

POINT
TEXAS CHANCERY COURTS

MY VIEW

THE MISSING LINK TO MORE TEXAS ENTITIES

By Byron F. Egan

The Texas House of Representatives in its 2015 session considered legislation supported by the Texas Business Law Foundation¹ to establish a chancery court system in Texas.² As lawmakers will have an opportunity to do so again in the next legislative session, the need for chancery courts should be discussed and become better understood.

Texas needs to establish a chancery court system to adjudicate sophisticated and complex business-related legal matters involving Texas entities, such as corporate governance, mergers and acquisitions, and securities issues. The assurance of an efficient, knowledgeable, and stable forum in Texas for the resolution of those kinds of issues would encourage businesses and their advisers to organize in Texas. We have a vibrant economy and business statutes as good as any in the country,³ and our state tax environment is generally considered favorable to businesses; but we have a missing link: specialized business courts. If Texas had chancery courts that businesses and their advisers were confident would resolve their disputes efficiently, they would choose Texas as their place of domicile. This in turn would lead to disputes being resolved by Texas judges in Texas courts rather than in other states by judges and lawyers domiciled and paying taxes there.

The state in which an entity is organized is important to all Texans because it is often decisive in determining where an entity is taxed and where and under whose laws disputes involving the entity will be adjudicated. Under the internal affairs doctrine followed by Texas and most other states,⁴ the law of the state of organization governs its internal affairs,⁵ including the liability of an owner or governing person for actions taken in that capacity.⁶ Thus, the state in which an entity is organized is critical to the rights and obligations of its owners and governing persons, which gives Texas a vital interest in having entities organized under Texas law. Both plaintiffs and defendants have an interest in having disputes resolved in Texas under Texas law.

Likewise, bankruptcy cases can, and increasingly are, filed and adjudicated in the state in which the entity is organized. Thus, with many of our Texas energy companies in financial difficulty and being organized under Delaware law, associated bankruptcy cases are increasingly being filed in Delaware by Delaware lawyers, which forces Texans to travel to that state to deal with their cases.

As proposed, the Texas chancery court would be based on the established and well-regarded Delaware Court of Chancery⁷ but would incorporate features designed to accommodate Texas's needs and its existing constitution and statutes. Recent trends in Delaware law are causing some commentators and businesses to question whether it remains a good place to be domiciled.⁸ Thus, Texas has an opportunity to attract

businesses by implementing a chancery court system.

Chancery court judges would be appointed for a six-year term with the advice and consent of the Senate and with no more than a majority being from the same political party. The number of chancery court judges would be low in relation to the number of district court judges—seven chancery court judges compared with 464 district court judges (amounting to a mere 1.5 percent of Texas's district court judges). The impact of having chancery courts, however, would be a huge advantage in the competition with other states for business domiciles, particularly if there is a movement away from Delaware.

An effective and active chancery court focused exclusively on business issues, with specialized judges making decisions, will provide a very efficient, consistent, and stable forum for the resolution of business disputes. Businesses are on both sides of the docket and want to do business where they are confident that their specialized disputes will be decided in an efficient and timely manner by judges who are knowledgeable and experienced in laws and practices affecting businesses and business entities. Establishing a chancery court system will underscore Texas's commitment to a strong and healthy business environment and move the state to the next level in attracting astute companies and businesses to move their workforces here and organize their businesses under Texas business entity statutes.

Legislation to establish chancery courts in Texas did not pass in the 2015 Legislature, but it served to start a dialogue on why Texas needs such a system and what it should be. This dialogue should continue as the next legislative session approaches.

NOTES

1. See Alan R. Bromberg, Byron F. Egan, Dan L. Nicewander, and Robert S. Trotti, *The Role of the Business Law Section and the Texas Business Law Foundation in the Development of Texas Business Law*, 41 TEX. J. BUS. L. 41 (2005).
2. See Tex. H.B. 1603, 84th Leg., R.S. (2015), available at <http://www.legis.state.tx.us/BillLookup/Text.aspx?LegSess=84R&Bill=HB1603>.
3. Texas business entity statutes are codified in the Texas Business Organizations Code, which is continually updated through the efforts of the Texas Legislature, the Business Law Section of the State Bar of Texas, and the Texas Business Law Foundation. See Byron F. Egan, *Choice of Entity Decision Tree*, secs. 1.2 and 1.3 (Nov. 20, 2015), available at <http://www.jw.com/publications/article/2112>.
4. See Byron F. Egan, *Choice of Entity Decision Tree*, sec. 2.6.2 (Nov. 20, 2015), available at <http://www.jw.com/publications/article/2112>.
5. The internal affairs doctrine is codified in TBOC §§ 1.101-1.105 (2015). TBOC § 1.105 provides: Sec. 1.105. INTERNAL AFFAIRS. For purposes of this code, the internal affairs of an entity include:
 - (1) the rights, powers, and duties of its governing authority, governing persons, officers, owners, and members; and
 - (2) matters relating to its membership or ownership interests.
6. TBOC § 1.104.
7. See Joseph R. Slights III and Elizabeth A. Powers, *Delaware Courts Continue to Excel in Business Litigation with the Success of the Complex Commercial Litigation Division of the Superior Court*, 70 BUS. LAW. 1039 (Fall 2015).
8. Liz Hoffman, *Firms Sour on Delaware as Corporate Haven*, WALL ST. J., Aug. 3, 2015, at A1.



