Chapter 5

Evaluating Commercial Cases: Avoiding Icebergs

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5-1 INTRODUCTION

My firm, Susman Godfrey, which has pioneered handling commercial cases on an alternative fee basis, likes to say that winning is the most important part of our practice. That's not true. The most important part of our practice is evaluating and selecting cases at the outset. The key is avoiding the losing cases—the icebergs that could sink a practice.

PRACTICE POINTER:
In reality, there is only so much good lawyering can do for a case. Some cases simply are born losers. Commercial cases usually represent huge commitments of time and often money for lawyers. As a result, the downside of accepting a bad commercial case is magnified.

While no one case could kill our firm financially because we have a large and diverse docket, our firm was not always so large. For many firms, a "bet the company" commercial case also can represent a "bet the firm" case—a case that a firm cannot afford to lose. This chapter is intended to help lawyers evaluate and select commercial cases, and hopefully, to avoid hitting iceberg cases.

Absent a conflict, a lawyer who is paid by the hour "selects" cases based on a single criteria: the client's ability to pay the hourly bills timely. Given the growth of "alternative" fee arrangements in commercial cases, where a lawyer's compensation often turns more on results obtained than hours worked, case selection is critically important.

This chapter attempts to focus on two areas. First, this chapter addresses some general guidelines for evaluating potential cases. The guidelines are largely based on how my firm, Susman Godfrey, handles case evaluation. Since its founding 30 years ago as one of the first boutique commercial litigation firms, Susman Godfrey lawyers have met almost every Wednesday to discuss and vote on potential cases. While our system is imperfect and may not fit every practice, the case evaluation process that culminates in the Susman Godfrey "Wednesday Meetings" has been an integral part of our firm's financial success. The first part of this chapter, therefore, outlines how Susman Godfrey handles case evaluation and describes particular guidelines we try to employ when evaluating a case on the merits.

PRACTICE POINTER:
With our cowboy boots and Stetson hats, Texas is famous for having a unique culture. We also have unique legal rules that apply to many commercial cases.

The second part of this chapter focuses on a few common legal issues that arise when evaluating commercial cases for filing in Texas. Many of these rules can surprise lawyers who are not familiar with Texas jurisprudence and some are even surprising (usually unpleasantly so) to those of us who practice in Texas, especially on the plaintiff's side of the bar. This section of the chapter discusses the following particular areas of Texas law: (1) the scope of arbitration clauses; (2) motion to dismiss practice; (3) shareholder oppression; (4) negligent misrepresentation; (5) so-called "holder" claims for securities plaintiffs; (6) setting aside releases; (7) breach of fiduciary duty; and (8) tortious interference with prospective business relations. Commercial cases regularly touch on these

areas, so anyone evaluating a commercial case in Texas likely will confront the unusual wrinkles of Texas law on these topics.

5-2 GENERAL RULES OF EVALUATING BUSINESS CASES

For over 30 years, my firm has developed a systematic approach to case evaluation. While the specific system that we employ may not be appropriate for every firm, the basic rules that we apply work for any lawyer. This section outlines my firm's case selection process and provides some guidance for structuring a case evaluation procedure in any firm.

5-2:1 A System Approach to Case Evaluation

Navigating through potential cases is more art than science. Selecting good cases depends greatly on professional experience and subjective judgments. This does not mean, however, that the process should be ad hoc or haphazard. Given the importance of case evaluation to any law practice, you owe it to yourself and your partners to adopt a system for evaluating cases. Case intake implicates your allocation of resources—time and money—among cases. Obviously, you want to accept the better cases and turn away the inferior cases. However, the choice among cases rarely presents itself at the same time; instead, potential cases land on your doorstep at random times. As a result, you need to develop a way to evaluate cases in a uniform way—to apply a standard grading system.

PRACTICE POINTER:
One way to make sure that you are accepting cases that are relatively better than others that you evaluate is to apply the same procedures in evaluating each case—at a minimum, you will avoid accepting bad cases merely because you did not apply the same scrutiny that you would have in a typical case.

Our firm's specific procedure for case evaluation requires that a lawyer submit every non-hourly case to a firm-wide vote. We only take a case that gets a majority vote of all lawyers where the

client is paying expenses and a two-thirds majority where the firm is fronting expenses.

Every lawyer in the firm participates in these discussions—associates and partners. We have not adopted this inclusive approach merely because we love democracy (we do), but also because the best teaching tool for less-experienced lawyers is to listen to more-experienced lawyers debate the merits of potential cases.

In advance of the meeting, the lawyer or lawyers sponsoring the case must prepare a memorandum that outlines the basic facts of the case, provides details about the anticipated procedural path of the case (any procedural history if the case is already on file), and perhaps most importantly, explains the proposed fee arrangement. Most such memoranda do not exceed 5-pages in length.

