prongs of the test must be met to avoid a determination that an agreement is illusory under Texas law. *Id.* at *5.

Nelson's holding is key to the Fifth Circuit's application of Texas state law in determining whether an arbitration agreement is enforceable or not. And in the absence of a definitive ruling from the Supreme Court, it is likely to be persuasive in Texas state court as well, whenever an agreement allows one side to unilaterally change the rules of the game without notice.

VII. Covenants Not to Compete

A. Background

Under the common law, Texas determined 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). In 1989, however, this rule was superseded by the passage of the Covenant Not to Compete Act, which allowed for the enforcement of covenants not to compete in certain circumstances. TEX. BUS. & COM. CODE §15.50.

Section (a) of §15.50 provides the general rule, while §15.50(b) provides statutory provisions specific to physicians. Section 15.50(a) provides as follows: "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." Violations of a covenant not to compete can support both monetary damages and injunctive relief. TEX. BUS. & COM. CODE §15.51(a). In addition, where a covenant not to compete is overly broad in its time, geographical area, or scope of activity, the court may reform it and thereby render it enforceable. *Id.* §15.51(c). In addition, the statute preempts any previously existing common law action or remedy. *Id.* §15.52.

In applying the statutory scheme, the Supreme Court has identified two initial inquiries in the enforcement of covenants not to compete. First, was there an "otherwise enforceable agreement" between the parties? Second, was the covenant "ancillary to or part of" that agreement? *Marsh USA v. Cook*, 354 S.W.3d 764, 771 (Tex. 2011). Additionally, to be enforceable, the covenant not to compete must be reasonably limited as to time, geographical area, and scope of activity, with no more restraint than is necessary to protect the business interest of the promisee. *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 644 (Tex. 1994).

The "otherwise enforceable agreement" requirement is satisfied when the covenant is "part of an agreement that contained mutual non-illusory promises." *Alex Sheshunoff Mgmt. Servs., LP v. Johnson*, 209 S.W.3d 644 (Tex. 2006). For example, where an employee agrees not to solicit clients, recruit employees, or disclose confidential information in exchange for stock option awards, then the requirement is met. *See Marsh USA Inc.*, 354 S.W.3d at 773. Thus, a non-disclosure agreement involving "offer, acceptance, and consideration for mutual promises," is an "otherwise" enforceable agreement. *Id.* On the other hand, a contract for at-will employment, standing alone, does not satisfy the requirement of an "otherwise enforceable agreement" because the promise of a continued employment contract is illusory—neither the employer nor employee is bound in any way.

The Supreme Court gave definitive guidance concerning the second inquiry—whether the covenant is "ancillary to or part of" the agreement—in its decision in *Marsh USA Inc. v. Cook*, 354 S.W.3d 764 (Tex. 2011). There, the defendant, a managing director of Marsh, entered into a non-solicitation agreement with his employer which barred him from soliciting or accepting business of the type offered by Marsh in which he was involved from clients, prospective clients, or former clients. *Id.* at 768. According to evidence submitted by Marsh, the defendant was a "valuable employee" who was awarded stock options in recognition of his contributions to building goodwill with customers. *Id.* at 777. That evidence failed to convince both the trial court and the court of appeals that the covenant was "ancillary" to an otherwise enforceable agreement. Under their rulings, the fact that a company's goodwill benefits when the plaintiff accepted the offered incentive and continued his employment did not mean that the incentive "gave rise" to an employer's interest in restraining the employee from competing. 287 S.W.3d at 381-82. In so ruling, the lower courts followed the Supreme Court's earlier decision in *Light*, 883 S.W.2d 642, which held that the consideration given by an employer must "give rise" to the employer's interest in restraining the employee from competing. *Id.* at 647.

In its *Marsh USA* decision, the Supreme Court repudiated the "give rise" requirement, as it does not appear in the Act itself, nor does the Act define "ancillary." *Marsh USA*, 354 S.W.3d at 775-76. The Supreme Court declared "the Legislature did not include a requirement in the Act that the consideration for the non-compete must give rise to the interest in restraining competition with the employer. Instead, the Legislature required a nexus—that the non-compete be "ancillary to" or "part of" the otherwise enforceable agreement between the parties. *Id.* at 775. The Supreme Court further found that "ancillary" and "part" should be given their common meanings. *Id.* Thus, consideration given for a noncompete that is "reasonably related to an interest worthy of protection"—such as "trade secrets, confidential information or goodwill"—satisfies the statutory nexus. *Id.* The Supreme Court then returned the case to the trial court to determine whether the agreement was reasonable as to time, scope of activity, and geographical area. *Id.* at 778.

B. Recent Developments

1. "Ancillary to" or "Part of"

In the aftermath of *Marsh USA*, Texas courts have continued to focus on the nexus between the consideration provided for the non-compete and the employer's alleged protected interest. For example, in *Republic Services, Inc. v. Rodriguez*, 2014 WL 2936172 (Tex. App.—Houston [14th Dist.], no pet.), the plaintiff, a court reporting service, and the defendant, its manager/marketing director, signed an employment agreement containing non-competition and non-solicitation clauses, whereby plaintiff provided defendant certain confidential information relating to its customers. Later, defendant quit her job and went to a work for competitor, whereupon plaintiff brought suit alleging breach of the employment agreement. The Fourteenth Court of Appeals reversed the trial court's summary judgment in favor of the defendant, finding that the plaintiff failed to establish as a matter of law that the consideration for the non-competition clause—including defendant's business goodwill, customer order history, and training on its business software system—was not "reasonably related to an interest worthy of protection." *Id.* at *6 (quoting *Marsh USA*, 354 S.W.3d at 775).

