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Supreme Court of Texas
Dan Kelly and Laura Hofstatter, Petitioners,
v.
General Interior Construction, Inc., Respondent.
No. 08-0669
November 18, 2009

Oral Argument

Appearances: David C. Holmes, The Solomon Law Firm, Houston, TX, for petitioners.

Ross A. Sears, II, Sears Crawford, LLP, Houston, TX, for respondent.

Before:

Chief Justice Wallace B. Jefferson; Nathan L. Hecht, Harriet O'Neill, Dale Wainwright, David Medina, Paul W. Green, Phil Johnson, Don R. Willett and Eva M. Guzman, Justices.

CONTENTS

ORAL ARGUMENT OF DAVID C. HOLMES ON BEHALF OF THE PETITIONER

ORAL ARGUMENT OF ROSS A. SEARS, II ON BEHALF OF THE RESPONDENT

REBUTTAL ARGUMENT OF DAVID C. HOLMES ON BEHALF OF PETITIONER

CHIEF JUSTICE WALLACE B. JEFFERSON: The Court is now ready to hear argument in 08-0669, Dan Kelly and Laura Hofstatter vs. General Interior Construction, Inc.

MARSHALL: May it please the Court, Mr. Holmes will present argument for the Petitioner. The Petitioners have reserved five minutes for rebuttal.

ORAL ARGUMENT OF DAVID C. HOLMES ON BEHALF OF THE PETITIONER

ATTORNEY DAVID C. HOLMES: Mr. Chief Justice and members of the Court, may it please the Court, this case can be distilled we suggest to a single question. In analyzing a claim of specific jurisdiction, is it sufficient for the plaintiff to plead or allege a cause of action against a nonresident where the cause of action has some relationship to Texas, or must the plaintiff allege conduct by the defendant that has a substantial connection to the State of Texas? The court of appeals, the majority opinion, took the former approach focusing on the

existence of a cause of action that was related to Texas. The dissent and the prior decisions of this Court take the latter position, that there must be a showing of conduct by the defendant in the State of Texas that has a substantial connection to the cause of action. This is illustrated by the court of appeals, the majority opinion's treatment of the claim under Chapter 162 of the Property Code. That's an unusual statute that one day this Court may have to construe on the merits, which aren't here. It says that if money is paid by the owner in a construction project to the general contractor, that the funds are to be treated as trust funds for payment to the subcontractors. Now it's not clear what the parameters of that are, because the statute goes on to say that these trust funds are not subject to the Texas Trust Fund Act -- pardon me, the Texas Trust Act which governs trusts. So it's not clear what law really applies there, but that's not before us today. What this statute does provide is that there is at least a criminal penalty and possibly some sort of implied civil penalty that goes with nonpayment of funds by the general contractor to the subcontractor. Now Mr. Kelly and Ms. Hofstatter are officers of DIVA Consulting, and they had control or direction of the fund, and under the statute they are defined as being subject to the trust fund obligation, they are trustees, whatever that means in the context of this particular statute.

JUSTICE EVA GUZMAN: Counsel, if you negotiate a contract with no intent to perform and with the intent to defraud someone, even though you are a corporate officer, do you not have some individual liability for that?

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE EVA GUZMAN: And in this case your clients negotiated this contract, correct?

ATTORNEY DAVID C. HOLMES: It was actually -- I'm not sure if that's in the record or not, but, yes, certainly the corporation operated through its officers.

JUSTICE EVA GUZMAN: It signed change orders on the contract?

ATTORNEY DAVID C. HOLMES: I beg your pardon?

JUSTICE EVA GUZMAN: Signed change orders, et cetera?

ATTORNEY DAVID C. HOLMES: Yes, yes.

JUSTICE EVA GUZMAN: Okay. So why aren't those contacts, if you will, at least as to the fraud and the trust claim enough under this analysis?

ATTORNEY DAVID C. HOLMES: Well, when you turn and look at that claim, of course the starting point is what were the allegations as to -- it's still going to be a question of where did that happen. And as the dissent pointed out in the court of appeals, there was actually no jurisdictional allegation made by the -- well, actually I'll refer to General Interior Construction as the plaintiff, although it's actually a third party claim. They made no jurisdictional allegation as to actions taking place in the State of Texas, and we rebutted. We

presented evidence saying that they, you know, rebutting the existence of actions in the State of Texas. So the question would be under this record, yes, if Mr. Kelly and Ms. Hofstatter had come to the State of Texas and made, and done what you just said, that would be a grounds for personal jurisdiction in Texas. The question would be whether there are pleadings or evidence to support that. And as the dissent correctly pointed out in the court of appeals, there weren't. There was no showing that Mr. Kelly or Ms. Hofstatter did anything in the State of Texas.

JUSTICE EVA GUZMAN: Except overnight trips or?

ATTORNEY DAVID C. HOLMES: Well, they did make overnight trips, yes. I'm talking about in connection with what you're talking about the --

JUSTICE EVA GUZMAN: With the fraud.

