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Texas Law Controls That Issue(?) Don't Bet on It

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You've no doubt heard it argued. Maybe you've argued it yourself. "Ohio [*e.g.*] law controls substantive issues, but this a procedural [or remedial] matter, and Texas law therefore controls." *See Arkoma Basin Exploration Co. v. FMF Assocs. 1990-A, Ltd.*, 249 S.W.3d 380, 387 (Tex. 2008) (explaining that Texas courts ordinarily follow local procedure when applying the other state's substantive law). Don't make, or accept, this argument blithely—there's a very good chance it's wrong.

1. Texas Law Does Not Always Supply the Controlling Limitations Period

Limitations issues are governed by the forum law even if another state's law controls substantive matters, right? Wrong. For example, if the plaintiff's claim is based on another state's statute that incorporates a time limit for bringing the claim, then Texas law does not control. *See Hunt Oil Co. v. Live Oak Energy, Inc.*, 313 S.W.3d 384, 387 (Tex. App.—Dallas 2010, pet. denied); *see also* Restatement (Second) of Conflict of Laws § 143 ("An action will not be entertained in another state if it is barred in the state of the otherwise applicable law by a statute of limitations which bars the right and not merely the remedy."). Likewise, as discussed below, if another state's law applies under the internal-affairs doctrine, or if the parties' contract calls for another state's law to apply, then Texas law does not control on limitations issues.

[1] The author is currently representing parties in litigation involving the issues addressed in this article.

A. The internal-affairs doctrine

The internal-affairs doctrine recognizes that only one state should have the authority to regulate a company's internal affairs, such as the relationships between the company and its investors, and that state is the state of incorporation or formation. *See State Farm Mut. Auto Ins. Co. v. Lopez*, 156 S.W.3d 550, 557 n.7 (Tex. 2004); *Highland Crusader Offshore Partners, L.P. v. Andrews & Kurth, L.L.P.*, 248 S.W.3d 887, 890 n. 4 (Tex. App.—Dallas 2008, no pet.).

Texas has codified the internal-affairs doctrine. For example, § 101.462 of the Business Organizations Code adopts the doctrine for limited liability companies. Tex. Bus. Org. Code § 101.462; *see generally* 20 Tex. Prac., Business Organizations § 23:1 (3d ed.; updated October 2013); Byron F. Egan, *Choice of Entity Alternatives*, 39 Tex. J. Bus. L. 379, 478 & n. 628 (2004) (citing predecessor statute to § 101.462). Like the common-law doctrine, § 101.462 requires application of the "laws of the jurisdiction of organization of the foreign limited liability company." Tex. Bus. Org. Code § 101.462(a).

Section 101.462 contains no exception for the statute of limitations, and arguably, an exception may *not* be read into the statute. *See Union Carbide Corp. v. Synatzske*, 438 S.W.3d 39, 52 (Tex. 2014). Texas courts will presume that the legislature chose the statutory language carefully while purposely omitting exceptions not chosen. *See Morrison v. Seifert Murphy, Inc. v. Zion*, 384 S.W.3d 421, 427-28 (Tex. App.—Dallas 2012, no pet.). In § 101.462(a), the legislature specified those provisions of Texas law that it deemed procedural, and it did not include reference to any statute of limitations. Tex. Bus. Org. Code § 101.462(a).

Further, in § 101.462(a), the legislature *excluded* § 101.457 from the list of Texas Business Organizations Code provisions that it designated as procedural and thus applicable despite the internal-affairs doctrine. *Id.* Section 101.457 tolls the statute of limitations once a written demand has been filed

with a limited liability company. *Id.* Section 101.457's exclusion from the list of procedural statutes that apply despite the internal-affairs doctrine is a clear indication that the legislature intended for the law of the jurisdiction of formation to control statute-of-limitations issues. Thus, the internal-affairs doctrine as codified in § 101.462 does not permit the conclusion that Texas law controls the limitations period.