A Dallas federal court reached a similar result in *Travelhost, Inc. v. Brady*, 2012 WL 555191 (N.D. Tex. 2012). There, plaintiff Travelhost, a publisher of traveler information magazines, entered into a distribution agreement with defendants, giving them the right to use Travelhost's trademark and logo in connection with the promotion and distribution of the magazine in designated metropolitan areas. The parties further agreed to a non-competition clause. Subsequently, the defendants terminated the agreement and started a competing magazine, whereupon plaintiff Travelhost brought suit alleging a violation of the covenant not to compete. Applying *Marsh USA*, the court concluded that defendants' right to use plaintiff's trademarks and logos, along with the opportunity to keep revenues derived from selling advertising, constituted consideration reasonably related to plaintiff's interest in protecting its goodwill. On that basis, the covenant not to compete was "ancillary to" or "part of" an otherwise enforceable agreement.

2. "Otherwise Enforceable Agreement"

Recent case law also demonstrates the continuing vitality of the first requirement—the existence of an "otherwise enforceable agreement." Applying Texas law, the Fifth Circuit recently affirmed that where an employment agreement is devoid of any promises by the parties with respect to confidential information, then there can be no "otherwise enforceable agreement." *Hunn v. Dan Wilson Homes, Inc.*, 789 F.3d 573, 586 (5th Cir. 2015). Notably, the court rejected the employer's argument that the common law duty not to disclose confidential information was sufficient to establish the requirement, reasoning that the issue was not whether the employee "had a duty, enforceable in tort, not to disclose confidential information," but rather whether the parties had entered into "an enforcement *contract* to which the non-compete covenant was ancillary." *Id.* (emph. in original). The Texarkana Court of Appeals reached this same result in a case involving agreements between at-will employees and their employer, an employment recruiter, where the agreements identified "neither confidential, proprietary, or trade secret information to be divulged, nor any goodwill or specialized training to be provided the employees in consideration for the signing the contracts." *Lazer Spot, Inc. v. Hiring Partners, Inc.*, 387 S.W.3d 40, 47 (Tex. App.—Texarkana 2012, rev. denied). Under such circumstances, the consideration of at-will employment is "illusory." *Id.*

3. Injunctive Relief

Injunctive relief is commonly sought in cases brought under the Covenant Not to Compete Act. A number of courts have concluded that the Act does not preempt the common law requirements for a temporary injunction. As the First Court of Appeals has explained, since the language of the Act expresses "an intention to govern only final remedies," and because a temporary injunction is not a final remedy, then temporary injunctive relief under the Act is governed by common law. *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 239 (Tex. App.—Houston [1st Dist. 2003, no. pet.) (en banc). *See also Primary Health Physicians, P.A. v. Sarver*, 390 S.W.3d 662, 665 (Tex. App.—Dallas 2012, no pet.) ("We agree . . . that the Act governs only final remedies and does not supplant the common law requirements for a pretrial temporary injunction."); *EMSL Analytical, Inc. v. Younker*, 154 S.W.3d 693 (Tex. App.—Houston [14th Dist.] 2004, no pet.); *Wright v. Short Supply Group, Inc.*, 137 S.W.3d 289, 293 n.1 (Tex. App.—Beaumont 2004, no pet.).

Whether the enforceability of a covenant not to compete should be considered at the temporary injunction stage has drawn a mixed response from Texas courts. Some courts say no. *See e.g.*, *Loye v. Travelhost, Inc.*, 156 S.W.3d 615, 620 (Tex. App.—Dallas 2004, no pet.) ("the issue of whether the covenant not to compete is enforceable must await a final judgment on the merits"); *Vaughn v. Intrepid Directional Drilling Specialists, Ltd.*, 288 S.W.3d 931, 937 (Tex. App.—Eastland 2009, no pet.) ("At a temporary injunction hearing, a trial court does not address the ultimate issue of whether a covenant not to compete is enforceable under Section 15.50 of the Business and Commerce Code.").

Two more recent cases, however, have taken a more nuanced approach. In *Dickerson v. Acadian Cypress & Hardwoods, Inc.*¸ 2014 WL 1400659 (Tex. App.—Beaumont 2014, no pet.), Chad Dickerson worked for Acadian as a sales representative and signed a non-competition/non-solicitation agreement, which prohibited him from competing with Acadian within a certain geographical area for two years after leaving the company. Later, after Dickerson began working for a competitor, Acadian obtained a temporary injunction prohibiting Dickerson from working for others in Acadian's industry. On an appeal from that injunction order, the appellate court affirmed the trial court's determination that the agreement constituted an "otherwise enforceable agreement" to which Dickerson was bound, *id.* at *5, although it cited *Vaughn* for the proposition that "by granting a temporary injunction, a trial court does not declare that a covenant not to compete is valid." *Id.* at *3-4. In line with common law requirements, the court also determined that Acadian demonstrated irreparable harm would occur without a temporary injunction. *Id.* at *5.