ATTORNEY DAVID C. HOLMES: -- the fraud cause of action. Yes, Mr. Kelly did make site trips to the location of the Hilton in Houston where he did things, and Ms. Hofstatter and Mr. Kelly certainly did have communications with General Interior Construction and the material men and other subcontractors relating to the construction project, yes, they absolutely did. But none of these causes of action arise out of any of those contacts, there's no -- for example, if Mr. Kelly had come to Texas and destroyed some of General Interior Construction's equipment, clearly he would be subject to jurisdiction. If he had come to Texas and had made committed fraudulent acts in Texas, certainly he would be subject to jurisdiction in Texas, absolutely. But there's no showing that if these promises which are alleged in the third party complaint, that any of those took place in Texas. For all we know, they took place in Arizona.

JUSTICE HARRIET O'NEILL: Well, let me ask you a question, and this is just a practical question. You've got DIVA, and DIVA, let's say under the Trust Fund Act is holding funds that rightfully belong to the sub.

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE HARRIET O'NEILL: And DIVA can be held in Texas.

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE HARRIET O'NEILL: Because DIVA is wrongfully holding these funds. It's more of a constructive trust sort of theory, I think.

ATTORNEY DAVID C. HOLMES: I think that's a good way of looking at it.

JUSTICE HARRIET O'NEILL: And then you take the individuals who control the company, sole shareholders, they're holding the funds as well under the Trust Fund Act.

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE HARRIET O'NEILL: They're going to come here and defend the case against DIVA, they're going to be testifying in Court. If they're holding the funds as well as the corporation holding the funds, what's

wrong with sub-jecting them to the jurisdiction of the Court just on that claim?

ATTORNEY DAVID C. HOLMES: I think that's an excellent question. In fact, when I was reading the briefs in the last week, that's one of the questions that came to mind for me, how do I explain that to you. And I think the distinction there is there's a difference between coming here to be a witness and coming here to be a party. The arguments you make make excellent sense if you get to the substantial justice, fair play and substantial justice prong of specific jurisdiction. Certainly if you get to that point, we start looking at the convenience of the parties and issues like that, you can make a strong argument. But still constitutionally there have to be minimum contacts.

JUSTICE HARRIET O'NEILL: Well, sure there do, but if the purpose of the Trust Fund Act is to protect the sub --

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE HARRIET O'NEILL: -- and to fulfill the purposes of that act, anybody who is holding funds that rightfully belong to that sub, why shouldn't they be subject to the jurisdiction of the Court if they come within the parameters of the Trust Fund Act?

ATTORNEY DAVID C. HOLMES: Because you still have to have -- constitutionally, there is still a due process issue. There still have to be minimum contacts.

JUSTICE HARRIET O'NEILL: And let's go through the due process that favors they're going to be here anyway, so in terms of due process concerns, those seem to be satisfied.

ATTORNEY DAVID C. HOLMES: Well, except for that's the third element. The first element of a specific jurisdiction claim is purposeful availment. The second element is relationship of the contacts to the cause of action. The third element is fair play and substantial justice. That's where those sorts of consideration come into play, where you might say, if this is a convenient forum, they're going to be here anyway, but under Supreme Court precedent going all the way back to the days of Pennoyer vs. Neff and all those old -- International Shoe and the like, in order for a person to be sued in the state, they have to have minimum contacts here. And the fact that the Texas legislature has passed a statute that creates liability on somebody is not going to be sufficient to satisfy the constitutional requirement of minimum contacts. For example, there are old cases, which, gosh, I haven't read since law school, where various states tried to pass statutes that dealt with, you know, motorist statutes, "That if you drive into our state, you're going to be subject to jurisdiction here." And ultimately the way that the courts and the legislatures all worked around that was by creating the legal fiction that if you drive into our state, you appoint the Secretary of State as your agent for service of process. But underlying all those cases is still the notion that a legislature, a state legislature cannot evade the constitutional requirement of due process by passing a statute making somebody liable, there still has to be the minimum contact. In the case of those motorist statutes, driving into the state, in the case of the long arm

statute, doing business in the state, under any of those statutes -- or, in the case of the insurance statute, selling insurance in the state. There still has to be some minimum contact to the state. The state legislature does not have the power to override the Fourteenth Amendment requirement of due process, so ultimately there does still have to be the minimum contacts. That's still going to be the bottom line analysis. And in fact, that's what this Court talked about in the Michiana case, that the fact that there may be an impact in the state, there may be an effect in the state is not sufficient by itself, that what the Court should look to, what the courts must look to is the conduct in the state. As the Court disapproved prior case law, holding that specific jurisdiction turns on whether a defendant's contacts were tortious rather than on the contacts themselves. And this Court stated that the jurisdiction cannot turn on whether a plaintiff merely alleges wrong- doing. Well, in this situation, the fact that GIC has alleged a cause of action under the Trust Fund Act as opposed to some other theory, all that is is a matter of pleading. It's invoking a particular theory, a statute in Texas, as opposed to looking at what was the conduct, what were the contacts to the State of Texas. In this case it's not an academic distinction, there is, as I say there is a meaningful difference between being a witness in a state and being sued in a state. I've had -- back in the days when I represented banks, I actually got sued once by a debtor saying that I had been mean to them in my debt collection activities, and I have testified as a witness in many cases on attorney's fees and the like, and I can tell you it was a meaningfully different experience, actually being sued and having myself be the defendant. That's a whole different ballgame. We would all, if we got sued, we would want to have the right to be sued where we live with our own courts who with judges we voted for, with jurors who are our peers, who are our neighbors, who are the people we know who are like us. That's --

JUSTICE NATHAN L. HECHT: Help me, if you would, with the fraud claim.

