absent personal tort liability and that partner is not proper party in action against LLP, and holding trial court did not err in non-suiting partner in LLP where there was no evidence partner had any personal involvement in partnership's dealings with plaintiff); *U.S. Claims, Inc. v. Saffren & Weinberg, LLP*, 2009 WL 2179738 (E.D. Pa. 2009) (discussing Pennsylvania LLP provisions and concluding that partner in LLP is liable for partnership's breach of contract executed by another partner and not resulting from any error, omission, negligence, incompetence, or malfeasance by that partner); *iCore Networks, Inc. v. McQuade Brennan LLP*, 2009 WL 36596 (E.D. Va. 2009) (holding plaintiff's complaint sufficiently alleged partner's individual duty to client of LLP accounting firm); *iCore Networks, Inc. v. McQuade Brennan LLP*, 2008 WL 4550988 (E.D. Va. 2008) (recognizing limited liability of LLP partner and holding conclusory allegation that partner "assumed responsibility" for LLP accounting firm's performance was insufficient to allege individual duty by partner to client); *City of Bridgeport v. C.J. Fucci, Inc.*, 2007 WL 1120537 (Conn. Super. 2007) (stating that partner in LLP may be held liable for his or her own negligence but other partners may not be held liable for that partner's negligence simply because they are both members of the partnership); *Campbell v. Lichtenfels*, 2007 WL 447919 (Conn. Super. 2007) (imposing personal liability on partner for malpractice claim against partnership in absence of proof that partnership filed certificate of limited liability partnership with Secretary of State); *Chamberlain v. Irving*, 2006 WL 3290446 (Conn. Super. 2006) (stating that partners in LLP have limited liability even if designator is not used and third party does not know partnership is LLP); *Cordier v. Tkach*, 2006 WL 2407051 (Cal. App. 2 Dist. 2006) (holding that partner in LLP could not be held liable on contract of firm entered while partnership was registered as LLP because partner was not party in his individual capacity and California LLP provisions insulated partner from liability under agreement); *Dean Foods Company v. Pappathanasi,* 2004 WL 3019442 (Mass. Super. 2004) (concluding LLP as entity was liable for negligence and negligent misrepresentation based on legal opinion issued by firm, but negligence was entity's collective negligence, and no act of any individual partner standing alone was basis to hold individual partner liable); *Mantell v. Samuelson*, 4 Misc.3d 134(A), 2004 WL 1587555 (N.Y. Sup. App. 2004) (dismissing complaint against partners of LLP law firm in suit by court reporter to recover fees because partners in LLP are not liable for partnership debts); *Colliers, Dow & Condon, Inc. v. Schwartz*, 2004 WL 1246004 (Conn. Super. 2004) (concluding plaintiff was not entitled to judgment against LLP partner because partners in LLP are clearly protected from personal liability); *Rashti v. Miod*, 2003 WL 22995264 (Cal.App. 2003) (stating that issue of whether individual partner of LLP can be held liable for discriminatory action in which partner personally participated would appear to be unsettled in view of statutory language indicating partners may be liable in some situations, and concluding that action seeking to hold partners liable for employment discrimination claim could not be deemed frivolous where action was based on decision in which partner reputedly participated); *Megadyne Info. Sys. v. Rosner, Owens & Nunziato*, 2002 WL 31112563 (Cal.App. 2002) (concluding there were fact questions about extent of law firm LLP partners' involvement in matters that were subject of breach of fiduciary duty claim precluding summary judgment in favor of partners); *Liberty Mutual Ins. Co. v. Gardere Wynne, L.L.P.*, 1994 WL 707133 (D. Mass. 1994) (noting, in support of its decision to transfer venue to Texas, that there would be difficult issues under the Texas LLP statute governing the litigation of the merits of the case).