In a case involving similar facts where an employee left his employer to work for a competitor after signing a covenant not to compete, the Fort Worth Court of Appeals held that limited review of the enforceability issue was available on an appeal from a temporary injunction order. *Tranter, Inc. v. Liss*, 2014 WL 1257278 (Tex. App.—Fort Worth 2014, no pet.). According to that court, while "an appeal of an order denying temporary injunction based on noncompete clauses does not present for appellate review the ultimate question of whether the agreement is enforceable," the appellate court would still review enforceability "to the extent necessary to determine whether the requirements for a temporary injunction [i.e., the likelihood of prevailing on the merits of the claim] have been met." *Id.* at *3.

In contrast to temporary injunctions, the Act preempts the common law requirements for permanent injunctive relief. As the First Court of Appeals has explained, "if an applicant relies on a statute that defines the requirements for injunctive relief, then the express statutory language supersedes common law requirements." *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 795 (Tex. App.—Houston [1st Dist.] 2001, no pet.). Thus, because the Act has no requirement for a showing of irreparable injury, an applicant seeking permanent injunctive relief need not show irreparable injury for which there is no adequate legal remedy, as is required at common law.

TEX. BUS. COM. CODE ANN. §15.51(a) (providing for "damages, injunctive relief or both" for a breach of a noncompete by the promisor); *see also id.* §15.52 (stating that "the procedures and remedies . . . provided by Section 15.51 . . . are exclusive and preempt any other criteria for enforceability of a covenant not to compete or procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise").

4. Scope and Reasonableness

As noted, a covenant not to compete must contain "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." TEX. BUS. & COM. CODE §15.51. The reasonableness of the restraints is question of law for the court. *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 388 (Tex. 1991). An industry-wide bar is unreasonable. *Id.* When applied to a personal services occupation, a restraint on client solicitation is overbroad and unreasonable if it extends to clients with whom the employee had no dealings during his employment. *Id.* Likewise, geographic restrictions are reasonable to the extent they are commensurate with the territory in which the employee worked during his employment with the employer. *Butler*, 51 S.W.3d at 793.

The reasonableness of such restraints is a topic frequently addressed by Texas courts. In *Alex Sheshunoff Mgmt. Services, L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006), the Supreme Court upheld a covenant not to compete that restricted an employee from soliciting 821 customers of his former employer for a one-year period. The Court found this agreement reasonable, as evidenced by the fact that the employee developed clients for four years after the agreement was signed and could have unfairly capitalized on the resulting goodwill when going to work with a competitor and by the fact that the employee had been privy to the employer's development of a product to compete with the competitor. *Id.* at 657. Also persuasive to the Court was the fact that the employee subsequently entered into an agreement with the competitor whereby he agreed not to sell to anyone in the industry for a two-year period, representing terms more restrictive than those with his previous employer. *Id.*

In *U.S. Risk Ins. Group, Inc. v. Woods*, 399 S.W.3d 295 (Tex. App.—Dallas 2013, no pet.), the Dallas Court of Appeals recently considered a covenant not to compete that prohibited a former employee from "being associated with or employed by an business that competes in the business currently engaged in by USRIG or any of its subsidiaries," where the provision was not limited to the type of business the employee had personally performed for USRIG. The court determined that this provision was not reasonable because it extended beyond activities that the employee had previously performed for the company. *Id.* at 301. Likewise, in *Nacogdoches Heart Clinic, P.A. v. Pokala*, 2013 WL 451810 (Tex. App.—Tyler 2013, rev. denied), the Tyler Court of Appeals held that a covenant not to compete was overly broad where it prohibited a doctor, who had previously practiced only internal medicine and cardiology, from practicing any kind of medicine within ten miles of Nacogdoches. *Id.* at *4.

In a contrasting recent decision, a Houston federal court, applying Texas law, granted a preliminary injunction to enforce a two-year noncompete covenant which barred an employee from working in the field of the employer, a reactor thermometer manufacturer, for two years. *Daily Instruments Corp. v. Heidt*, 998 F.Supp.2d 553 (S.D. Tex. 2014). There, the court found that the field of reactor thermometry was "very narrow"; that the defendant-employee's knowledge of his employer's confidential information was "extensive"; and that limitations on the employee's ability to work for competitors extended only to "the kind of work he performed for [employer] in his last two years of employment." *Id.* at 568.

5. Attorney Fees

Section 15.51(c), which relates to procedures and remedies in actions to enforce covenants not to compete including an award of attorney fees in certain circumstances, provides in full:

> If the covenant is found to be ancillary to or part of an otherwise enforceable agreement but contains limitations as to time, geographical area, or scope of activity to be restrained that are not reasonable and impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee, the court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of covenant before its reformation and the relief should be limited to injunctive relief. *If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services*, the promisor establishes that the promise 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, *the court may award the promisor the costs, including reasonable attorney's fees,* actually and reasonably incurred by the promisor in defending the action to enforce the covenant.

TEX. BUS. & COM. CODE §15.51(c) (emph. added).