ATTORNEY DAVID C. HOLMES: Okay, sure.

JUSTICE NATHAN L. HECHT: Suppose someone out of state never sets foot in the state, but designs from afar to defraud people in the forum.

ATTORNEY DAVID C. HOLMES: Right.

JUSTICE NATHAN L. HECHT: And that's really the only purpose for the actions, all the actions occur outside the state, but that's -- it's not just a general fraud, whoever will come, it's really, "Defraud that guy in Houston."

ATTORNEY DAVID C. HOLMES: Okay. Okay, sure.

JUSTICE NATHAN L. HECHT: Would there be specific jurisdiction there?

ATTORNEY DAVID C. HOLMES: I would think so.

JUSTICE NATHAN L. HECHT: And so what distinguishes that from this case?

ATTORNEY DAVID C. HOLMES: We have to look at the record in this case of what was actually proven to have been done and where it was proven

to have been done. The only allegations here, that there were promises made with no intention to perform them. What we've shown you is that, and this is in the record, that after we made the contract, we paid them. I think the number was \$58,000. There became an issue down the road when there was a dispute between the parties. But I think the Court should be wary of taking the path that perhaps you're suggesting, in that there are a great many cases where it's not very difficult to say, "Well, I've got a contract with a company from California," wherever, and they breach it and I'm suing them. And if I want to say, "Okay, well, I want to bring in the president, I want to bring in the vice president, I want to bring in the other people personally," I'm just going to say, "Well, you never really intended to fulfill this contract." That is unfortunately, like it or not, it's an easy allegation to make and it's easy thus to suck people, individuals into the State of Texas with that sort of allegation. At a minimum what the Court should require is some showing that's more than what we have in this case, of where those promises took place, if they were made, some specificity about what the people did and the locus of the activity. In this case we don't have that, instead what GIC has put in the record and what they rely on and they've been relying on throughout this appeal, has been evidence that we, DIVA, gave a -- and through the officers and directors, gave a voucher to Meristar saying various things -- this happened in Arizona -- and that that voucher was false. That's the evidence of fraud that they've actually put in the record. One Arizona resident giving a piece of paper that they say is false, which we disagree with, but regardless, to another Arizona resident. Before you follow that path of letting people suck corporate officers and employees from out of state into Texas, you should at least require some sort of, you know, prima facie showing that there really was something that they did that would subject, some specific action that they committed that would subject them to the jurisdiction of the state. But otherwise let's say, it's ripe for abuse and you could have all sorts of corporate officers and directors who being forced to personally defend themselves. And as I say, that is, having been on that side, knowing that I'm being sued -- in my case I'm from Houston, I was being sued in Beaumont even -- the fact that I was being sued in Beaumont in a community I didn't know, with judges I don't know, with jurors I don't know, was a gut-wrenching experience. Now fortunately it turned out well.

JUSTICE EVA GUZMAN: Well, you're a director, you're negotiating a contract you know you have no intent in performing, you're coming to Texas to make sure everybody is doing everything they should do under the contract that you negotiated, and those are your contacts with Texas to further your fraud, I mean wouldn't you expect to some day be sued in Texas if that's what you were engaged in?

ATTORNEY DAVID C. HOLMES: Certainly, and if that kind of factual showing had been made in this case, this would be a different case.

JUSTICE EVA GUZMAN: There was a showing that they did come here.

ATTORNEY DAVID C. HOLMES: Yes, but there was no showing that they made any promises here or --

JUSTICE EVA GUZMAN: Well, and I guess we're looking at pleadings. Can you address their pleadings as they relate to the contacts with Texas by Kelly and Hofstatter?

ATTORNEY DAVID C. HOLMES: Certainly, I've --

JUSTICE EVA GUZMAN: Okay, in three seconds.

ATTORNEY DAVID C. HOLMES: Yeah. Well, they simply say very little. They simply say something along the lines that Mr. Kelly -- or I think they may have called them "the officers" in the pleading, I don't remember -- that the officers made promises with no intent to perform, something like that. There was no, as I recall not having it in front of me, there was very little specificity about where the promises were made, when they were made, to whom they were made. GIC had the obligation under the -- you know, going back to U-Anchor v. Burt [Ph.], whatever the name of the case was, and all that line of cases, to come forward with evidence and to specific pleadings to establish jurisdiction, and they simply didn't do it. If they had, this might be a very different case. But as you point out, I'm about out of time.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there any other questions? Thank you, Counselor. The Court is now ready to hear argument from the Respondent.

MARSHALL: May it please the Court, Mr. Sears will present argument for the Respondent.