Additionally, courts applying the common-law internal-affairs doctrine routinely hold that the law of the jurisdiction of formation supplies the controlling statute of limitations. *See 100079 Canada, Inc. v. Steifel Labs, Inc.*, 954 F. Supp. 2d 1360, 1371 & n.6 (S.D. Fla. 2013); *In re Direct Response Media, Inc.*, 466 B.R. 626, 646-47 (D. Del. 2012); *In re Mervyn's Holdings, LLC*, 426 B.R. 488, 502-03 (D. Del. 2010); *In re Norstan Apparel Shops, Inc.*, 367 B.R. 68, 80-82 (E.D.N.Y. 2007); *In re Verisign, Inc. Derivative Litig.*, 531 F. Supp. 2d 1173, 1214-15 (N.D. Cal. 2007); *In re Circle Y of Yoakum, Texas*, 354 B.R. 349, 359 (D. Del. 2006); *see also* 9 Fletcher, Cyclopedia of the Law of Corporations § 4283, p.141 (rev. ed. 2008) ("an action involving the internal affairs of a corporation brought in a state other than the state of incorporation would be governed by the statute of limitations of the state in which the corporation was formed."). Those holdings, along with the absence of any statute-of-limitations exception in § 101.462, suggest that under the internal-affairs doctrine as applied in Texas, the law of the state where the limited liability company was formed supplies the controlling limitations period.

An attorney arguing for Texas law might cite cases such as *In re Brick*, 351 S.W.3d 601, 603 n.1 (Tex. App.—Dallas 2011, no pet.), for the general notion that in a derivative proceeding brought in the right of a foreign corporation, the substantive law of the jurisdiction where the foreign corporation is incorporated applies, but Texas law governs matters of

remedy and procedure. *Brick* and other cases stating that proposition, however, do not mention the Texas statutes adopting the internal-affairs doctrine. Nor can those cases—to the extent any stand for the notion that Texas's statute of limitations controls—be reconciled with the case law holding that under the internal-affairs doctrine, the law of the jurisdiction of formation controls, *including* the statute of limitations.

The old bromide that Texas courts generally apply Texas procedural rules is no reason at all for refusing to apply the limitations period of the state whose substantive law controls the litigation. *Cf.* Restatement (Second) of Conflict of Laws § 122, cmt. b (1971) (cautioning against "unthinking adherence" to precedents classifying a given issue as "procedural" or "substantive"); Unif. Conflict of Laws Act § 2(a)(1) (1982) (providing that where claim is substantively based on law of another state, the limitations period of that state controls). There is no sound legal basis for holding that Texas courts must apply the Texas statute of limitations in a case where the internal-affairs doctrine requires the application of another state's law. The rationale underlying the internal-affairs doctrine, on the other hand, supplies a compelling legal basis for applying the other state's statute of limitations. *See McDermott Inc. v. Lewis*, 531 A.2d 206, 216 (Del. 1987) (explaining justifications for internal-affairs doctrine).

B. Choice-of-law clauses

Texas courts enforce choice-of-law clauses. *See Monsanto Co. v. Boustany*, 73 S.W.3d 225, 229 (Tex. 2002); *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984). And the law chosen by the parties also applies to extra-contractual claims, such as fraud and breach of fiduciary duties, when the claim arises from or is based on the contract. *See Stier v. Reading & Bates Corp.*, 992 S.W.2d 423, 433 (Tex. 1999) (indicating that where tort claims rise or fall on interpretation and enforcement of contract, choice of law clause selecting a

state's law to govern interpretation and enforcement of contract will apply to tort claims); *see also Cunningham Charter Corp. v. Learjet, Inc.*, 870 F. Supp. 2d 571, 575-80 (S.D. Ill. 2012) (choice of law clause providing that agreement would be "governed and interpreted in accordance with the laws of the State of Kansas" applied to fraud claims that were dependent on the parties' contract).