In *Franlink, Inc. v. GJMS Unlimited, Inc.*, 401 S.W.3d 705, 711 (Tex. App.—Houston [1st Dist.] 2013, rev. denied), the Fourteenth Court of Appeals considered whether a promisee (i.e., the one to whom a promise is made) could invoke §15.51(c) as a basis for the recovery of its fees. There, the plaintiff/franchisor brought suit against certain of its franchisees and a competitor seeking enforcement of a noncompete provision contained in the governing franchise agreement. After reforming the franchise agreement's noncompete provision to narrow its geographical area and scope, the court granted a preliminary injunction but denied the franchisor's motion for an award of fees. That denial was affirmed on appeal. Viewing §15.51(c) in its entirety, the appellate court concluded that attorney fees are available in the "single circumstance" of where "in the context of a personal-services agreement," a promisor satisfies "certain evidentiary requirements in defending against enforcement of an unreasonable covenant." *Id.* at 711. Because the franchisor stood in the role of a promisee rather than a promisor, that circumstance did not apply. Instead, the franchisor attempted to argue that it was entitled to an award of fees under the first sentence of §15.51(c), which authorizes a court to reform an unreasonable covenant. The court rejected that contention, noting that in the event of reformation, the only relief available to a promisee is "injunctive relief," per the terms of the statute. *Id.* at 712. Explaining the rationale for the formulation of §15.51(c), the court noted that it reflected a legislative intent to discourage the enforcement of unreasonable covenants not to compete "by precluding a promisee from obtaining an award of either damages or attorney's fees when it seeks to enforce a covenant so overly restrictive that it requires reformation." *Id.*

In addition, most courts considering the issue have concluded that §15.52 of the Act, which provides for preemption of other "procedures and remedies in an action to enforce a covenant not to compete," precludes other grounds for the recovery of fees in an action seeking relief under the Act. TEX. COM. & BUS. CODE §15.52; *see also Ginn v. NCI Building System, Inc.*, 472 S.W.3d 802, 824-27 (Tex. App.—Houston [1st Dist.] 2015, no pet.) (preempting claim for attorney fees for statutory-fraud claim pursuant to TEX. BUS. & COM. CODE §27.01(e); *Franlink, Inc.*, 401 S.W.3d at 708-09 (preempting claim for attorney fees for contract claim under TEX. CIV. PRAC. & REM. CODE §38.001(8)). That preemptive scope extends to contractual bases for an award of fees. *See Glattly v. Air Starter Components*, *Inc.*, 332 S.W.3d 620, 644-45 (Tex. App.—Houston [1st Dist.] 2010, no pet.) (Act preempts common law rule that a party may recover attorney fees if provided for by contract).

VIII. Shareholder Relationships

A. Minority Shareholder Oppression.

1. Background

The most significant recent development concerning shareholder relationships has been the Texas Supreme Court's decision in *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014), in which the Court declined to recognize a Texas common law cause of action for minority shareholder oppression. In *Ritchie*, a minority shareholder alleged that the defendants engaged in oppressive conduct and breached their fiduciary duties by declining to offer her a fair price for her shares and refusing to assist in the sale of those shares by meeting with third parties. Among other relief, the plaintiff sought an order obligating the company to purchase her shares, claiming as grounds a violation of the Texas receivership statute, TEX. BUS. ORGS. CODE §11.404. and a breach of fiduciary duty. At trial, the jury found in plaintiff's favor on her claims and found that the fair value of plaintiff's stock was $7.3 million, whereupon the trial court ordered that the company purchase plaintiff's stock in that amount. The appellate court affirmed, finding as a matter of law that the defendants' refusal to meet with the plaintiff's prospective purchasers constituted oppressive conduct as a matter of law.

In its decision, the Supreme Court considered both whether the defendants' conduct was "oppressive" within the meaning of the Texas receivership statute and, more generally, whether an action for shareholder oppression exists under common law. As to the first issue, the Supreme Court concluded that conduct was "oppressive" only if directors or managers abused their authority with the intent of harming a shareholder "in a manner that does not comport with the honest exercise of their business judgment" and thereby create "a serious risk of harm to the corporation." *Ritchie*, 443 S.W.3d at 871. Applying that standard, the Supreme Court concluded that defendants' refusal to cooperate in the sale of plaintiff's shares was not "oppressive." Further, according to the Court, even if the conduct had been oppressive, the only remedy afforded by the receivership statute was the appointment of a rehabilitative receiver, not a buy-out of plaintiff's shares.

As to whether a claim for shareholder oppression exists under Texas law, the Supreme Court found that such a cause of action is unnecessary in light of other available remedies. Those remedies include (1) judicial proceedings to enforce close corporation provisions, appoint a provisional director, or appoint a custodian, pursuant to TEX. BUS. ORGS. CODE §21.752; (2) a derivative action on behalf of the corporation; (3) enforcement of shareholder agreements; and (4) various common law causes of action, including breach of fiduciary duty, fraud and constructive fraud, conversion, fraudulent transfer, conspiracy, unjust enrichment, quantum merit, and an action for an accounting. *Ritchie*, 443 S.W.3d at 881-82.