In some cases, courts have erroneously applied the rules regarding the limited liability of a limited partner in a limited partnership when analyzing the liability protection of a general partner in an LLP. *See United States v. 175 Inwood Assocs. LLP,* 330 F.Supp.2d 213 (E.D. N.Y. 2004) (holding that LLP provisions do not protect general partners from personal liability if partnership assets are insufficient to satisfy judgment, relying on non-LLP case law and mistakenly characterizing such case law as involving LLPs); *Schaufler v. Mengel, Metzger, Barr & Co., L.L.P.*, 745 N.Y.S.2d 291 (N.Y. Sup. 2002) (stating that defendants had submitted insufficient evidence to establish that managing partner of accounting firm had no liability as a matter of law on buy-out agreement negotiated with plaintiff partner because the limited partnership act imposes joint and several personal liability on a general partner and on a limited partner who participates in the control of the business); *Damaska v. Kandemir*, 760 N.Y.S.2d 842, withdrawn 2004 WL 852298 (N.Y. A.D. 1 Dept. 2003) (stating that "[a] partner in a limited liability partnership may be held liable for tortious conduct committed by another partner or individual working for the entity if the partner participates in the control of the business [citing *Schaufler v. Mengel, Metzger, Barr & Co., LLP*, and thereby perpetuating the confusion between a limited partnership and an LLP] or if the person for whose conduct the partner is called upon to answer was, at the time of the misconduct, rendering professional services on behalf of the partnership under the partner's direct supervision and control").

G. Limited Partnership LLP

A limited partnership may become an LLP by complying with the applicable provisions of Chapter 152, as modified by Chapter 153 of the BOC. *See* Tex. Bus. Orgs. Code §§ 152.805, 153.351-153.353. Specifically, a limited partnership may register as an LLP by following the procedures specified in Chapter 152 of the BOC and in the partnership agreement or, if the partnership agreement does not contain provisions in this respect, with the consent of the partners required to amend the agreement. Tex. Bus. Orgs. Code § 153.351. The BOC requires the name of a limited partnership registered as an LLP to contain the phrase "limited liability partnership" or an abbreviation of that phrase in addition to the required limited partnership designator. Tex. Bus. Orgs. Code § 5.055(b). The phrase "limited liability limited partnership," or an abbreviation of that phrase, satisfies the requirements for both the limited partnership and limited liability partnership designators. Tex. Bus. Orgs. Code § 5.055(c). When applying the registration requirements found in Chapter 152, an application by a limited partnership to become an LLP must be executed by at least one general partner, and all other references to partners mean general partners only. Tex. Bus. Orgs. Code § 153.352. The filing fee is $200 per general partner. Tex. Bus. Orgs. Code §§ 4.155(12), 4.158(1). If a limited partnership is an LLP, the liability limitations of the LLP provisions apply to its general partners and to any limited partners who, under other provisions of the limited partnership statutes, are liable for the debts and obligations of the limited partnership. Tex. Bus. Orgs. Code § 153.353. Thus, if a limited partner would otherwise be liable for participating in the control of the partnership, the limited partner should be protected in an LLP limited partnership even though the creditor reasonably believed the limited partner was a general partner.

Currently, a number of states do not expressly provide for limited partnership LLPs, and there is considerable variation among the statutes that do. Thus, the LLP shield of a limited partnership that has registered in Texas may not be recognized in all states. The new Uniform Limited Partnership Act (2001) ("ULPA 2001"), which is a complete revision of the prior Revised Uniform Limited Partnership Act (1976 with 1985 amendments), provides that a limited partnership may elect LLP status. As of the beginning of 2021, ULPA 2001 had been adopted in twenty-one states and the District of Columbia.