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COUNTERPOINT
TEXAS CHANCERY COURTS

MY VIEW

AN UNCONSTITUTIONAL
MONEY-WASTING PROPOSAL

By David E. Chamberlain

A solution in search of a problem, the chancery court proposal would create two costly statewide court systems—a set of new trial courts and a new appellate court—solely to adjudicate a subcategory of business disputes. The bill's advocates, and they are still advocating, seek to plug a judicial void that does not exist at considerable expense to taxpayers and clients.

The chancery court bill, House Bill 1603, was filed in the last legislative session but failed to reach the House floor for a vote—and for good reason.

The chancery court's proposed wide-ranging subject matter jurisdiction changed over the course of the session, but the bill's sponsor stated that it centered on business disputes exceeding \$10 million in controversy. The seven chancery trial court judges would be appointed, not elected, and the chancery appellate judges would be appointed from a pool of active justices from the 14 courts of appeals. Terms of office would be six years, and judges would be eligible for reappointment thereafter.

Why a new two-tier court system is needed in Texas was never adequately explained by the bill's backers. Some said the new courts would attract more commercial enterprises to incorporate and conduct business in Texas rather than Delaware, which has a chancery court system. Others said the new courts would get cases out of the hands of local judges as well as create more fee-generating Texas lawsuits for Texas lawyers.

Yet, these supporters could not articulate why the existing system was no longer up to the task of handling business disputes. Not once during legislative hearings or elsewhere were the proponents able to identify a Texas judge who had bungled a business case in any way, much less to the extent that it would justify the creation of costly new courts.

In my 30-plus years of practice, I have never heard of any company avoiding business in Texas because of its court system or lack of a business court system. Moreover, incorporating in a state does not translate to a company's activities in a state. Texas business activity dwarfs that of Delaware.

The purported need for a chancery court system is further undermined by the nature of the legal territory that these courts would attempt to occupy. Ten million-plus dollar business disputes in these days of economic globalization usually do not end up in the state courts. These mega-disputes frequently are destined for federal court on the basis of a federal question or diversity of citizenship—if

they are not otherwise bound for arbitration due to contract requirements. In sum, chancery courts should not expect much business.

The proposed chancery courts would doubtlessly cost our clients more. For example, while venue of the action and its trial would be governed by established venue requirements, the proposed bill states that pretrial hearings can be conducted wherever the court determines is convenient. Thus, a case filed in Orange County may have pretrial hearings in El Paso, Texarkana, or Brownsville, depending on the appointed judge's view of what is convenient.

Taxpayer burden is also an issue. The bill supporters made inconsistent claims that these new courts would simply pay for themselves through filing fees while at other times they conceded that it would cost the state at least \$4 million annually.

Moreover, no data was produced to show that our existing civil courts are so busy that they do not have the capacity to handle business disputes. Texas judges and trial lawyers know that our courts have time for these rare cases. Busy, yes; overloaded, no.

Occasionally, there may be a Texas trial court that struggles to handle a big business dispute. However, the solution to this atypical problem was addressed by the Texas Legislature several sessions ago. The court resources statute made provisions for courts in need. Upon request, the state will provide additional resources to a court that is handling a large or complex case, including funds for additional support staff, equipment, facilities, specialized legal education, and even a visiting judge to handle the court's other cases while the complex case is being pretried and tried by the sitting judge. The Legislature should now follow up and adequately fund the statute. It wouldn't take much—a lot less than \$4 million annually.

Beyond the practical reality that there is no need for an expensive two-tier court system, there is the constitutional infirmity presented by the bill. The bill calls for an appointed judiciary. Our Texas Constitution provides for an elected trial and appellate judiciary.

There are many good reasons that the chancery court bill was opposed by virtually all segments of the Texas trial bar and judiciary. A better, more economical, and more efficient solution is to adequately fund the judiciary we currently have. **TBJ**



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