ORAL ARGUMENT OF ROSS A. SEARS, II ON BEHALF OF THE RESPONDENT

ATTORNEY ROSS A. SEARS, II: Chief Justice Jefferson, Honorable Court, it's truly an honor to be here today. And Justice Guzman, congratulations on your recent appointment. If you all see me shaking, I'm going to blame it on the temperature not the fact that you all are an intimidating bunch and this is my first time here, but nonetheless, let me say this. Traditional notion of fair play and substantial justice is one of the cornerstones in the jurisprudence of this area, and I would submit to this Court that allowing this petitioner to escape the jurisdiction of this Court would be patently unfair and gravely unjust.

JUSTICE HARRIET O'NEILL: Well, I understand he pretty much conceded fair play and substantial justice works in favor of jurisdiction here, but that there has to be individual purposeful availment of the forum. And what evidence do we have that Kelly and Hofstatter individually availed themselves of the forum to subject themselves to the fraud and constructive trust claims?

ATTORNEY ROSS A. SEARS, II: Well, Judge O'Neill that's a good question and the answer is, they came here, they literally had a business here, DIVA Construction that did, they were doing a construction project on the Hilton Hotel in Westheimer. They hired several subs here, in their individual capacity came here. I believe we had an affidavit in response, certainly we pled it and also I think had an affidavit in response to one of the motions early on in the case by my client, Art Williams with GIC, that said that Mr. Kelly came here and told him, "Look, we need you to do extra work, we need change orders, we're going

to get you paid, we promise we're going to pay you." They owed him a total of about \$300,000 on this project and only paid them 58.

JUSTICE HARRIET O'NEILL: But that was as a corporate officer. That was -- I mean anybody who works for a company that travels on company business and makes those representations, what takes them out of the corporate capacity and puts them in an individual one?

ATTORNEY ROSS A. SEARS, II: Unless you had no intent to perform that at the outset, Judge, in which case it becomes a tort, in which case it becomes specific jurisdiction as opposed to general and I think it takes them outside the realm of the alter ego or you don't have to pierce the corporate veil. But in addition to that -- I'm sorry. Judge?

JUSTICE EVA GUZMAN: Let's talk about your pleadings though as they relate to the relationship between Texas and the contacts. Did you plead sufficient facts as to those contacts and why they occurred in Texas and how they relate to --

ATTORNEY ROSS A. SEARS, II: Well, I certainly think I did, Judge, and I think Texas is a notice pleading state, I think we've put them on notice and I think without having to go into the merits of those claims, I think there's clearly evidence, and in going a little bit further on what Justice O'Neill just asked and in following up on what your saying, Justice Guzman -- excuse me -- I mean they took, in addition to what I just said, they came here and made these representations that they clearly did not intend to do, and we know that because on at least four if not five occasions, they signed affidavits saying they paid subs when they hadn't. The husband --

JUSTICE NATHAN L. HECHT: Where was that done?

ATTORNEY ROSS A. SEARS, II: That was done in Arizona.

JUSTICE NATHAN L. HECHT: Arizona.

ATTORNEY ROSS A. SEARS, II: Yes, sir, and I'm going to touch that in just a second. I apologize, Judge, I promise I'll --

JUSTICE NATHAN L. HECHT: Okay, that's fine.

ATTORNEY ROSS A. SEARS, II: But in answer to your question, they also took those funds under the Texas Property Code, and again that exposes them individually. And my position before this Court is and I think the prior rulings of this Court are, if you're doing business in this state, then you are subjected to the laws of this state. If you're profiting from a business in the state, you're clearly availing yourself to this state.

JUSTICE EVA GUZMAN: And some of that may have happened, but do you have to plead that some of that happened in Texas?

ATTORNEY ROSS A. SEARS, II: Well, Judge, if they're doing business in Texas and they are holding funds that belong to people in Texas, I guess the other prong of that is and my opinion is, is those funds even though they're coming from Arizona and they're paid in Arizona, they belong to residents of Texas. That's undisputed. Once that work was

done, and by the way, in order for DIVA, Larry and his wife to get paid -- I call him Dan Kelly and Laura Hofstatter -- in order for them to get paid, they had to submit affidavits with her notary saying that we've already paid these subs.

JUSTICE DAVID M. MEDINA: Opposing counsel said that you should have to make a prima facie case of fraud to have these individuals subjected to the jurisdiction of Texas. It sounds like perhaps you've made one.

ATTORNEY ROSS A. SEARS, II: I believe I have, Judge. And I believe and I will say this, I think that the U.S. Supreme Court in *Calder vs. Jones* in 1984 and also in *Keeton vs. Hustler*, both held out-of-state individual defendants liable. Even though all their actions occurred out of state, they published articles and one was in the *National Enquirer* I believe, and one was Florida and one was from California, they both held them individually liable even though their actions occurred out of the state and they never set foot in Texas, but they knew the results of their actions were going to occur in Texas. And in this case I submit to you that when they submitted those fraudulent affidavits to say, we've already paid these Texas subs, we want the money now that belongs by the way to these Texas subs, we're taking it in trust and we're supposed to give to them, we're going to steal that money, there's no way they didn't know that that was going to be a ramification that was going to be felt in Texas. That money didn't belong to anybody in Arizona, it belonged to people in Texas.