No authority supports the notion that when it comes to the statute of limitations, a Texas court may disregard the parties' contractual agreement to apply another state's law. On the contrary, correct application of the law calls for applying the limitations period found in the law of the state chosen by the parties. *See Hambrecht & Quist Venture Partners v. Am. Med. Int'l, Inc.*, 38 Cal. App. 4th 1532 (Cal. Ct. App. 1995) (applying Delaware limitations period because parties contractually agreed to be governed by Delaware law).

To determine whether the law chosen by the parties controls an issue, Texas courts must look to § 187 of the Restatement (Second) of Conflict of Laws. *Sonat Exploration Co. v. Cudd Pressure Control, Inc.*, 271 S.W.3d 228, 231 (Tex. 2008). Under § 187, the law of the state chosen by the parties to govern their rights and duties will be applied "if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue." Restatement (Second) of Conflict of Laws § 187(1); *see also Midwest Med. Supply Co., L.L.C. v. Wingert*, 317 S.W.3d 530, 536 (Tex. App.—Dallas 2010, no pet.) (same).

Under Texas law, the time period in which a party may bring a claim based on or arising out of their contract is a matter that contracting parties may explicitly resolve in their agreement. *Hewlett-Packard Co. v. Benchmark Electronics, Inc.*, 142 S.W.3d 554, 560 (Tex. App.—Houston [14th Dist.] 2004, pet. denied). Thus, the law selected by the parties governs the statute-of-limitations issue, regardless of whether the contract specifically provides for application of the

selected state's limitations periods—it is a matter the parties "could have" resolved by an explicit provision in their agreement.

A party wanting Texas law to supply the limitations period might point to Texas cases holding that limitations periods are procedural in nature and then insist that Texas, as the forum state, *must* apply its own procedural rules. No Texas case so holds. It is merely a "general rule" that Texas courts will apply Texas law regarding the applicable limitations period. *Hunt Oil Co. v. Live Oak Energy, Inc.*, 313 S.W.3d 384, 387 (Tex. App.—Dallas 2009, pet. denied). And again, no case holds that Texas will selectively disregard the parties' choice-of-law agreement when it comes to the controlling limitations period. Texas strongly favors freedom of contract and will enforce parties' contractual arrangements. *See Gym-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 912 (Tex. 2007).

When the forum state applies its own procedural rules, it does so purely as a matter of convenience. Restatement (Second) of Conflict of Laws § 122, cmt. a (1969); *Jacobs v. Adams*, 505 A.2d 930, 936 (Md. Ct. App. 1986). The policy favoring freedom of contract and enforcement of the parties' bargain cannot be sacrificed for the sake of mere convenience. Thus, the law chosen by the parties in their agreement should govern all matters that the parties could have explicitly provided in the agreement would be governed by the selected state's law, including "procedural" issues that Texas law might otherwise control.

2. Texas Law Does Not Control "Remedial Issues"

Courts sometimes recite, "As a general rule, questions of substantive law are controlled by the laws of the state where the cause of action arose, but matters of remedy and procedure are governed by the laws of the state where the action is maintained." *Intevep, S.A. Research & Tech. Support Establishment v. Sena*, 41 S.W.3d 391, 394 (Tex.

App.—Dallas 2001, no pet.). Although Texas intermediate appellate courts continue state this proposition, it appears to be an incorrect statement of Texas law. James P. George, *False Conflicts & Faulty Analyses: Judicial Misuse of Governmental Interests in the Second Restatement of Conflict of Laws*, 23 Rev. Litig. 489, 579 & n. 512 (2004); *cf. Kinesoft Dev. Corp. v. Softbank Holdings Inc.*, 139 F. Supp. 2d 869, 908 (N.D. Ill. 2001) ("remedial issues are so bound up with substantive issues that they ought to be decided according to the same law that governs the substantive issues.").