A sample of one such memorandum is attached as Exhibit A to this chapter. The memorandum is from an actual case that was presented and accepted at our firm. Obviously, much of the factual information has been redacted to protect the client's confidential information. Nevertheless, even the redacted version provides a good idea of what such a memorandum should look like and what issues it should address.

While all lawyers are welcome and expected to participate in the debate about potential cases, we appointed a rotating (it changes monthly) panel of five lawyers who are charged with providing particular scrutiny to potential cases and with leading the debate. The panel acts as a devil's advocate to make sure that cases do not avoid a hard look because other lawyers are distracted with their day-to-day practices. Before the entire firm votes, the panel members each announce their votes.

For what it is worth, the approval rate for cases that get presented is very high. The high pass rate, however, does not mean that we are easy graders. To the contrary, a questionable case (even one we end up taking) often gets a withering attack, including a lot of mocking. The high pass rate comes from the fact that most lawyers are reluctant to submit a borderline case. I often find myself listening to prospective client explain a case and thinking, "I will never get this past the firm." In short, the mere existence of the process seems to cause lawyers to exercise

extra prudence when evaluating cases before the firm itself considers a case.

Lawyers at larger firms may find this process unwieldy. However, my firm has almost one hundred lawyers, which is probably the size of many litigation departments within large firms, and we find the process works. In fact, it provides a nice opportunity for the entire firm to get together once a week. Each office meets collectively in a conference room (food is served if the meeting occurs at a meal time in that time zone), and then each office calls into a conference call number.

PRACTICE POINTER:
Writing the memorandum forces you to focus on the pros and cons of a case early.

On the opposite extreme, lawyers at smaller firms may find the formality (writing a memorandum and conducting a meeting to debate the merits) unnecessary. But these procedures serve a useful purpose even in a firm with only two lawyers. For example, if a potential case faces a legal obstacle but you believe there is a good legal argument to navigate the problem, there is nothing like trying to commit the argument to writing to test it—if the argument does not write well, you may reconsider taking the case. Moreover, most cases ultimately have to be synthesized into a short and easily digested story. If you find it hard to make a compelling argument for a case in five pages at the outset, you ought to reconsider taking the case.

Once you have a process in place, there are basic rules that can be applied for approaching the substance of case evaluation. The next section attempts to outline some rules of the road for case evaluation.

5-2:2 Basic Rules for Case Evaluation

Speed is critical. You are rarely the only lawyer the client is talking to. The potential client is probably not waiting around for your answer; rather, they are probably on the phone with other potential trial lawyers to gauge their interest. Potential contingent fee clients

often are anxious to get their suit filed. As well, potential clients wisely may conclude that a lawyer who delays evaluating a case at the outset will be even less responsive once he or she has the case signed up. If you want to get the case, you need to act quickly.

PRACTICE POINTER:
Even if you don't take the case, or the client doesn't hire you, case evaluation is an opportunity to show your stuff to the client or referring lawyer.

Do a thorough job, even for bad cases. Clients are often very impressed when a lawyer provides a quick and clear reason for rejecting a case. They may not like the answer at the moment you give it to them, but they may remember you a year or two later when their case turns out to have the very problem that you predicted. Remember that business clients looking for contingent-fee lawyers are very often repeat litigants; at a minimum, they always know someone who may ask them for a recommendation or referral.

Of course, there is an inherent tension between the need for a quick case assessment and careful analysis. Moreover, in most instances, you will be evaluating a case where no discovery has been taken. As a result, you will not know and cannot know much about the potential case, but you have to make a relatively quick decision. In short, case evaluation is usually a pretty rough and ready process.

Like jury selection, where you are looking for bad jurors to strike because you do not get to "pick" the good ones, you are really looking for the bad apples when evaluating cases. Truly great cases are relatively easy to spot. But such cases are very rare, especially on an alternative fee basis. If you are looking only for perfect diamonds, you are going to have a lot of free time on your hands.

More likely, you will confront cases that are full of unknowns or potential warts. Moreover, cases are very unpredictable and usually there isn't much time or information to evaluate. A case that looks great at the outset often turns out to have problems. Alternatively, things may break your way, and a seemingly mediocre case may develop into a great case. In short, it is hard to tell a "winner" at

the outset. As a result, you should aim to spot the clear loser cases and avoid them. While our firm has turned down cases only to see some other lawyer hit a home run with the same case, this is a relatively rare occurrence. More often, we err by accepting a case only to regret it.

At the same time, risk is inherent in alternative-fee cases. Frankly, most clients would never agree to give away a large percentage of any recovery if recovery were a sure thing. While you are trying to avoid losing cases, you have to be willing to take risky cases.

