

TEXAS LAWYER

Choosing a Corporate Home: Deep in the Heart of Texas?

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After the Delaware Chancery Court's decision in *Tornetta v. Musk*, 310 A.3d 430 (Del. Ch. 2024), where the court vacated Tesla's \$55.8 billion compensation package for Elon Musk because it found Tesla failed to establish that the package was fair in both process and outcome, businesses have started to seriously consider incorporating in states other than Delaware. In response, Delaware recently passed new legislation attempting to undo aspects of the *Musk* decision and to address criticism that Delaware courts have substituted their own judgment for that of corporations and their leadership. Even so, there are some legitimate reasons why businesses might consider other states for incorporation and dispute resolution, such as Texas. Texas has a new business court designed to rival the Delaware Chancery Court, and Texas has its own pending legislation intended to strengthen protections for corporations from shareholder litigation that go beyond Texas's already business-friendly standards. Businesses considering incorporation in Texas should also know that the Texas Securities Act creates some additional shareholder litigation risk not present in Delaware.

In an effort to draw more businesses to incorporate and operate in Texas, the state has recently established new business-specific courts



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L-R: Jarod Stewart, Nate Kritzer, Brent Hanson, and Julie Wilson Lascano of Steptoe.

in which the judges are appointed by an openly pro-business governor, and where appeals go to a statewide, elected special court of appeals. See Tex. Gov't Code Sections 25A.009, 25A.007. This business court is designed to rival the Delaware Chancery Court. Like the Chancery Court, the Texas Business Courts have a mandate to issue written and reasoned opinions, which historically Texas trial courts have not done. See Tex. Gov't Code Section 25A.016. The judges of the business court must be at least 35 years old and have at least 10 years of experience, either practicing complex

civil litigation or business transactions, as a civil court judge, or any 10-year combination thereof. Tex. Gov't Code 25A.008. The business courts currently serve five divisions, covering major Texas cities Dallas, Fort Worth, Austin, San Antonio, and Houston. The business courts are courts of limited jurisdiction and therefore have greater capacity to focus on complex business disputes. For example, general business disputes must arise out of qualified transactions exceeding \$10 million, and disputes over corporate governance-type claims must generally be greater than \$5 million. See Tex. Gov't Code Section 25A.004.

Additionally, Texas is actively considering legislation that permits corporations to enact an ownership threshold as high as three percent to bring a derivative claim, effectively eliminating so-called "strike suits" by plaintiffs who purchase one share to bring a claim. Senate Bill 29 is currently making its way through the legislative process and provides that a publicly traded corporation may include in its certificate of formation or bylaws the three-percent ownership threshold. Delaware has no such legislation planned. But even without Texas's new legislation, Texas has more rigorous derivative lawsuit requirements for shareholders than Delaware does. For instance, Texas law does not allow shareholders to bring derivative suits without requesting that the board bring the lawsuit first. See Tex. Bus. Org. Code Section 21.553. In contrast, Delaware provides a demand futility exception that allows shareholders to circumvent the board in certain circumstances. *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1047 (Del. 2021). As a result, there are fewer derivative actions in Texas than there are in Delaware.

Texas and Delaware now have similar safe harbor provisions for interested director or officer transactions. See Tex. Bus. Org. Code Section 21.418. Texas's statutory safe harbor insulates conflicted transactions if (1) the facts are disclosed to the directors and a majority of disinterested directors approve the transaction, or (2) if the

facts are disclosed to the shareholders entitled to vote on the transaction and they approve the transaction, or (3) if the contract is deemed fair. In March 2025, in response to concerns in the wake of the *Musk* case, Delaware amended its corporate law to insulate from challenges transactions that are ratified by a majority of disinterested stockholders. Del. Code Section 144. As in Texas, such shareholder-ratified transactions are now protected by a safe harbor even if there are interested directors or officers involved in the decision. The amendment also created a broad safe harbor provision for transactions that are "fair to the corporation and the corporation's stockholders," which essentially codifies the entire fairness standard. The amendment is retroactive to past transactions, but not for transactions subject to court proceedings pending on or before Feb. 17, 2025, the date the bill was originally introduced.

Delaware and Texas differ significantly, however, in shareholder access to books and records. Texas law imposes a five percent ownership threshold for a shareholder to be able to inspect a corporation's books and records. Tex. Bus. Org. Code Section 21.218. The same pending bill seeking to increase the ownership threshold for bringing a derivative suit also would explicitly exclude from book and records "e-mails, text messages or similar electronic communications, or information from social media accounts unless the particular e-mail, communication, or social media information effectuates an action by the corporation." The new Texas bill would also prohibit demands in connection with an active or pending derivative proceeding that has been or is expected to be instituted. Through its recent amendment, Delaware has also narrowed the scope of books and records requests and provided additional confidentiality safeguards for directors and officers, but there is no ownership threshold. Del. Code Section 220.

Despite business-friendly aspects of Texas law, there are also litigation risks that companies should consider when weighing incorporation

in Texas. For instance, the Texas Securities Act provides for liability when a person (which can include a company) “offers or sells a security ... by means of an untrue statement of material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.” Tex. Gov’t Code Section 4008.052. In contrast to other securities laws, to prevail on a claim against a seller or offeror of a security under the Texas Securities Act, plaintiffs do not have to plead that the defendant acted with scienter (*i.e.*, that the defendant knew that the representation was false or made it without regard to its truth or falsity). See *Dorsey v. Portfolio Equities*, 540 F.3d 333, 344 (5th Cir. 2008). The Texas Securities Act also provides for liability for aiders and abettors and control persons. To prove derivative liability, the plaintiff must allege a primary violation of the securities laws, that the aider and abettor had “a general awareness of his role in the violation,” that he gave “substantial assistance” in the violation, and that he “intended to deceive the plaintiff” or acted with reckless disregard for the truth of the primary violator’s misrepresentations. Aiders and abettors or control persons are subjected to joint and several liability, which means individuals or entities on the periphery of a securities offering may be liable for the entire fraud.

Should companies decide to leave Delaware for Texas, they likely will not be subjected to the rigorous “entire fairness” review for making the decision. Notably, a recent February 2025 Supreme Court of Delaware decision reversed a Chancery decision that would have imposed limitations on corporations leaving Delaware. *Palkon v. Maffei*, 2025 WL 384054, at *8 (Del. Feb. 4, 2025). The Chancery decision held that a corporation moving from Delaware to a state with purportedly lower fiduciary standards

is subject to the entire fairness standard and required the corporation to provide compensation to the stockholders for impairing their “litigation rights” to bring derivative suits. In reversing, the Supreme Court of Delaware rejected the lower court’s reliance on “litigation rights” as speculative and held that a corporation leaving Delaware for Nevada would not be subjected to entire fairness review because of the additional barriers to bringing a derivative suit in Nevada.

As a result of these developments, including new and planned legislation and recent court decisions, corporations seeking more insulation from individual shareholder lawsuits and a bespoke corporate litigation forum should strongly consider incorporating in Texas.

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