Even if Texas law does control on "remedial" issues, that does not mean that it controls the recovery of damages. For example, courts have held that the law of the state supplying the controlling substantive law also governs the recoverability of exemplary damages because it is a matter of substantive law. *See ASARCO LLC v. Americas Mining Corp.*, 382 B.R. 49, 82-83 (S.D. Tex. 2007) (availability of exemplary damages is a matter of substantive law); *see also Braun v. Medtronic Sofamor Danek, Inc.*, 2014 WL 3038687, at *3 (D. Utah July 3, 2014) (same); *Harlan Feeders, Inc. v. Grand Laboratories, Inc.*, 881 F. Supp. 1400, 1403-10 (N.D. Iowa 1995) (same). There is no Texas case to the contrary.

Obviously, this can be important. For example, if your case is governed by Delaware law, and the Delaware Chancery Court would have had exclusive jurisdiction were the case brought there, then the plaintiff is not entitled to recover exemplary damages even though Texas law would permit them. *See U.S. Bank Nat'l Ass'n v. Verizon Commc'ns, Inc.,* 817 F. Supp. 2d 934, 944 (N.D. Tex. 2011). This is because Delaware's Chancery Court lacks jurisdiction to award exemplary damages. *Id.*

3. Texas Law Does Not Necessarily Control an Issue that Appears to be Procedural in Nature

Some issues that seem procedural on their face are not. For example, under the Restatement, whether a party is entitled to a jury trial on a particular claim is typically deemed a procedural issue governed by the forum's law. Restatement (Second) of Conflict of Laws § 129 (1969). But typically does not mean invariably. Section 129, entitled "Mode of Trial," is premised on the assumption that whether an issue is to be tried by the court or jury is a purely procedural matter. Section 129 is in Chapter Six of the Restatement (Second) of Conflict of Laws, entitled "Procedure." And by titling § 129 "mode of trial," the drafters showed that they were thinking in terms of pure procedure. *See Crosby v. Bonnowsky*, 69 S.W. 212, 213 (Tex. Civ. App. 1902, writ ref'd) ("mode of trial" refers to a purely procedural matter).

Under Restatement § 133, where the locus state's law "goes beyond questions of trial administration and is primarily designed to affect decision of a particular issue," the forum state must apply the locus state's law, rather than its own. Restatement (Second) of Conflict of Laws § 133, cmt. b (1971). Thus, when a rule "singles out a relatively narrow issue" and gives it "peculiar treatment," the rule is presumably substantive. *Id.* Rules of this type "will usually be set forth in a statute." *Id.* Thus, in some situations where another state has enacted a statute calling for a court, rather than a jury, to decide an issue, the other state's law should control.

Nevada law, for example, provides, "The question of whether a stockholder, director or officer acts as the alter ego of a corporation must be determined by the court as a matter of law." Nev. Rev. Stat. § 78.747(3). Thus, Nevada's rule that alter ego is a question of law for the court to decide is set forth in a statute, and it is one of only a small handful of Nevada

civil statutes requiring that a court decide a particular issue as a matter of law. This is precisely the sort of rule that § 133 characterizes as intended "to affect decision of the issue rather than to regulate the conduct of the trial." Restatement (Second) Conflict of Laws § 133 (1971).

The larger point here is, in some instances "the procedure itself creates a substantial legal right." *Cassan v. Fern*, 109 A.2d 482, 484 (N.J. Super. 1954). That is, the procedure "is clearly not a mere form or mode for enforcing rights and obligations, but rather the procedure is bound up with those rights and obligations." *Hines v. Elkhart Gen. Hosp.*, 603 F.2d 646, 648 (7th Cir. 1979). By analogy, when a federal court must decide whether a state rule is procedural or substantive for *Erie* purposes, it will consider whether the rule "though undeniably 'procedural' in the ordinary sense of the term," is limited to "a particular substantive area, such as contract law." *S.A. Healy Co. v. Milwaukee Met. Sewerage Dist.*, 60 F.3d 305, 310 (7th Cir. 1995). If so, "the state's intention to influence substantive outcomes is manifest. . . ." *Id.* Thus, if a procedural rule's goals "are substantive—designed to shape conduct outside the courtroom and not just improve the accuracy or lower the cost of the judicial process," *id.*, it may treated as a matter of substance, rather than procedure, for choice-of-law purposes.