CHIEF JUSTICE WALLACE B. JEFFERSON: What does it mean to divide jurisdiction between or among different causes of action? I mean are you subject to the jurisdiction for tort but not contract, and what does that mean in terms of the trial of the case?

ATTORNEY ROSS A. SEARS, II: Well, Judge, and I think the contract claim candidly was a little more difficult, and I don't necessarily fault the appellate court for kicking that out and I haven't really reurged it on appeal at this level because I think it is a little tougher because I think to say that they contracted in an individual capacity as opposed to through DIVA is a little trickier. But I think the case law is clear that if there's a tort, if you have done, if you've committed a tort the results or ramifications of which are felt in this state, you can be held individually liable. This Court held that in *Ratamco [Ph.]*, which was the 2009 decision where they talked about the Fraudulent Transfer and Conveyance Act, and if you remember, that defendant was in California. But they had allegedly consorted with people in Texas to fraudulently transfer some monies and some real estate and this Court held that they could be held accountable even though they were in California and they never came to Texas.

JUSTICE NATHAN L. HECHT: So when Justice Frost said in dissent, she went through the allegations of mis-conduct, but she then said, "Notably, General does not allege that any of these acts occurred in Texas." You don't disagree with that, you just don't think it matters?

ATTORNEY ROSS A. SEARS, II: I didn't think it mattered in that case and I certainly don't think it matters in this case either, Judge, for the reasons that I think this Court has held in *Ratamco* and in *Siskind*, which was even an older Court back in '82, but also the U.S. Supreme Court on the two cases I cited in *Calder* and *Keeton*. Both held that

even though they were out of-state defendants that never set foot in this state, when you undertake an action that you know the consequences of which are going to harm a Texas resident and you do it anyway, it is not farfetched to think you might get sued in the State of Texas. And more importantly than that, this isn't like the Michiana case where that defendant never had any contacts with Texas, these guys were doing business in Texas, they came to Texas, they made representations in Texas, and then they decided under the Texas Statute, we're going to be trustees and fiduciaries of your money, Texas residents' money, and I submit to you they're bound by that statute. If you're going to do business in Texas, make money in Texas, you're going to be bound by Texas law, and one of the laws says if you steal our money, you can be individually liable. And I think for them to come in here and say that they shouldn't be or that, "Yes, we got caught with our hand in the cookie jar, but we think we should be sued in Arizona instead of Texas" is disingenuous and it certainly, getting back to what Justice O'Neill said, does not violate their due process rights.

JUSTICE PAUL W. GREEN: Is it clear that a corporate officer acting as in a corporate officer capacity is individually liable as opposed to someone, say, who is acting as a sole proprietorship that would be liable individually under some other circumstance?

ATTORNEY ROSS A. SEARS, II: If I understand your question, Justice Green, are you asking if they're acting in their corporate capacity, can they still be held liable individually?

JUSTICE PAUL W. GREEN: Right. I mean obviously if you've got an individual who runs a sole proprietorship business in contracting and so forth, and it's not a corporate entity, and he commits, say, a trust fund violation or an allegation of that, okay, there's some individual liability there. But an officer acting on behalf of a corporation and solely in that capacity, is it clear under the Trust Fund Statute that there's individual liability in that instance as well?

ATTORNEY ROSS A. SEARS, II: I believe it is, Judge. I think it's very clear that they are individually accountable, and I also believe that this Court and others have held that when you're --

JUSTICE PAUL W. GREEN: But then how far would that go? Just the person who is alleged to have made the statement or committed the act? Does it extend to all of the officers and directors? How far does it go, because it benefits the entire corporation?

ATTORNEY ROSS A. SEARS, II: Well, candidly I think that's a good question, Judge, and I think it probably doesn't apply. I have an easier answer in this case and that's because there were only two shareholders, a husband and wife that owned the business, so in this case I think it would be simple. How far you took it beyond that, I don't know. I would certainly leave that to you all's decision perhaps on a future case, but with regard to this case, there's just a husband and wife running this business. They're clearly -- they took the trust money and used it in their -- they have said they put it in their corporate account, their general account, and used the money to fund their general business, which I think is in violation of the Act and it specifically states they can be individually liable. But also I think

anytime you allege a tort, which I think the fraud is and I also think violation of that statute is, then the corporate shield doctrine does not apply, particularly when you're suing for specific jurisdiction as opposed to general jurisdiction.

JUSTICE DAVID M. MEDINA: Mr. Sears, it seems like you're implying that we need to look at the size of the business unit. If you have two shareholders, then perhaps there's a different burden or different test for perhaps a major corporation that has not its direct officers down to negotiate deals in Texas but some subordinate.

ATTORNEY ROSS A. SEARS, II: You know, Judge, the short answer is I think that the people that are responsible for handling the account in which the trust funds were administered are probably the ones that should be held accountable. How far down the train that goes, I don't think it should go any further than those that actually took the money, were in charge of the money and responsible for the money. But in this case, I think it's a simpler answer and that is because there's only two of them and they both handled the account, so I think it's an easier decision.

JUSTICE DAVID M. MEDINA: Well, that seemed to catch my attention, but I don't know if that's a proper legal analysis.

