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TEXAS HOUSE BILL 19 ESTABLISHES A BUSINESS DISPUTE-SPECIFIC COURT, INCLUDING PROPOSED APPOINTMENT OF JUSTICES AND SUBJECT MATTER JURISDICTION PARAMETERS

(This memo was prepared during the Legislative session. It does not reflect the opinions of Gray Reed or its clients)

Summary of the Bill

Texas House Bill 19, paired with Senate Bill 27, proposes a new Texas Business Court (“TBC”) with jurisdiction to hear cases involving qualified business transactions.

A party may opt to move an action filed in a district or county court, to the TBC if there is subject matter jurisdiction as follows: The TBC will have concurrent jurisdiction with several district courts in civil disputes if the amount in controversy exceeds either (1) \$5 million in controversies that are derivative actions on behalf of an organization, business-related actions alleging a breach of duty, or actions regarding governance, governing documents, or internal affairs of an organization; or (2) \$10 million in actions arising suits out of a qualified action (discussed below in “Key Terms”). The court would have the authority to grant the same forms of relief as a district court, including the power to issue writs of injunction, mandamus, and the like. However, the court would not have jurisdiction over legal malpractice suits, personal injury actions, or civil suits against government entities without government consent.

The bill also creates a new Fifteenth Court of Appeals, which would have exclusive jurisdiction over all TBC appeals.

The Governor of Texas, with the advice and consent of the Senate, will appoint each of the judges on the TBC. There will be two judges to each of the First, Third, Fourth, and Eleventh Divisions of the court and one judge to each of the Second, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Divisions. Each judge will serve a term of two years (but can be reappointed) and must be at least 35 years old, a U.S. citizen, and a resident of the county within the division of the TBC to which the judge is appointed for a minimum of five years before appointment. These judges must be licensed in Texas and have at least 10 years of experience either (1) practicing complex civil business litigation or business transaction law, (2) serving as a judge of a Texas court with civil jurisdiction, or (3) a combination thereof.

Key Terms

A qualified transaction under this bill involves a minimum aggregate value of \$10 million and does not include transactions involving loans or advances by banks, credit unions, or equivalent institutions.

A derivative proceeding is a civil action brought in the right of a corporation, limited liability company, or limited partnership, as provided by the Business Organizations Code.

“Governmental entity” refers to the state of Texas or a political subdivision thereof, such as a municipality, county, or district.

“Governing documents” refers to documents or agreements concerning the organization’s formation and internal affairs. Examples include articles of incorporation, bylaws, shareholder or partnership agreements, and voting agreements.

The Judicial Adjacent: A Comparison with the Delaware Court of Chancery

The primary difference between the proposed TBC and Delaware’s Court of Chancery is that in Texas, questions of fact would be decided by a jury rather than a judge. This is a striking difference—in Delaware, business litigation is expedited because judges and lawyers do not have to take the time to educate uninformed juries about business law and practices.

The Court of Chancery is also unique because it was first established in 1792, meaning there are over 200 years of caselaw for the court to draw from. As a result, more corporations incorporate in Delaware than people living there, each seeking the opportunity to benefit from the court’s efficient and consistent rulings. Revenue from these companies and the lawsuits are a significant portion of the state’s economy and budget. To institute such a court could benefit Texas for the same reasons. The Court of Chancery is also preferred because it follows the business judgment rule, which favors decisions of company boards or leadership if, in their judgment, the decision is in the stockholders’ best interest. This rule aids the efficient resolution of disputes because it results in frequent dismissals of plaintiff complaints. Like the Court of Chancery, the Texas Supreme Court has also favored the business judgment rule in complex business cases; thus, the TBC could attract businesses to incorporate there to seek the rule’s protections.

In contrast, it will take years for the TBC to develop firm and consistent precedents. This is particularly so with judges having terms of only two years. Thus, Texas may lack Delaware’s consistency, as the judges on the Court of Chancery serve twelve-year terms. Texas also has more stringent standards for TBC judges than Delaware’s Court of Chancery judges, as it requires residence in the county within the division that the judge is appointed rather than residence more generally within the state. This could potentially limit the number of judges qualified to take the bench.

This bill also creates a Fifteenth Court of Appeals that will operate independently from other state appellate courts. Here, Texas cases appealed from the TBC will be heard by the Fifteenth Court of Appeals unless the Texas Supreme Court has concurrent or exclusive jurisdiction. Many critics say that the purpose of creating this new court of appeals is to protect these business cases from Democratic judges who have gained traction in regional appellate courts in Dallas and Houston in recent elections. This contrasts with the Court of Chancery, where direct appeals are taken solely to the Delaware Supreme Court. Note, however, that there is a provision in the House bill stating that if the Fifteenth Court of Appeals is not created, all TBC

appeals will be filed in the court of appeals with appellate jurisdiction of civil cases for the county.