As noted above, my firm subjects every potential case to a firm-wide vote. Occasionally, a case will fail to get the required votes, and the sponsoring lawyer will return later for a second try after getting certain questions answered. Some of these re-vote cases have produced the largest fees in the firm's history. The lesson from this phenomenon is that sometimes the seemingly most risky cases turn out to be most lucrative.

There are some considerations that can help you evaluate a case and perhaps act as proxies for your lack of information. For example, is the client willing to pay expenses? It is important to make sure a client has some skin in the game even if the client is not paying 100 percent of expenses. As well, the client often knows where the bodies are buried. If the client has the means but is unwilling to invest his or her own money in the case, then you probably should not invest your time and money.

PRACTICE POINTER:
Because ultimately cases are won by witnesses (not lawyers), your putative client's honesty is critical. A simple way to evaluate your putative client's honesty is to ask around the community among people who might know the client.

Always search the internet to see what information you can find about a prospective client—if for no other reason than the other side certainly will do this looking for incriminating information and you need to know what they will find. If client is an experienced litigant, you can ask to contact lawyers that they have used before.

While I would not turn away a case merely because a prospective client has a bad reputation, I would recommend that you raise the bar higher for such a client; in other words, I would not take their case unless it was very, very strong on the merits. The biggest mistakes that I have made in selecting cases have been in situations where I heard rumblings about the prospective client's honesty and discounted them. Not only did the clients turn out to be terrible witnesses (bad reputations go with bad liars) and had misled me about the merits of their cases, but also the clients were incredibly difficult and unpleasant to deal with while their cases were underway.

Obviously, you need to meet the client in person to get some sense of what sort of witness they might make. Beware the prospective client who is selling their case too hard; you should be very skeptical of such a client. If a prospective client claims to have lots of documents to support his story, you should never rely on such claims; demand to see the documents. If a prospective client's case depends on the testimony of a third-party witness and the prospective client assures you the witness will corroborate the story, you should insist on talking to the witness. Even if you cannot actually reach the person before making a decision on the case, you can learn a lot from the prospective client's reaction when you make the request. If the prospective client balks at you trying to contact such a witness, you should be wary, even if they have a good excuse, which the liars always do.

In some cases, a third-party witness may be so crucial that you cannot take the case without talking to that person. For example, in patent cases, the inventors are the key witnesses, but often they do not control the patent. In such a situation, it is critically important to talk to any such witness before you accept a case to make sure they are cooperative at a minimum.

PRACTICE POINTER:
Taking on an existing case presents advantages and disadvantages. An existing case can be a bird in the hand if a lot of the work has been done. Plus, you should have a lot more information about the case due to discovery that you can use to evaluate the case. At the same time, you must ask, "why is the client switching horses?" Always ask to speak to prior counsel if the split is amicable.

Obviously, you need to make sure that any lingering fee dispute between prior counsel and your client is resolved or addressed in your fee agreement.

In evaluating business cases, the following is a standard set of requests you can make to a client and questions you need to answer. First, you should tell the client to provide you with all relevant contracts and key documents (especially, emails or letters discussing the dispute). If the case is on-going, you should ask the client to provide you with any legal memoranda from prior counsel.

Once you have the relevant material, you need to always consider whether there are any arbitration or forum selection clauses that might be implicated. As well, you need to consider choice-of-law problems at the outset to make sure that you are considering all relevant sources of law. To the extent the dispute relates to events that are not immediately current, you obviously need to consider limitations issues at the outset.

Finally, a critically important question is this: Does the defendant have money? Obviously, even the best case is worthless unless the defendant can afford to pay a settlement or judgment. But not all wealthy defendants are the same. Big corporations (and insurance companies) view litigation as a business risk and are generally dispassionate about resolving litigation. In contrast, individuals—even very rich ones—feel the pain of paying large sums of money, which they often worked hard to earn, and, thus, are much more reluctant to settle. Moreover, it is virtually impossible to tell whether a seemingly rich individual really has liquid assets. I have encountered plenty of cases where I assumed that the defendant had plenty of money (they had a big house, lived large, *etc.*) only to discover later that, in fact, they did not have much cash and could not afford to settle on attractive terms. If a potential case involves a claim against a "rich" individual, you should not assume that they have the money to resolve the case; you need to do due diligence about their financial capacity—do not take your prospective client's word for it.

PRACTICE POINTER:
If you will need to file somewhere that is unknown to you, think about local counsel and even begin to make contacts. Even a weak case with the right local counsel can be a good opportunity.

My firm has accepted a fair number of borderline cases in part because of the strength of local counsel who we have lined up. In Texas, state judges are elected in partisan races. Despite their best efforts to ignore this reality, such judges are elected politicians, and it never hurts to have a lawyer with you who is sensitive to issues in the community.