Continuing its analysis, the Supreme Court concluded that these remedies were sufficient to address those categories of conduct identified as frequent causes of shareholder oppression, including rights of access to corporate books and records, withholding or refusing to declare dividends, misapplication of corporate funds or misappropriation of corporate opportunities, and manipulation of corporate share values. *Id.* at 888. Further, given the "lack of clarity and predictability" associated with traditional common law standards for "oppression," the creation of new and independent remedies would represent "bad jurisprudence." *Id.* at 890. Finding no compelling grounds for changing the law, the Supreme Court declined to create a new remedy.

A week later, the Supreme Court decided *Cardiac Perfusion Services, Inc. v. Hughes*, 463 S.W.3d 790 (Tex. 2014), in which it applied its holdings from *Ritchie*. In that case, plaintiff Hughes was hired by defendant Jourban to work for his company CPS, an operator of heart/lung machines, in which Hughes subsequently purchased a ten percent ownership interest for $25,000. As part of the transaction, a buy/sell agreement was executed whereby Jourban was required to repurchase Hughes' shares at book value in the event Hughes was terminated. Jourban subsequently fired and then sued Hughes seeking enforcement of the agreement. Hughes brought a counter-claim for shareholder oppression, claiming, among other things, that Jourban had misused corporate funds, suppressed the payment of dividends to Hughes, and denied him access to corporate books and records. *Id.* at 791. Based on jury findings of shareholder oppression, the trial court nullified the agreement and determined that Hughes' ownership interest should be bought out at $300,000, its fair market value. In light of its ruling in *Ritchie*, the Supreme Court reversed on the basis that the buy-out remedy awarded Hughes is not available under a common-law claim for shareholder oppression or under the receivership statute. *Id.* at 792. The Supreme Court remanded the case, however, to allow the plaintiff to pursue other potential legal protections, specifically noting the availability of a derivative action for breach of fiduciary duties under TEX. BUS. & ORGS. CODE §21.563(c). Based on a review of both the trial and appellate court records, it does not appear that Hughes elected to pursue that remedy.

2. Recent Developments

After *Ritchie* and *Hughes*, some courts have addressed the issue of what kind of conduct is "oppressive" for purposes of the Texas receivership statute, TEX. BUS. ORGS. CODE §11.404.

According to the Supreme Court, a showing of oppressive conduct requires evidence of actions that did not comport with the business judgment rule and created a serious risk of harm to the corporation. *Ritchie*, 443 S.W.3d at 871. In applying the Texas receivership statute, the Fifth Circuit has found that standard satisfied where the defendant, a co-founder of a start-up search engine company, engaged in a combination of bad acts, including usurping business opportunities, failing to prosecute intellectual property belonging to the corporation, using litigation as a means to prevent rightful owners from reclaiming their intellectual property, and creating a competitor to develop substantially similar intellectual property. *In re Mandel*, 578 Fed. Appx. 376, 388 (5th Cir. 2014). In *Texas Ear Nose & Throat Consultants, PLLC v. Jones*, 470 S.W.3d 67 (Tex. App.—Houston [14th Dist.] 2015, no pet.), the plaintiff succeeded in his shareholder oppression claim against a medical practice corporation, and in a verdict rendered prior to *Ritchie*, secured an order requiring the buy-back of his minority shares. On appeal, the Fourteenth Court of Appeals reversed the award of damages but remanded for a determination of whether the defendants' actions were justified under the business judgment rule, where the jury had made findings that defendants had failed to allow plaintiff to inspect financial books and records, improperly refused to conduct an audit, and improperly deprived the plaintiff of participating in company decisions. *Id.* at 92-93.

B. Fiduciary Duty

1. Background

The Texas Supreme Court has yet to rule as to whether shareholders owe each other a fiduciary duty as a matter of law, even in close corporations. In the case of *Willis v. Donnelly*, 199 S.W.3d 262 (Tex. 2006), the trial court instructed the jury that a majority shareholder owed a minority shareholder a fiduciary duty. On appeal, the Supreme Court noted that it was an open question "whether a majority shareholder in a closely held corporation owes a minority shareholder a general fiduciary duty under Texas law." *Id.* at 276. The Supreme Court continued, however: "We do not explore [this] issue . . . but hold instead that the breach of fiduciary duty claim in the pending case fails because all the alleged breaches of fiduciary duty occurred before Donnelly became a shareholder and before he was entitled to shareholder status." *Id.* at 267-77. The Supreme Court noted a general unwillingness to recognize a fiduciary relationship in these circumstances, "consistent with our previously recognized reluctance to recognize fiduciary relationships, especially in the commercial context." *Id.* at 278.

A number of opinions from the appellate courts have similarly declined to find a fiduciary duty between shareholders as a matter of law, but have left open the possibility of an informal duty depending on the facts of the case. *See, e.g.*, *Pabich v. Kellar*, 71 S.W.3d 500, 504-05 (Tex. App.—Fort Worth 2002, pet. denied); *Hoggett v. Brown*, 971 S.W.2d 472, 487-88 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); *Kilpatrick v. Kilpatrick*, 2013 WL 3874767, at *4 (Tex. App.—Fort Worth 2013, no pet.); *Opperman v. Opperman*, 2013 WL 6529228, at *4-5 (Tex. App.—Amarillo 2013, no pet.).