Ultimately, the potential creation of the TBC does not directly mirror the form of the Court of Chancery because it adopts a jury system, lacks centuries of precedent, adopts shorter terms for judges, and has a separate court of appeals.

Potential Effects on Texas Jurisprudence on Corporate Law

Arguments in Favor

A central argument favoring House Bill 19 is that a court specializing in complex business cases will expedite the litigation process. Such cases, especially when tens of millions of dollars are at stake, can take years to litigate. When a judge who has expertise in business law can, in theory, make decisions faster and more efficiently, establishing a body of precedent. The result should be that clients will have more consistent, prompt rulings. Without this system, judges, especially in rural counties, lacking business law knowledge or experience will have to learn the law as the litigation progresses.

Furthermore, this court will have jurisdiction over a minority of civil cases. Although few, these costly and time-consuming cases can clog a state district court. This bill allows state district courts to focus on other civil disputes and leave complex business transactions to the judges with expertise.

Another argument in favor is that others are doing it. Texas is not the only state seeking a separate court for high-dollar business cases. Apart from the Delaware example, approximately twenty-five other states have some form of a specialized business court, including New York and Florida; therefore, Texas is not the trailblazer and will have several models to consult in the coming years if the TBC is created.

There are also business incentives for creating a business court. When companies are deciding where to locate, a business court can assure that potential “bet the company” disputes will not sit on the trial court’s docket for years. Companies have flocked to incorporate in Delaware for decades because of its entrenched caselaw; thus, Texas can potentially gain hundreds of millions in revenue from companies that choose to incorporate there.

Arguments Opposed

Concerns have arisen based about the bill’s constitutionality. The Texas Constitution provides that the legislature “may establish such other courts as it may deem necessary and prescribe the jurisdiction and organization thereof.” However, it also provides that appeals courts will have “appellate jurisdiction co-extensive with the limits of their respective districts,” which traditionally refers to geographic districts within the state. The Fifteenth Court of Appeals will have jurisdiction over cases without regard to geographic location or districts. In response to these concerns, House Bill 19 includes language giving the Texas Supreme Court exclusive and original jurisdiction over challenges to the bill’s constitutionality. If, for example, a plaintiff challenges the constitutionality of the Fifteenth Court of Appeals, any appeal from the TBC will

then be filed with another court of appeals with the appropriate appellate jurisdiction. Similarly, if constitutional challenges to the judicial appointment requirements under this bill succeed, the business court would be staffed by retired or former judges or justices through appointment. Other challenges can lead the Texas Supreme Court to issue injunctive or declaratory relief.

A driving concern about this bill is that it may establish a different system of justice separating businesses from everyone else. The argument is that larger companies can expect to litigate in a business court more frequently, thus gaining an advantage over opposing parties that are less familiar with the court.

Critics also highlight the current Texas Supreme Court's pro-business reputation with its Republican justices. The concern is that the Governor will have too much influence over the judicial system if he or she can also appoint TBC judges. The response is that most of these cases will involve multiple businesses or internal disputes between officers, owners, or board members. In effect, any advantage one company may have over another should be minimal. There is also the added balance that a jury, rather than a judge, is the factfinder; thus, plaintiffs who seek relief from a large company will have as a factfinder a jury of their peers.

Another concern is that the two-year appointments can leave judges susceptible to political pressure. When judges have their appointments on the line that frequently, they may not make decisions in a wholly unbiased manner. Parties to a suit in the court's jurisdiction may also seek to affect the Governor's appointments. As a result, questions arise as to whether the court would be an independent judiciary. There is also no guarantee that every dispute will take less than two years, so a judge may leave a case midway through the process and be replaced if the Governor does not reappoint them.

Additionally, this bill could lengthen the litigation process because parties will have disputes over the case's venue. Certain parties will advocate for being heard in the business court, whereas others will seek to file in state district courts. It is also questionable whether this court will be as efficient because the jury will likely be as uninformed as juries in other district courts. Thus, the benefit of having a judge specialized in business law will minimize if the judge is not the factfinder as in the Court of Chancery. It will also take time to instruct the jury on business practices. Given that only a minority of cases will be heard by this court, it is uncertain whether the benefits outweigh the costs.