Of course, these general rules are helpful regardless of where the putative case might be filed. The next section focuses on certain repeat legal issues that arise in commercial cases and focuses on how Texas law handles those issues in sometimes quirky ways. Obviously, it is impossible to address every substantive legal issue that you might encounter when evaluating a commercial case. Nevertheless, there are some issues that seem to pop up routinely in commercial cases; the next series of sections attempt to provide some guidance on how Texas law handles these issues, ranging from procedural issues (such as the scope of arbitration clauses) to issues of substantive law (such how Texas deals with negligent misrepresentation claims).

Texas was once regarded a plaintiff's paradise, where big verdicts were easy to get and hold. For commercial plaintiffs (frankly, for any kind of plaintiff), Texas is no longer a welcoming environment always. Some of the rules outlined above highlight a few of the unusual pitfalls of Texas law; there are plenty more given the conservative tilt of the courts over the past two decades. As a result, a lawyer evaluating a commercial case that would be filed in Texas (or governed by Texas law) should examine the case carefully before taking it on.

5-3 COMMON LEGAL ISSUES THAT ARISE IN THE EVALUATION OF COMMERCIAL CASES FOR FILING IN TEXAS

5-3:1 Texas Rules on Arbitration

One of the first questions any lawyer evaluating a potential case must ask is: where will the case be filed? In commercial cases, arbitration is always a potential answer so lawyers evaluating a case routinely turn to the dispute resolution provisions of any contracts between the potential adversaries. In Texas, merely reading the arbitration clause does not end the analysis; in fact, merely reading

the contracts that your prospective client signed does not end the analysis.

Texas courts adopt a very broad view of arbitration clauses. While courts generally are pro-arbitration, Texas courts are especially inclined to compel a dispute to arbitration. Texas courts have adopted a broader test that potentially sweeps many more disputes within the scope of an arbitration clause.

To begin with, the mere fact that your prospective client did not sign an agreement with an arbitration clause does not mean their claim will escape arbitration. The Texas Supreme Court has recognized six theories under which a nonsignatory can be bound to an arbitration clause: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) equitable estoppel, and (6) third-party beneficiary.[1] These theories may require a party whose claim implicates a contract containing an arbitration clause to submit their claim to arbitration even if they did not sign the contract. As a result, when evaluating a business case, you must examine every contract, not just contracts signed by your prospective client, relating to the dispute to determine whether you may end up in arbitration. For example, in Texas, a beneficiary of a trust can be bound to an arbitration clause in a trust agreement even though the beneficiary never signed the trust agreement.[2]

Whether an arbitration agreement binds a nonsignatory is a gateway matter to be determined by the court, rather than the arbitrator.[3] The party seeking arbitration bears the burden to establish that the arbitration agreement binds a non-signatory.[4]

Under Texas law, a dispute is subject to arbitration if it "touches upon the subject matter" of the contract that contains the arbitration clause or if the dispute is "inextricably intertwined with the facts" of arbitrable clause. As one court has put it, "[t]o be within the scope of an arbitration provision, the allegations need only be factually intertwined with arbitrable claims or otherwise touch on the subject matter of the agreement containing the

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1. *In re Kellogg Brown & Root, Inc*., 166 S.W.3d 732, 739 (Tex. 2005).
2. *Rachal v. Reitz*, 403 S.W.3d 840 (Tex. 2013).
3. *In re Weekley Homes, L.P*., 180 S.W.3d 127, 130 (Tex. 2005).
4. *In re Citgo Petroleum Corp*., 248 S.W.3d 769, 776 (Tex. App.—Beaumont 2008, orig. proceeding) (per curiam).

arbitration provision."[5] As a result, a claim is potentially subject to arbitration even if it relates to a different contractual relationship than the contract which contains the arbitration clause. Moreover, this standard, which is not well-defined, gives parties seeking to compel arbitration a powerful tool; it does not take much creativity to develop an argument about how a potential dispute between parties in business "touches upon the subject matter" of any contract between them that contains an arbitration clause.

5-3:2 Motion to Dismiss Practice in Texas

Until recently, Texas state courts offered litigants a way to file suit and obtain discovery without facing an early motion to dismiss. Effective March 1, 2013, Texas has a motion to dismiss practice. The standard to obtain dismissal, however, is high. Only a claim that "has no basis in law or fact" is subject to dismissal.[6] A claim has no basis in law if the allegations, taken as true, together with any reasonable inferences, "do not entitle the claimant to relief."[7] A claim has no basis in fact if "no reasonable person could believe the facts as pleaded."[8] This standard is considerably tougher than the standard for dismissal under Rule 12(b) of the Federal Rules of Civil Procedure. As a result, it is not clear whether the Texas dismissal practice will provide a significant deterrent to litigants.

Importantly, the dismissal rules require automatic fee-shifting. Given that this rule is relatively new, it is unclear what impact this fee-shifting component will have on dismissals. On the one hand, it could scare off plaintiffs with questionable claims. On the other hand, it could cause courts to refrain from granting dismissals on the theory that the fee-shifting will add insult to injury, preferring instead to wait for summary judgment where no fee-shifting exists.