ATTORNEY ROSS A. SEARS, II: Well, if not, I apologize, but it wasn't for lack of trying.

JUSTICE DAVID M. MEDINA: Well, I'm just asking, I'm wondering, I don't know if it or isn't.

ATTORNEY ROSS A. SEARS, II: Well, all I know, Judge, is that the statute -- and prior to this case, I'd never dealt with it before, never even heard of it -- but the statute is very clear that you are a trustee of those funds and if you violate that trust, you can be held individually liable.

JUSTICE EVA GUZMAN: And that's true, but when we're looking at your pleadings, we're looking at the alle-gations, the jurisdictional allegations, what you pled about those officers and their connection with Texas. So how did you plead your jurisdiction over these officers?

ATTORNEY ROSS A. SEARS, II: Well, Judge, and my recollection is and the record will speak for itself, but I pled that they committed fraud by coming here and making representations individually, by the way, to my client, the president of the company, and it's arguably in the capacity of -- but he came here and told my guy, "Keep working," because my guy kept complaining he's not getting paid and you keep asking me to do more work, and he says, "You're going to get paid, you're going to get paid."

JUSTICE EVA GUZMAN: And if your petition fails to mention Texas or that any of that occurred in Texas, then what affect does that have as it relates to their burden to negate all basis for jurisdiction?

ATTORNEY ROSS A. SEARS, II: Well, I think it does, Judge. The implication is that since all the work was here, the project was here, the contract was here, my clients were here, the representations were

here, everything about this transaction was here literally except the trust money. I think it's implied by the facts of the case. And then to follow up on that, I think you're right, Judge, that once that is pled, I think it's their burden to negate that element and to say that somehow jurisdiction by this Court would be patently unfair on them, and I don't think they've done that. I don't think they can show that having jurisdiction over them in this case would be unduly burdensome or somehow a violation of their due process rights, particularly -- and what they're asking really is, "We want you to allow two lawsuits on the same facts, same witnesses, same damages, same everything, we just want you to have to sue part of it in Arizona and part of it here." I mean there's no dispute that DIVA's suit is going to be going here, and they want to do the same exact case all over again in Arizona, and I don't think that due process requires that to happen.

JUSTICE EVA GUZMAN: And then you agree though that if you didn't plead jurisdictional allegations, that all they had to show then was present evidence that they were nonresidents of Texas and then the inquiry is over at least at this stage, if you failed to plead sufficient jurisdictional facts or allegations?

ATTORNEY ROSS A. SEARS, II: I don't think I did, and I think it is in the pleadings, Judge, and if it's not, then I certainly don't think they have met their burden to show that somehow jurisdiction on them is going to violate the due process provision.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there more statutory damages for the fraud and the -- are there more damages for fraud in the statutory violations than what exists for the contract breach and other commercial questions?

ATTORNEY ROSS A. SEARS, II: Potentially, given the fact that it has punitive damage implications, potentially, Judge, so in that sense, yes. But I mean I will point this out, Judge, because there's been -- I mean in addition to that, there's another Court out of the Houston Court of Appeals, 2005, the First Court, that was the Glattlys vs. CMS. It's G-l-a-t-t-l-y-s. I mean it is identical. A sub suing a contractor under the same statute, same provision. Those were Illinois defendants, they made this same exact arguments that this defendant is making here. "All of our action, all of our alleged fraud occurred there, the trust money was there," and the Court held that there was jurisdiction because the consequences of the acts were felt here, and I think again that's 100 percent supported by the Calder, the Keeton and the previous cases cited -- or ruled on by this Court where it's held that even though your actions are outside the state, if the consequences of it is directed to this state, you can be held responsible in this state, which makes sense.

JUSTICE DALE WAINWRIGHT: Okay, let me change directions just a little bit back to something we've talked about. As I understand it, Meristar, the owner of the project, paid money to DIVA?

ATTORNEY ROSS A. SEARS, II: Yes, sir.

JUSTICE DALE WAINWRIGHT: DIVA held those funds in its corporate accounts out of state.

ATTORNEY ROSS A. SEARS, II: Yes, sir.

JUSTICE DALE WAINWRIGHT: Your client, one of the subcontractors, GIC was allegedly not paid?

ATTORNEY ROSS A. SEARS, II: Yes, sir.

JUSTICE DALE WAINWRIGHT: What specific statutory language makes the two shareholders and officers of this entity, DIVA, personally liable? In your brief on page 11, you cite to 163.003 of the Texas Property Code and a Houston Court of Appeals case, and then further down you say, "These persons may be held personally liable" without a direct citation, without a citation at all. What specific language do you contend makes these two individuals liable for the handling of the funds in DIVA's corporate accounts?

ATTORNEY ROSS A. SEARS, II: Judge, if I have left it out of my brief or misstated the section, I thought it was 162.003, but I don't have a copy of it with me here today believe it or not, but I didn't --

JUSTICE DALE WAINWRIGHT: 162 point --

ATTORNEY ROSS A. SEARS, II: I'm sorry.