2. Recent Developments

Recent cases addressing the existence of a fiduciary duty between shareholders based on particular circumstances have produced a mixed bag of results. The continuation of the litigation described in *Ritchie v. Rupe*, 443 S.W.3d 856, marks an unfavorable result for minority shareholders. In addition to her oppression claim, the plaintiff also prevailed on a breach of fiduciary duty claim in the trial court based on what she claimed was an informal fiduciary relationship between her and the defendants. Because the appellate court based its decision only on the finding of oppressive conduct, the Supreme Court remanded the case for a resolution of defendants' challenges to the fiduciary breach claim, including the availability of a court-ordered buyout remedy. *Ritchie*, 443 S.W.3d at 891-92.

On remand to the Dallas Court of Appeals, the court concluded there was insufficient evidence to establish that a relationship of trust and confidence existed between the plaintiff and defendants and thus no informal fiduciary relationship existed. *Ritchie v. Rupe*, 2016 WL 145571 (Tex. App.—Dallas 2016, Rule 53.7(f) motion granted). According to the plaintiff, after her husband's death, she approached other shareholders in the family-owned company who were her husband's relatives about buying shares held by a trust of which she and her son were beneficiaries. The court said the plaintiff could not have placed trust and confidence in the defendants given her testimony that she was treated like an outsider from the beginning, that she admitted being told that "you'll never get any money in this family," and that her feelings of trust were entirely subjective. *Id.* at *5-6. The court also rejected plaintiff's argument that evidence of domination and control by the majority shareholder alone established a relationship of trust, but instead represented an additional requirement the jury was required to find, pursuant to the instructions submitted in the case. *Id.* at *3-4.

Other recent cases represent more favorable outcomes for minority shareholders. For example, in *Allen v. Devon Energy Holdings, LLC*, 367 S.W.3d 355 (Tex. App—Houston 2012, pet. granted, judm't set aside, remanded by agr.), the plaintiff, a minority shareholder, sold his interest in an oil and gas exploration company. Two years later, the company sold for approximately twenty times the value that had been used to calculate the plaintiff's redemption price. The plaintiff then sued both the company and its majority owner for breach of fiduciary duty, among other claims. In particular, the plaintiff claimed that the majority owner withheld information that would have caused him to reject the redemption offer at the time it was made. The majority owner moved for summary judgment, claiming the plaintiff could not demonstrate that a fiduciary duty existed, and his motion was granted by the trial court.

The First Court of Appeals reversed. While the court acknowledged that Texas law has not recognized a general fiduciary duty between a majority and a minority shareholder in a closely held corporation (which they analogized to a closely held LLC), it proceeded to consider whether there is a formal fiduciary duty owed by a majority owner of an LLC in the context of a redemption. *Id.* at 389-91. The court concluded that there is such a duty. *Id.* at 391-92. Based on the lack of controlling law on the issue, the court compared the situation to that of a partnership. Considering that the defendant majority owner ran the company's day-to-day operations and had "intimate knowledge" of its plans and daily business, the court determined that the majority owner essentially held the powers and responsibilities of a general partner. *Id.* at 392-93. In contrast, the plaintiff was a "passive investor" without the majority owner's knowledge of the business. *Id.* at 393. As a result, the court held that "the relationship between [the majority owner and plaintiff] is substantially similar to the relationship between the general partner and a limited partner in a limited partnership. The nature of this relationship supports recognizing a fiduciary duty . . . ." *Id.*

Another recent case, *Opperman v. Opperman*, 2013 WL 6529228 (Tex. App.—Amarillo 2013, no. pet.), also supports the extension of fiduciary duties between shareholders in a closely held corporation. Plaintiff Richard Opperman owned 10% of the shares in the corporation, while his brother, defendant Randal Opperman, owned the other 90%. After the sale of the corporation, the plaintiff filed suit for breach of fiduciary duties. The defendant moved for summary judgment, arguing that there was no fiduciary relationship between the parties. While the trial court granted summary judgment for the defendant, the Amarillo Court of Appeals reversed. The opinion noted that an informal fiduciary duty may exist between shareholders "where there is a confidential relationship between the parties." *Id.* at *4. The court considered the parties' status as co-officers and co-directors of the corporation, and also noted their familial relationship. Based on these factors, the court held there was a genuine issue of material fact as to whether an informal fiduciary relationship existed between the plaintiff and defendant. *Id.* at *5.

IX. Litigation Finance

A. Background

Advancing funds to help both individuals and business entities pursue litigation claims has become a common practice, although its full extent is difficult to gauge because third-party funding arrangements are not typically disclosed. Nevertheless, based on publicly available information, it is clear that litigation finance has increased significantly in the past five years.

A relative newcomer to the field—Chicago-based Gerchen Keller Capital—is currently reported to have more than $1.4 billion in assets under management, a dramatic increase from April 2013 when it launched its first $100 million fund. Other funders have reported growth in assets as well. U.K-based Harbour Litigation Funding, which has a reported to have $585 million in assets, disclosed in March 2015 that it secured nearly $400 million in new funding. Australia-listed funder IMF Bentham operates offices in New York and California and has recently teamed with a major U.S. firm to bring a $45 billion shareholder action on behalf of large institutional investors against Volkswagen AG over its diesel emissions problems. *See* "Topping $1 Billion Mark, Big Litigation Funder Gets Bigger," *The Am Law Daily*, Jan. 6, 2016. Another major player in the litigation finance field, Burford Capital LLC, is reported to have more than tripled its investment commitments to over $500 million at the beginning of 2015. "Q&A With Litigation Financier Chris Bogart," *New York Business Journal*, Feb. 27, 2015.