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[5] *In re BP America Production Company*, 97 S.W.3d 366, 370 (Tex. App.—Houston [14th], 2003, no pet.); *see also* 7 Texas Forms Legal & Bus. § 12:47.10 ("Broad arbitration clauses are not limited to claims that literally 'arise under the contract,' but rather embrace all disputes between the parties having a significant relationship to the contract regardless of the label attached to the dispute.").

[6] Tex. R. Civ. P. 91a.

[7] Tex. R. Civ. P. 91a.

[8] Tex. R. Civ. P. 91a.

5-3:3 Shareholder Oppression

Increasingly, minority shareholders in closely-held Texas corporations have invoked the doctrine of shareholder oppression to obtain significant damage awards. The awards represent the court-ordered "buyout" of the shares, usually without any discount for a minority interest or lack of marketability. In short, the shareholder oppression claim is a powerful tool in Texas that is not available, for example, in Delaware, where many corporations are incorporated.[9]

The Texas Supreme Court has not formally recognized a claim for shareholder oppression. However, starting with a decision in 1988, numerous intermediate appellate courts have recognized the claim.[10] The claim is powerful in two respects.

First, what constitutes oppressive conduct is vague, so a plaintiff can make a claim based on an array of misconduct. Texas courts have applied a two-prong analysis to determine what constitutes oppressive conduct: (1) whether the majority shareholders' conduct substantially defeats the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (2) the majority's conduct was burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely. Both prongs are so generic that a plaintiff can fit almost any perceived slight into one of the prongs.

Second, the buy-out remedy is a powerful tool. Under most circumstances, a prevailing plaintiff can obtain a damage award that represents the fair market value of their interest but without any discounts for the minority status.[11] Since such discounts often run as a high as 50% if the minority owner tried to sell on the open market (even assuming a buyer could be found), the buyout remedy results in a potential windfall for the plaintiff.

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9. *See Nixon v. Blackwell*, 626 A.2d 1366, 1380 (Del. 1993).

10. *Davis v. Sheerin*, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

11. *ARGO Data Resource Corp. v. Shagrithaya*, 380 S.W.3d 249, 271-72 (Tex. App.—Dallas 2012) (petition filed).

As with many pro-plaintiff commercial theories in Texas, however, the Texas Supreme Court may not let shareholder oppression survive for long. During 2013, the Texas Supreme Court granted review of a lower court decision to determine whether shareholder oppression should continue as a viable claim.[12] As of this writing, the Court has not ruled on the issue.

5-3:4 Negligent Misrepresentation in Texas

Many commercial cases involve efforts to recover for a misstatement against a third-party with whom your client has no privity or contractual relationship. Obviously, such cases can be pursued under either a fraud or negligent misrepresentation theory. Texas law governing fraud claims is not materially different from other jurisdictions. Texas law governing negligent misrepresentation claims, however, is more restrictive in certain notable respects than in many other jurisdictions.

Generally, Texas has adopted the tort of negligent misrepresentation as described by the Restatement (Second) of Torts Sec. 522.[13] Courts applying Texas law have recognized a section 522 cause of action against a variety of professionals and business.[14] Negligent misrepresentation claims are tricky when brought against professionals by non-clients. Two types of claims raise particular concerns: (1) claims against lawyers by non-clients; and (2) claims against auditors by non-clients.

5-3:5 Claims Against Attorneys

The Texas Supreme Court has held that non-clients could sue attorneys for negligent misrepresentation without regard to

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12. *Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011) (petition granted).

13. *See Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991).

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

the non-client's lack of privity with the attorney.[15] The Court rejected arguments that a negligent misrepresentation claim is equivalent to a legal malpractice claim, stating that liability is not based on the breach of duty that a professional owes his or her clients, but on an independent duty to the non-client based on the professional's manifest awareness of the non-client's reliance on the misrepresentation and the professional's intention that the non-client so rely.

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

Second, the Court stated that the "justifiable reliance" element required a consideration of the nature of the relationship among the attorney, client, and non-client. Generally, a third party's reliance on an attorney's representation is not justified when the representation takes place in an adversarial context.[16]

5-3:6 Claims Against Auditors

PRACTICE POINTER:
Texas is not a good place to bring a claim against an accountant or auditor. The substantive law, especially regarding the scope of any duty to third-parties (not the client), is unfriendly to plaintiffs.

Accountants' representations in written documents such as audit reports are often disseminated and read by persons that have no direct contact with the accountant, raising the question of what

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15. *McCamish, Martin, Brown, and Loeffler v. F. E. Appling Interests, et al.*, 991 S.W.2d 787 (Tex. 1999).