JUSTICE DALE WAINWRIGHT: I can read part of it and maybe this will ring a bell, it's pretty short. 162.003 of the Property Code here says that, "Among others, a subcontractor who furnishes labor and materials for the construction in this state is a beneficiary of any trust funds paid or received in connection with the improvement." Is there something in that language that you think makes these two individuals liable?

ATTORNEY ROSS A. SEARS, II: Judge, my short answer would be without having it in front of me, I don't know. I can certainly supplement my brief. But I will say this, I don't think it's even contested, Judge. I mean I think they agree that they can be held individually liable, they're just saying it has to be in their state not our state.

JUSTICE DALE WAINWRIGHT: Well, that issue does go to liability as opposed to necessarily personal juris-diction, but I mean the statement has been made several times and I'm trying to find the exact basis for that conclusion.

ATTORNEY ROSS A. SEARS, II: And I don't remember it off the top of my head, Judge, and I know the minute I sit down I'm going to remember it, but I apologize and I'll be happy to do a supplemental brief on it if I need to.

CHIEF JUSTICE WALLACE B. JEFFERSON: Why don't you supplement with a letter, I don't think you need much more than that.

JUSTICE DALE WAINWRIGHT: Okay, thank you, Counsel.

ATTORNEY ROSS A. SEARS, II: I would be happy to, and I apologize that I didn't have it for you here today, Justice Wainwright. But again I think that that is not an issue that they're contesting. I think the statute clearly says they can be individually liable. I would have

sworn it was in my brief, but nonetheless I mean I think that goes to the liability, and they're contesting more the jurisdictional end of it. And I would submit to the Court that when you look at the pattern of the ruling of this Court from BMC Software to Michiana to Mokimac [Ph.], I mean it's always been the reason that jurisdiction has been denied is because these were parties that were outside the state that had little if any contact, certainly not any purposeful availments I believe was the gist of the rulings, and then the contacts with the Court were not substantial related to whatever minimal contacts they had. And in this case I mean I think you have a situation where they are doing business in Texas, they're hiring subs in Texas, they're taking trust money on behalf of Texas subs, and by the way, this isn't the only sub, there were two or three other subs that got stiffed as well that were formerly part of this case, and they're in the original petition and I think it's all part of the record. I'm not speaking outside the record. But so the bottom line is they took trust money ---

JUSTICE NATHAN L. HECHT: Is the main case still pending?

ATTORNEY ROSS A. SEARS, II: I think -- most of the other subs, Judge, were so small, they resolved it with Meristar and didn't pursue it. My sub was the largest sub and had the largest loss and therefore was more determined to make sure that they didn't get stiffed, and so they have sent me here today.

JUSTICE DALE WAINWRIGHT: Just to put a little finer point on what I was asking about before, under the Trust Fund Act, DIVA Construction would be liable if they committed the acts that you have alleged under that section, right? It's a corporate entity that had Meristar's funds paid to DIVA in part to pay the subs, and those funds were in DIVA's corporate accounts, DIVA would be liable if it did the things you've alleged under this statute, right?

ATTORNEY ROSS A. SEARS, II: Yes, sir.

JUSTICE DALE WAINWRIGHT: The question is the individual officers and shareholders of DIVA. You're not alleging any kind of piercing theory, you're saying the individuals did something that made them individually liable under the statute?

ATTORNEY ROSS A. SEARS, II: Yes, sir. The statute specifically says as shareholders of an entity that receives the trust money, you can be individually liable, the shareholders and operators of the entity can be individually liable. And again, Judge, I mean we clearly have -- there's never been a dispute about the jurisdiction over DIVA, the issue is now that DIVA has been shelved and basically is a skeletal company and they've left the Texas residents with no recourse, given the fraud claims and the breach of this Texas statute claim that were intentionally done with the knowledge that it was going to be felt in Texas, does that subject them individually to the jurisdiction of this Court? I believe that it does and I believe that to let them not be held to the jurisdiction of this Court would be a grave injustice and I hope that the Court doesn't do that. And I notice I'm out of time, but I'm happy to answer any more questions if you have them, otherwise.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions?

ATTORNEY ROSS A. SEARS, II: Thank you. It was a great experience, and I appreciate it.

CHIEF JUSTICE WALLACE B. JEFFERSON: Thank you, Mr. Sears.

ATTORNEY ROSS A. SEARS, II: Thank you for the opportunity.

JUSTICE HARRIET O'NEILL: If the individuals are fiduciaries, vis-á-vis the subcontractor, where would the breach of fiduciary duty occur if they don't pay over the funds that they're obligated to pay?

REBUTTAL ARGUMENT OF DAVID C. HOLMES ON BEHALF OF PETITIONER

ATTORNEY DAVID C. HOLMES: Well, you've identified one of the fundamental problems we've got with the statute, in that on the one hand it refers to these as "trust funds," but on the hand it doesn't say what duties arise out of that. If these people are "fiduciaries," as we use that term in Common Law, then they could not commingle the money in their general operating account, but the statute allows them to do that. If they have the ordinary liabilities of trustees, those would be governed by the Texas Trust Act.

JUSTICE HARRIET O'NEILL: But they're not.

ATTORNEY DAVID C. HOLMES: But they're not.