Under a typical funding agreement, the party providing financing will give money to a plaintiff to pay for the cost of the lawsuit and then receive a specified return if there is a settlement or judgment in the plaintiff's favor. If the plaintiff fails to make a recovery, then the party advancing funds receives nothing. Proponents of the practice have claimed that it helps level the playing field for those who would otherwise be unable to pursue their claims. Critics have contended that third-party investors give outsiders undue influence over legal decisions and facilitate lawsuits that would otherwise not be pursued, thus increasing litigation costs. These differing viewpoints are reflected in a number of recent high-profile disputes related to litigation funding, including disputes among attorneys soliciting such funding and at the extreme periphery, allegations of judicial-tampering in foreign jurisdictions. *See Chevron Corp. v. Donziger*, 974 F.Supp.2d 362 (S.D.N.Y. 2014) (barring enforcement of foreign judgment); "Firms Draw Huge Profits With Third-Party Assisted Litigation," *Houston Chronicle*, Nov. 8, 2015 (describing lawsuit among Houston attorneys arising from acquisition of docket of personal injury cases, funded by third-party investor).

Litigation funding agreements are legal in Texas, provided they are not structured as loans and do not thereby run afoul of the state's usury laws or violate other public policy considerations, such as the doctrine of champerty and maintenance.

B. Usury

If an advance of money is deemed to be a loan rather than a funding agreement, then any return of funds are characterized as interest, which are then subject to state usury laws. Under the Texas Finance Code, "loan" means "an advance of money that is made to or on behalf of an obligor, the principal amount of which the obligor has an obligation to pay the creditor." TEX. FIN. CODE ANN. §301.002(a)(10). Therefore, if the plaintiff has no "obligation" to pay the funder, then there is no "loan." Without a loan, any payment back to the funder at the conclusion of the lawsuit cannot be "interest," and without interest, there is no usury.

Accordingly, where a repayment of an investment is based on an absolute contingency beyond the control of the investor, the transaction is not a loan. *Holley v. Watts*, 629 S.W.2d 694, 696 (Tex. 1982). For example, where pursuant to the terms of a litigation funding agreement, a recovery of principal and any return is contingent upon a case recovery, then no absolute obligation exists. Such agreement is not a loan and cannot be usurious. *Anglo-Dutch Petroleum Int'l v. Haskell*, 193 S.W.3d 87, 96 (Tex. App.—Houston [1st Dist.] 2006, rev. denied). Likewise, where a funding agreement provides that if the plaintiff recovers nothing or any insufficient amount of damages and therefore has no obligation to reimburse the investor or pay any return, the agreement is not a loan and cannot be usurious. *Id.*

The contingency set forth in the agreement is not "erased" by expectations of the parties, including by a subjective belief that the investment has "no risk" or that the likely recovery far exceeded the amount invested. *Id.* at 100. But decisions outside Texas recognize that where recovery is a "sure thing" or there is "no real probability" of non-payment, then a funding agreement can constitute a usurious transaction. *See, e.g.*, *Lawsuit Financial, L.L.C. v. Curry*, 683 N.W.2d 233, 239 (Mich. Ct. App. 2004) (payment to plaintiff resulting in four-fold return was usurious loan where prior to payment defendants in underlying litigation admitted liability and jury returned verdict far in excess of advanced amount); *Echeverria v. Estate of Lindner*, 2005 WL 1083704, at *8 (N.Y. Sup. Ct. 2005) (because strict liability applied to labor law cause of action asserted by injured plaintiff, recovery was a "sure thing" and $25,000 payment at rate of 3.85% per month was usurious)

C. Champerty and Maintenance

Champerty is defined as an "agreement by a stranger to a lawsuit and a litigant by which the stranger pursues the litigant's claim as consideration for receiving part of any judgment proceeds." Black's Law Dictionary 224 (7th ed. 1999). The Texas Supreme Court has recognized that "free alienation of chooses of action [is] the general rule," although some contractual assignments are "inoperative on grounds public policy," particularly those that tend to increase and distort litigation. *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696, 707 (Tex. 1996) (insured's assignment of claim against insurer to plaintiff who had no right to recover against insurer to be void against public policy). *See, e.g.*, *Zuniga v. Groce*, *Locke & Hebdon*, 878 S.W.3d 313, 316 (Tex. App.—San Antonio 1994, writ ref'd n.r.e.) (holding assignments of legal malpractice claims invalid).