16. *McCamish, Martin, Brown, and Loeffler v. F. E. Appling Interests, et al.*, 991 S.W.2d 787, 794 (Tex. 1999).

persons can bring a negligent misrepresentation claim under section 522 of the Restatement. The Texas Supreme Court has confirmed that the scope of liability for negligent misrepresentation is limited, adopting an approach that imposes a duty only when disseminating information to "a known party for a known purpose."[17] A "known" party is one who falls in a limited class of potential claimants, "for whose benefit and guidance [one] intends to supply the information or knows that the recipient intends to supply it."[18] This formulation limits liability to situations in which the professional who provides the information "is aware of the non-client and intends that the non-client rely on the information."[19] Unless a plaintiff falls within this scope of liability, a defendant cannot be found liable for negligent misrepresentation.[20] The Texas Supreme Court has rejected expressly a foreseeability approach to determining the scope of duty for negligent misrepresentation.[21]

Texas law makes claims against auditors difficult in another respect. Typically, the scope of liability for negligent misrepresentation is more limited than for fraudulent misrepresentation. The reason is that negligent misrepresentation imposes a higher burden of conduct on defendants than fraud. "Negligent misrepresentation implicates only the duty of care in supplying commercial information; honesty or good faith is no defense, as it is to a claim for fraudulent misrepresentation."[22] In other words, because defendants have fewer defenses available to defeat a claim of negligent misrepresentation, the scope of the duty is more limited. In many jurisdictions, lawyers assume that a defendant always has a duty not to commit intentional fraud on every potential plaintiff. That assumption is not correct in Texas.

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17. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 920-21, 929-30 (Tex. 2010).

18. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 920-21, 929-30 (Tex. 2010).

19. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 920-21, 929-30 (Tex. 2010).

20. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 920-21, 929-30 (Tex. 2010).

21. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, at 921 (Tex. 2010) (quoting *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co*., 81 F.3d 606, 614 (5th Cir. 1996)).

22. *D.S.A., Inc. v. Hillsboro Independent School Dist*., 973 S.W.2d 662, 664 (Tex. 1998).

The Texas Supreme Court has adopted Section 531 of the Restatement (Second) of Torts, which imposes a fraud liability on a party who makes a misrepresentation to a person where the speaker has "reason to expect" the representations will affect the other parties' conduct.[23] The Court has held this does not equate to the foreseeability standard; rather, it requires evidence that the plaintiff's reliance was "especially likely and justifiable."[24] Exactly what that standard means is unclear. However, the Texas Supreme Court has held that the standard is not met where an auditor provides intentionally misleading financials that are relied upon by prospective investors in a deal (as opposed to existing investors).[25]

5-3:7 Holder Claims

A common securities fraud claim involves so-called "holder" claims. In these cases, the plaintiff was an existing investor at the time of the misrepresentation. The plaintiff claims that but for the misrepresentation, the plaintiff would have sold the securities. As a result, the plaintiff seeks damages for the diminished value of the stock, or the value of a forfeited opportunity, allegedly caused by the defendant's misrepresentations. The status of these claims is uncertain in many jurisdictions—federal law expressly refuses to recognize such claims.[26] The status in Texas is unclear too, although the Texas Supreme Court does not seem inclined to support such claims.

The Texas Supreme Court has held that to the extent such claims would be permissible in Texas, the plaintiff must have received a direct communication from the defendant.[27] In other words, a plaintiff can base a holder claim on misrepresentations contained in public filings (such as financial statements filed with the Securities Exchange Commission) or public statements by corporate executives (such as earnings announcements). Because in the case before it there was no evidence of such direct communication, the Court

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23. *Ernst & Young, L.L.P. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 575 (Tex. 2001).
24. *Ernst & Young, L.L.P. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 580 (Tex. 2001).
25. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 922 (Tex. 2010).
26. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).
27. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 930 (Tex. 2010).

declined to decide whether a holder claim involving more specific and direct communications is actionable under Texas law.[28]

PRACTICE POINTER:
Given the generally conservative nature of the Texas Supreme Court, a lawyer contemplating a holder claim in Texas might consider other filing options.

5-3:8 Setting Aside Releases

Another common feature of commercial cases is parties that have second-thoughts about a contract that is clear and unfavorable. A common reaction of lawyers to circumvent such bad contracts is to invoke the fraudulent inducement doctrine. In Texas, however, it is hard to set aside a contract based on fraudulent inducement if the contract contains exculpatory language that is often found in commercial contracts.

PRACTICE POINTER:
The black-letter rule is that "fraud vitiates whatever it touches."[29] Thus, a contractual release may be avoided by proof that it was fraudulently induced, and the parole evidence rule does not bar evidence of such fraud.[30] At the same time, Texas law provides greater protection than many other jurisdictions to parties who obtain contractual protection against fraud-in-the-inducement claims.