H. Piercing the LLP Veil

Texas courts have not directly addressed the application of veil-piercing principles to limited liability partnerships. In *Genssler v. Harris County*, 584 S.W.3d. 1 (Tex. App.—Houston [1st Dist.] 2010, no pet.), the court analyzed the claim that an individual was liable for environmental violations committed by a group of entities that owned and operated two waste water facilities. Harris County and the State of Texas had obtained a receivership over the individual's property on the theory that the individual was the alter ego of the entities. The designators in the names of the entities indicate that the group of entities consisted of a limited partnership, two limited liability partnerships, and a limited liability company, but the court did not specify or discuss the nature of the entities. The court spoke in general terms about the separate legal existence of a "business entity" and the application of the alter-ego theory when "there is such unity between the business entity and the individual that the business entity has ceased to be a separate entity, and allowing the individual to avoid liability through the use of the business entity would work an injustice." The court analyzed the evidence and concluded the entities were not the individual's alter ego because there was no evidence he diverted profits for his individual use, owned any interest in the entities, or personally paid any debts owed by the entities. There was testimony that the individual was the president, the "man in charge," and "made all the decisions," but the court stated that the individual's status as an officer or director, standing alone, was insufficient to support application of the alter-ego theory.

I. Liability of Partners of LLP for Wrongful Distributions

The LLP statutes of some states impose limitations on distributions to partners by an LLP and provide for liability to return improper distributions. The Texas LLP provisions do not contain any such provisions; however, creditors may look to the Texas Uniform Fraudulent Transfer Act as a means to recover distributions to partners by an insolvent LLP. *See* Tex. Bus. & Com. Code §§ 24.001 et seq. In addition, if an LLP is a debtor in bankruptcy, distributions to partners may be recoverable under the fraudulent transfer provisions of the Bankruptcy Code.

In 2013, the TUFTA was amended to address a glitch that arose in the definition of "insolvency" with the advent of limited liability partnerships. Before September 1, 2013, the TUFTA provided that a partnership is insolvent "if the sum of the partnership's debts is greater than the aggregate, at a fair valuation, of all the partnership's assets and the sum of the excess of the value of each general partner's nonpartnership assets over the partner's nonpartnership debts." Tex. Bus. & Com. Code. § 24.003(c) (repealed Sept. 1, 2013). Thus, the statute essentially included each general partner's net worth in determining the partnership's solvency. The term "general partner" is not defined in the TUFTA, but partners in a general partnership registered as an LLP are still technically general partners under the BOC, albeit with liability protection, just as general partners in a limited partnership registered as an LLP are general partners with liability protection. Tex. Bus. Orgs. Code Ann. § 1.002(33). With respect to a transfer by an LLP prior to September 1, 2013, a court would likely interpret the term "general partner" as used in the TUFTA definition of insolvency to mean a partner with personal liability for the obligations of the partnership, as that is the obvious assumption underlying the use of the term "general partner" in that context. That approach, however, creates inconsistencies in the use of the term in other provisions of TUFTA, such as the definition of "insider," in which "general partner" would include a general partner with liability protection in an LLP. *See* Tex. Bus. & Com. Code § 24.002(7). Repeal of the special definition of insolvency for a partnership in the TUFTA means that partnerships will be subject to the same insolvency analysis as other entities and is thus consistent with the current entity theory of partnerships. The amendment to the TUFTA also leads to treatment of an LLP under the TUFTA that is consistent with the treatment of an LLP under the fraudulent transfer provisions of the Bankruptcy Code inasmuch as the assets of a partner of an LLP apparently would not be taken into account in determining insolvency of an LLP under the Bankruptcy Code. Although the Bankruptcy Code contains a definition of insolvency for a partnership that is similar to the repealed definition of the TUFTA, an LLP is apparently a "corporation" rather than a "partnership" under the Bankruptcy Code. *See* 11 U.S.C. § 101(9)(A)(ii) and *In re Rambo Imaging, L.L.P.*, 2008 WL 2778846 (Bankr. W.D. Tex. 2008).

J. Liability of "Directors and Officers" for Debts Incurred After Tax Forfeiture of LLP

As discussed in Section II.D. above, forfeiture of a corporation's privileges due to failure to pay franchise taxes or file required reports results in personal liability of directors and officers for certain corporate debts. *See* Tex. Tax Code § 171.255. Issues arising in interpreting and applying these provisions are further discussed in Section II.D. above. Although these provisions are expressed in corporate terms, they also apply to other taxable entities, such as LLCs, limited partnerships, and limited liability partnerships. Tex. Tax Code § 171.2515(b). The statute does not state who is a "director" or "officer" of a partnership for purposes of Section 171.255.