If there is any room for doubt whether another state's law is substantive—as opposed to purely procedural—then as a matter of comity, Texas courts should err on the side of finding it substantive and thus controlling over Texas procedure. This is particularly true when no substantial local interest will be sacrificed. Our federal system benefits from state-to-state comity, "a principle of mutual convenience whereby one state or jurisdiction will give effect to the laws and judicial decisions of another." *In re AutoNation, Inc.*, 228 S.W.3d 663, 670 (Tex. 2007) (internal quotation marks omitted). Comity is a traditional component of choice-of-law

theory. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 817 (1993); *see also* Restatement (Second) of Conflict of Laws § 6(2) (factors relevant to choice of law include comity considerations).

The choice-of-law rule that the forum's procedural rules apply is generally a matter of mere convenience. *See* Restatement (Second) of Conflict of Laws § 122, cmt. a (1969). Convenience ought not control over the goals of comity when it is debatable whether an issue is substantive or procedural.

4. The Line Between Substance and Procedure is Not Easily Delineated

Substance and procedure are not "mutually exclusive and separated by a sharp boundary." Walter Wheeler Cook, "*Substance" and "Procedure" in the Conflict of Laws*, 42 Yale L. J. 333, 333 (1933). On the contrary, "These are not clean cut categories." *Sampson v. Channell*, 110 F.2d 754, 754 (1st Cir. 1940) (described by § 7 of the Restatement (Second) Conflict of Laws as "an excellent case on characterization"); *see also Sun Oil Co. v. Wortman,* 486 U.S. 717, 726 (1988) ("Except at the extremes, the terms 'substance' and 'procedure' precisely describe very little except a dichotomy, and what they mean in a particular context is largely determined by the purposes for which the dichotomy is drawn").

Where the boundary between substance and procedure is at best porous, a court must consider the fundamental purpose for making this classification. Cook, 42 Yale L. J. at 355-56. In the conflict of laws context, the distinction between substance and procedure is merely to ensure that the forum state is not inconvenienced by having to apply another state's procedural rules. *Id.* at 346. Because all that is at stake for the forum court is convenience, when the classification is fuzzy, the scales must be balanced in favor of applying the foreign rule. That is, the interest in fulfilling the policy behind the

foreign rule outweighs the forum court's interest in serving its own expediency. *See id.* at 344.

Professor Cook's views have carried the field, being reflected in § 7 of the current Restatement, entitled "Characterization." Restatement (Second) Conflict of Laws § 7 (1971). The commentary explains that a rule should not be deemed procedural unless the court "is convinced that the policy underlying the distinction between substance and procedure in choice-of-law dictates such result." *Id.* at cmt. d, Illustration 3; *see also Jacobs v. Adams*, 505 A.2d 930, 936 (Md. Ct. Spec. App. 1986) ("To categorize as procedural the law of another jurisdiction which created and defined the legal rights that accrued within its territory would render that law impotent.").

The Restatement reiterates the importance of this analysis in § 133. *See* Restatement (Second) Conflict of Laws § 133 (1971). Again, comment b to § 133 teaches that courts must consider whether the foreign rule goes beyond questions of trial administration and is primarily designed to affect decision of a particular issue. If it is, then it is a substantive rule that will be governed by the law of the state that applies to substantive issues in the litigation.

5. Conclusion

Too often, when another state's substantive law controls, attorneys are willing to accept at face value the shopworn notions that Texas law always controls matters of procedure and that certain issues are always procedural. The line between substance and procedure is often blurry, and even if an issue has traditionally been deemed a matter of procedure, it does not necessarily mean that the forum state's law controls. If another state's law controls in a case, and seemingly procedural or remedial aspects of that state's law are more favorable to your client, do your homework. You might find solid support for arguing that the "procedural" or

"remedial" rule controls despite the old platitudes about the forum state's law controlling procedural and remedial matters.

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