Under Texas law, a contract itself may preclude a valid fraudulent inducement claim if it (1) "clearly expresses the parties' intent to waive fraudulent inducement claims" or (2) "disclaims reliance on representations about specific matters in dispute."[31]

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28. *Grant Thorton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 930 (Tex. 2010).

29. *Estate of Stonecipher v. Estate of Butts*, 591 S.W.2d 806, 809 (Tex.1979).

30. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am*., 341 S.W.3d 323, 331 (Tex. 2011); *see also Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 178 (Tex. 1997).

31. *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 181 (Tex. 1997); *see also Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 332 (Tex. 2011); *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 61 (Tex. 2008).

The threshold requirement for an effective disclaimer of reliance is that the contract language be "clear and unequivocal" in its expression of the parties' intent to disclaim reliance.[32] In imposing this requirement, the Texas Supreme Court has balanced three competing concerns. First, a victim of fraud should not be able to surrender its fraud claims unintentionally. Second, the law favors granting parties the freedom to contract knowing that courts will enforce their contracts' terms, as well as the ability to contractually resolve disputes between themselves fully and finally. Third, a party should not be permitted to claim fraud when he represented in the parties' contract that he did not rely on a representation.

The Texas Supreme has held that an express disclaimer of reliance on particular subjects is sufficiently clear to eliminate any later claim of reliance to support a fraud-in-the-inducement claim. As well, the Texas Supreme Court has held that a general merger clause is not sufficiently "clear and unequivocal."

Even if the release language is sufficiently clear, the Texas Supreme Court has identified four extrinsic factors that courts must consider in evaluating the validity of a contractual disclaimer of reliance: whether (1) the terms of the contract were negotiated or boilerplate; (2) the complaining party was represented by counsel; (3) the parties dealt with each other at arm's length; and (4) the parties were knowledgeable in business matters.[33] In the context of a complicated business transaction, the contract terms typically will not have been boilerplate, the complaining party will have been represented by counsel, and the parties will have been knowledgeable about business.

As a result, the third-factor may be dispositive of whether a release is enforceable. In particular, Texas law is not completely settled whether the mere existence of a fiduciary relationship alone can render unenforceable a crystal-clear release between sophisticated parties.

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[32] *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 336, 337 n. 8 (Tex. 2011) (stating need "to protect parties from unintentionally waiving a claim for fraud," that clarity of the disclaimer is a "requirement" for its enforceability, and that only when disclaimer is "clear and unequivocal" does analysis "then proceed" to contract's circumstances).

[33] *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008).

5-3:9 Breach of Fiduciary Duty

Texas law is particularly hostile to recognizing fiduciary relationships in business transactions outside certain well-known categories. Under Texas law, a fiduciary relationship will be found in some relationships as a matter of law.[34] These categorical fiduciary relationships are common in many jurisdictions. In this respect, Texas law is similar to other jurisdictions.

PRACTICE POINTER:
Texas law, however, is different in many respects from many other jurisdictions. For example, family relationships, although a factor in determining whether a fiduciary duty exists, are not enough alone to establish a fiduciary relationship.[35] The fact that someone subjectively trusts another is insufficient to establish a fiduciary relationship.[36]

The biggest difference between Texas law and many jurisdictions, however, arises when a party seeks to establish a fiduciary relationship based on an informal business relationship of trust and confidence. In Texas, they face a steep, uphill road. The Texas Supreme Court's decision in *Meyer v. Cathey*[37] is illustrative. In *Meyer*, the parties worked together on various projects for three years prior to their involvement in the disputed transactions. The parties were partners in one prior project. The plaintiff clearly relied exclusively on the defendant to handle all aspects of the disputed transaction. Moreover, the parties were close friends; the evidence was that they ate lunch together every day for four years. The *Meyer* Court, however, held that these facts were insufficient to create an informal fiduciary relationship.

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34. *See e.g.*, *Langford v. Shamburger*, 417 S.W.2d 438 (Tex. Civ. App. – Fort Worth 1967, writ ref'd n.r.e.) (trustee-beneficiary); *Archer v. Griffith*, 390 S.W.2d 735 (Tex. 1965) (attorney-client); *Johnson v. Peckam*, 120 S.W.2d 786 (Tex. 1938) (partners) (*see also* Texas Revised Partnership Act, Art. 6132b-1.01 et seq.); *Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App. – Fort Worth 1973, writ ref'd n.r.e.) (real estate brokers and agents); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963) (directors and officers-corporation); *Hyde Corporation v. Huffines*, 314 S.W.2d 763 (Tex. 1958) (licensee-licensor).

35. *Tex. Bank & Trust Co. v. Moore*, 595 S.W.2d 502, 508 (Tex. 1980).

36. *Schlumbergre Tech. Corp. v. Swanson*, 959 S.W.2d 171, 177 (Tex. 1997).