There is limited Texas case law addressing the doctrine of champerty and maintenance in the context of litigation funding agreements. In *Anglo-Dutch*, the First Court of Appeals concluded that the doctrine was not implicated under the facts of that case by considering whether the agreement "prey[ed] on [a] financially desperate plaintiff" and whether the investor (as opposed to the plaintiff) maintained control over the lawsuit. *Anglo-Dutch*, 193 S.W.3d at 104. As to the first factor, the *Anglo-Dutch* court found that plaintiff's solicitation of the investment and evidence that the agreement was bargained for negated any inference that the plaintiff was "preyed" upon or was "financially desperate." *Id.* Likewise, there was no evidence that the investor "controlled" the litigation as shown by the absence of provisions in the funding agreement permitting the investor to select counsel, direct trial strategy, or participate in settlement negotiations. *Id.*

A New York state court decision provides a recent example of circumstances where the champerty doctrine is applicable. In *Justinian Capital SPC v. Westlab AG*, 128 A.D.3d 553, 10 N.Y.S.3d 41 (1st Dept. 2015), nonparty Deutsche Pfandbriefbank AG (DPAG) purchased notes from two investment vehicles known as Blue Heron, of which defendant Westlab acted as asset manager. Fearing that if it sued Westlab directly that it would displease Westlab's part owner, the German government, DPAG conveyed its interests in the notes to plaintiff Justinian pursuant to a purchase agreement. In relevant part, the agreement recited a purchase price of $1 million, which plaintiff never paid; provided that DPAG retained rights in the notes related to the litigation and any settlement; and required plaintiff to pay 85% of any settlement to DPAG, less the $1 million purchase price. On defendants' motion, the trial court found that the purchase agreement was champertous and dismissed the complaint. The appellate court affirmed, concluding that the intent of the plaintiff was not to enforce the notes on its own behalf, but instead entered into the purchase agreement "with the intent of pursuing litigation on DPAG's behalf in exchange for a fee." *Id.* at 555. Particularly persuasive to the court were the facts that DPAG maintained significant rights in the notes and expected "the lion's share of any recovery." *Id*. While these facts are admittedly unique, they do suggest that courts will look to the underlying economic reality in addressing champerty issues.

Proponents of litigation finance appear to have won an important victory when on March 8, 2016, a Delaware Superior Court held that the use of funding provided by a subsidiary of Burford Capital did not run afoul of champerty laws. The plaintiff in the suit, Charge Interjection Technologies, Inc., sued DuPont Co. in 2007, asserting that DuPont improperly used and disclosed the plaintiff's technology. The Burford subsidiary became involved in the case in 2012. According to the Delaware court, Burford did not "stir up" the litigation, nor was there any evidence that Burford controlled or forced the plaintiff to pursue the litigation. "Litigation Funder Doesn't Violate Ethical Boundaries, Court Finds," *Wall Street Journal*, Mar. 9, 2016.

D. Legislative Developments

The Texas Legislature has considered legislation on two occasions in the past ten years that would have impacted litigation funding agreements. Neither was enacted.

The first, proposed in the 2005 session, would have applied the usury interest prohibition in the Texas Finance Code to litigation funding agreements and declared a rate of return in excess of that prohibition to be against state public policy. That bill passed the Texas House, but never received a vote in the Senate. In the 2013 session, legislation was proposed in the House that would have set out a regulatory framework allowing plaintiffs to assign contingent rights to receive any recovery to third parties. Under the proposal, companies providing funding would have been required to register with a state agency, would have had no say in any settlement decisions, and would have been barred from interfering with the judgment of the attorney handling the claim. Notably, the proposed legislation would have applied only to lending arrangements involving individuals and would have exempted such transactions from state laws governing loans. *See* "Third-Party Litigation Funding Regs Proposed In Texas," *Law360*, Feb. 14, 2013. The bill was not reported out of House committee and did not become law.

Other states have considered regulation of litigation finance as well, either through legislation or judicial intervention. In November 2015, the Colorado Supreme Court affirmed a decision by the Administrator of the Colorado Uniform Consumer Credit Code that litigation financing agreements that provide money to plaintiffs with pending personal injury claims are subject to the Colorado UCCC. Among other factors cited by the court in deciding that the agreements were debt under the UCCC were provisions that caused the amount to be repaid to grow with time. The fact that the borrower's repayment obligation was conditioned on a recovery was not dispositive. *Oasis Legal Finance Group, LLC v. Coffman*, 361 P.3d 400, 409-10 (Colo. 2015).

On the legislative front, according to the National Conference of State Legislatures, twelve states addressed lawsuit financing transactions in the 2014 legislative session, two of which enacted legislation. Oklahoma amended provisions regarding administrative fees for violations by consumer litigation funders. More significantly, Tennessee enacted a comprehensive consumer protection act for litigation financing, which among other things, requires registration in the state as a litigation financer; regulates charges and fees; requires the posting of a surety bond; and provides consumers with a right of rescission. *See* http://www.ncsl.org/research/financial-services-and-commerce/litigation-funding-transactions-2014-legislation.aspx. In the 2015 legislative session, ten states addressed litigation finance, two of which enacted legislation. Arkansas passed legislation applying state usury laws to consumer lending arrangements. Notably, according to the terms of the Arkansas legislation, it applies only to funds used for purposes other than prosecuting the consumer's dispute. In addition, Vermont enacted legislation required its commissioner of Financial Regulation and attorney general to prepare recommendations or draft legislation. *See* http://www.ncsl.org/research/financial-services-and-commerce/litigation-or-lawsuit-funding-transactions-2015-legislation.aspx.