JUSTICE HARRIET O'NEILL: And so let's say that it's just that they're a fiduciary of the sub. Let's just make that presumption with me.

ATTORNEY DAVID C. HOLMES: Okay.

JUSTICE HARRIET O'NEILL: Then why doesn't the breach of fiduciary duty occur here by nonpayment of funds that rightfully belong to the sub?

ATTORNEY DAVID C. HOLMES: Well, I'm not sure what the -- well, the money would be in Arizona in a bank account there, and when it is used for some other purpose, that would take place in Arizona.

JUSTICE HARRIET O'NEILL: No, but I'm talking about the breach of fiduciary duty. If it's my duty to turn funds over to you, I'm your fiduciary, then why does the breach not occur in the state where I failed to pay the funds?

ATTORNEY DAVID C. HOLMES: Well, I understand, you could certainly make that argument, but the standard is, the ultimate issue is going be, not the locus of the cause of action per se, but that would go to, that would be a question of choice of law, does Texas law apply. For example, you look at the locus of the cause of action. But rather what we're looking at would be minimum contacts, and as the Court held in Michiana, then we're talking about conduct, looking to conduct, not to pleadings, not to causes of action, what is the conduct that we're looking at, and the conduct all took place in Arizona.

JUSTICE HARRIET O'NEILL: Well, you keep saying that, but if the conduct is withholding your funds, then it seems like the conduct, that the breach is something that could be occurring in Texas. If you're

supposed to pay those funds in Texas and you don't do that, why isn't the breach directed at Texas?

ATTORNEY DAVID C. HOLMES: Well, perhaps it is, but again in Michiana what the Court held was that where the consequences of something are felt is not determinative, it's where the conduct is held. And admittedly, sure, prior to Michiana --

JUSTICE HARRIET O'NEILL: There the conduct was committed out of state.

ATTORNEY DAVID C. HOLMES: Yes.

JUSTICE HARRIET O'NEILL: Here if you say the breach, the failure to pay the funds occurs in Texas, then why wouldn't that come within the conduct within Texas?

ATTORNEY DAVID C. HOLMES: Well, because once again that's not conduct per se it's not a physical action.

JUSTICE HARRIET O'NEILL: Well, it's a breach, the breach occurred in, the breach of fiduciary duty occurred in Texas, why doesn't that give you sufficient contacts?

ATTORNEY DAVID C. HOLMES: Because that's a legal consequence as opposed to conduct, the actual conduct. What the Court said in Michiana is simply, it's easier to look at the bright line of where is the -- that's not the language of the Court, but --

JUSTICE HARRIET O'NEILL: Well, that was a directed, a tort case. I mean that was a little bit different.

ATTORNEY DAVID C. HOLMES: Well, yes, I would certainly agree with that, but nonetheless we have to look at the parameters of the law, and what the Court has said is we look at conduct. And the mere fact that somebody does something in another state, even if it's in some sense foreseeable that it will cause consequences in another state, that's not going to be good enough to establish minimum contacts.

JUSTICE HARRIET O'NEILL: But it -- well, I don't want to beat this to death, but if I steal your money from another state, if I'm in Arizona and I steal your money out of an account, why would I not -- why would that not be conduct directed at Texas, why wouldn't I be subject to liability here? Because that's basically what the Trust Fund Act Claim is, you've stolen that money from the subs.

ATTORNEY DAVID C. HOLMES: Well, I think the answer there, if the money was stolen in Arizona and you have no other contacts with Texas, that you would have to be -- I would have to sue you in Arizona in that situation. I wouldn't have the right to sue you in Texas based on you stealing money from me in Arizona because once again you would have committed no, you would have no conduct, no minimum contacts with Texas, other than the mere fact that I happen to be a Texas resident. If my money is in Arizona, then that's where the theft occurs. But if I could I wanted to answer a question and save Mr. Sears the necessity of filing a --

JUSTICE DALE WAINWRIGHT: I was actually coming to that. On a prior page in the Respondent's brief, it does mention 162.002 not for this direct proposition, but looking at 002 it does say, "An officer or director who has control and direction of trust funds is a trustee of the trust fund."

ATTORNEY DAVID C. HOLMES: Yes, and that's what I'm --

JUSTICE DALE WAINWRIGHT: And you could see that that could make Mr. Kelly and Ms. Hofstetter personally or individually liable?

ATTORNEY DAVID C. HOLMES: I think -- yes, but that's under their interpretation, yes. I mean there's an open question as to whether this statute creates a private cause of action as opposed to being criminal liability, and there's questions as to what the nature of the private remedy would be. We're not here for that today, and he's pleaded that as a cause of action and for purposes of this proceeding, you have to assume that he's right, so, yes, I would agree with that.

CHIEF JUSTICE WALLACE B. JEFFERSON: Are there any further questions? Thank you, Counsel. That cause is submitted, and that concludes all argument for this morning. The Marshall will adjourn the Court.

MARSHALL: All rise.

[End of proceedings.]

Dan Kelly and Laura Hofstatter, Petitioners, v. General Interior Construction, Inc., Respondent.
2009 WL 4823931 (Tex.) (Oral Argument)

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