37. *Meyer v. Cathey*, 167 S.W.3d 327, 330-31 (Tex. 2005).

The Court has repeatedly held that "not every relationship involving a high degree of trust and confidence rises to the stature of a fiduciary relationship" and such relationship will not be "created lightly."[38] "To impose an informal fiduciary duty in a business transaction, the special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit."[39]

Specifically, the *Meyer* Court suggested that the prior relationship must have been fiduciary in nature. For example, the Court dismissed the significance of the prior projects between the parties because they were "arms-length transactions." The *Meyer* Court gave no weight to the fact that one party placed subjective trust in the other or to the fact that the parties were close friends.[40] To practitioners outside of Texas, this result may seem surprising, but illustrates the hostility of Texas courts to recognizing informal fiduciary relationships.

5-3:10 Tortious Interference with Prospective Business Relations

Texas law has some unique features regarding the law governing tortious interference with prospective business relations.

PRACTICE POINTER:
While the Texas Supreme Court is more receptive to claims for tortious interference with an existing contract, the Court has been wary of claims for tortious interference with prospective business deals, presumably because there is an inherent speculative component to such claims.

In 2001, the Texas Supreme Court addressed tortious interference with prospective relations with the express intent of bringing "some

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38. *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 176-77 (Tex. 1997) (citing *Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992), superseded by statute on other grounds as noted in *Subaru of Am., Inc. v. David McDavid Nissan, Inc.*, 84 S.W.3d 212, 225–26 (Tex. 2002)).

39. *Associated Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 288 (Tex. 1998).

40. *Meyer v. Cathey*, 167 S.W.3d 327, 331 (Tex. 2005) ("Furthermore, the fact that Cathey trusted Meyer does not transform their business arrangement into a fiduciary relationship. Nor can we justify imposing a fiduciary duty based on the fact that, for four years, Cathey and Meyer were friends and frequent dining partners." (citations omitted)).

measure of clarity to this body of law."[41] However, the Supreme Court still did not identify the specific elements of the cause of action. The Supreme Court reviewed a case in which the plaintiffs sued for tortious interference with prospective relations, claiming that Wal-Mart interfered with their contract to purchase some real estate next to one of the Wal-Mart stores. The Supreme Court looked at the historical development of the interference tort in Texas and other jurisdictions and reached the conclusion that plaintiff must prove that it was harmed by conduct that was either independently tortious or unlawful. The plaintiff is not required to prove an independent tort; instead, the plaintiff need only establish that the defendant's conduct would be actionable under a recognized tort.[42]

The Supreme Court stated that conduct that is merely "sharp" or "unfair" cannot be the basis for the action, specifically disapproving a line of cases that had seemingly lowered the bar for such claims. In regard to justification as a defense, the Court held that the concept was "subsumed" in plaintiff's proof, and was only a defense to the extent that it is a defense to the "tortiousness of the defendant's conduct." "Justification and privilege are not useful concepts" in assessing interference with prospective relations.[43]

Subsequent cases have indicated that conduct such as breach of fiduciary duty, making fraudulent statements to a third person, threatening a person with physical harm if he does business with the plaintiff, or engaging in an illegal boycott are the sorts of independently tortious conduct that suffices under the *Sturges* standard.[44] In contrast, courts have indicated that quantum meruit, promissory estoppel, or unjust enrichment do not qualify as independent torts.[45]

5-4 CONCLUSION

Evaluation of commercial cases is a complicated process. Commercial cases are complicated by their nature. Moreover,

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41. *Wal-Mart v. Sturges*, 52 S.W.3d 711, 713 (Tex. 2001).

42. *Wal-Mart v. Sturges*, 52 S.W.3d 711, 726 (Tex. 2001).

43. *Wal-Mart v. Sturges*, 52 S.W.3d 711, 727 (Tex. 2001).

44. *Video Ocean Group LLC v. Balaji Management Inc.*, 2006 WL 964565, at *6 (S.D. Tex. 2006).

45. *CSTM Corp. v. AM General LLC*, 2005 WL 1923605, at *4 (S.D. Tex. 2005).

unlike personal injury or mass tort cases, commercial cases rarely are the same, so each potential case has to be evaluated individually. Given the investment required by commercial cases, the stakes also are high for a lawyer who accepts a commercial case. A mistake can be especially costly. And, case evaluation is thankless; no one ever congratulates a lawyer on his great work evaluating a potential case.

At the same time, case evaluation can be incredibly rewarding. The facts are new to you, and the prospect of new business is always exciting. Frankly, case evaluation is one of the things that I like best about practicing law.

PRACTICE POINTER:
Case evaluation tests your skills at making good judgments, which is the key to serving as a good lawyer and counselor, and thus it acts a conditioning drill for your legal mind.