K. Liability for Committing or Knowingly Participating in Tortious or Fraudulent Acts

As noted in Section II.E., courts have long held that corporate officers may be held personally liable when they commit or knowingly participate in tortious or fraudulent acts even though the conduct occurred while the officer was acting on behalf of the corporation. *See, e.g., Gore v. Scotland Golf, Inc.*, 136 S.W.3d 26, 32 (Tex. App.—San Antonio 2003, pet. denied); *Kingston v. Helm*, 825 S.W.3d 755, 764-67 (Tex. App.—Corpus Christi 2002, pet. denied). Similarly, as discussed in Section III.E., Texas courts have held that LLC members and managers are liable for their own fraudulent or tortious acts even if the acts are committed in the service of the LLC. *See Nwokedi v. Unlimited Restoration Specialists*, 428 S.W.3d 191 (Tex. App.–Houston [1st Dist.] 2014, pet. denied) (holding controlling member of LLC was personally liable for knowingly participating in LLC's fraud in relation to LLC's contract and fraudulent transfers of LLC assets based on the principle that a corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though the officer was acting as an agent of the corporation). These principles would apply as well to partners, officers, and other agents in the limited liability partnership context. *See also* Tex. Bus. Orgs. Code § 152.801(d)(2) (LLP does not protect partner from liability imposed by law independently of partner's status as partner).

L. Liability on LLP's Contract as Agent of Partially Disclosed Principal or as Guarantor

As discussed in Sections II.F. and III.F., an agent is not liable on a contract entered into on the principal's behalf if the agent discloses the agent's representative capacity and the identity of the principal, but the agent is personally liable on the contract if the representative capacity of the agent and the identity of the agent's principal are not disclosed to the other party to the contract at the time the contract is entered into. Restatement (Third) of Agency §§ 6.01, 6.02 (2006); Restatement (Second) of Agency §§ 320, 322 (1957). These principles would apply to a partner, officer, or other agent of a limited liability partnership. Additionally, a person who signs a contract of a limited liability partnership as a guarantor or co-signer would have liability as such on the contract. *See* Tex. Bus. Orgs. Code § 152.801(d)(2) (LLP does not protect partner from liability imposed by contract independently of partner's status as partner). Entity representatives should be vigilant when signing credit applications and other contracts on behalf of the entity in order to avoid subjecting themselves to personal liability under provisions that may be interpreted to obligate signatories in their individual capacities.

20 Tex. Prac., Business Organizations § 29:5 (3d ed.)

Texas Practice Series TM November 2020 Update

Business Organizations

Elizabeth S. Miller[a0], Robert A. Ragazzo[a1]

Part V. For-Profit Corporations

Chapter 29. Piercing the Corporate Veil

§ 29:5. Veil piercing under the Business Organizations Code

The limitations on veil piercing formerly contained in Article 2.21 of the Texas Business Corporation Act[1] have been transferred to § 21.223 of the Business Organizations Code, which provides:

> (a) A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to:
>
> (1) the shares, other than the obligation to pay to the corporation the full amount of consideration, fixed in compliance with Sections 21.157 to 21.162, for which the shares were or are to be issued;
>
> (2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory; or
>
> (3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to:
>
> (A) comply with this code or the certificate of formation or bylaws of the corporation; or
>
> (B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.
>
> (b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, subscriber, or affiliate if the obligee demonstrates that the holder, beneficial owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.[2]

The exclusivity provision formerly contained in Article 2.21B has been transferred to § 21.224 of the Business Organizations Code, which provides:

> The liability of a holder, beneficial owner, or subscriber of shares of a corporation, or any affiliate of such a holder, owner, or subscriber or of the corporation, for an obligation that is limited by Section 21.223 is exclusive and preempts any other liability imposed for that obligation under common law or otherwise.[3]

The exceptions to the exclusivity provision formerly contained in Article 2.21B have been transferred to § 21.225 of the Business Organizations Code, which provides:

> Section 21.223 or 21.224 does not limit the obligation of a holder, beneficial owner, subscriber, or affiliate to the obligee of the corporation if that person:
>
> (1) expressly assumes, guarantees, or agrees to be personally liable to the obligee for the obligation; or
>
> (2) is otherwise liable to the obligee for the obligation under this code or other applicable statute.[4]

It appears that the statutory limitations on veil piercing have solved most of the problems created by *Castleberry*. For example, in *Sarratt v. Alamo Square, Inc.*,[5] one Texas court summarized the original holding in *Castleberry* and then stated:

> Yet *Castleberry* is no longer controlling law. In 1989, the state legislature amended article 2.21 of the Texas Business Corporation Act to negate portions of *Castleberry*. Now, the only way a shareholder may be held liable for the contractual obligations of a corporation is through article 2.21 …. Thus, if the shareholder is not liable as per article 2.21 or other statute, he is not liable. It is no longer enough to merely invoke the arcane theories of *Castleberry* and proffer the amorphous concepts of inequity.

There are numerous similar warnings that *Castleberry* has been overruled or superseded by statute.[6] Many federal and Texas courts quote the broad language of *Castleberry* without mentioning any statutory limitations or qualifications but then conclude that the facts of the case do not require veil piercing under *Castleberry*.[7]

The current legal principles in Texas may be summarized by stating that, in cases based on contract, veil piercing currently requires proof of actual fraud[8] for the direct personal benefit of a shareholder.[9] The alter ego and constructive fraud theories of Castleberry, as well as other veil-piercing theories, have been eliminated in Texas in contract cases. The corporate veil may not be pierced in Texas based on failure to follow corporate formalities.[10]

Perhaps the most difficult issue in interpreting § 21.223 of the Business Organizations Code is what constitutes "actual fraud" so that the corporate veil may be pierced with respect to a claim involving a contractual obligation or a claim relating to or arising from such an obligation. This question was posed in *Latham v. Burgher*.[11] In that case, the defendant requested the following instruction:

> Fraud occurs when:
>
> a. a party fails to disclose a material fact within the knowledge of the party,
>
> b. the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth,
>
> c. the party intends to induce the other party to take some action by failing to disclose the fact, and
>
> d. the other party suffers injury as a result of acting without knowledge of the undisclosed fact.[12]

In other words, the defendant equated fraud in the veil-piercing context with common-law fraud.[13] The court of appeals sustained the trial court's refusal to give this instruction: "[I]n the context of piercing the corporate veil, actual fraud is not equivalent to the tort of fraud. Instead, in that context, actual fraud involves 'dishonesty of purpose or intent to deceive.'"[14] The court quotes *Castleberry v. Branscum*[15] for this proposition.

There is some danger in the *Latham* approach. It remains to be seen whether *Castleberry* will be revived by jury verdicts that rely on broad equitable principles to pierce the corporate veil and then conclude that there was "dishonesty of purpose or intent to deceive."[16] To date, the cases finding actual fraud in the veil-piercing context have tended to involve serious abuses of the corporate form to the detriment of creditors.[17] *Latham* itself was such a case.[18]

Footnotes

a0 Baylor University School Of Law.

a1 University Of Houston Law Center.

1 Tex. Bus. Corp. Act. Ann. art. 2.21 (expired).
As the court noted in In re Technicool Systems, Inc., 2018 WL 920013, at *5 (Bankr. S.D. Tex. 2018) (Texas law), although veil-piercing liability is normally limited to shareholders it may be imposed on affiliates of shareholders in appropriate cases.

2 Tex. Bus. Orgs. Code Ann. § 21.223.

3 Tex. Bus. Orgs. Code Ann. § 21.224.
In TecLogistics, Inc. v. Dresser-Rand Group, Inc., 527 S.W.3d 589, 602 (Tex. App.—Houston[14th Dist.] 2017, no pet.), the court applied the exclusivity provision in section 21.224 to preempt the common law claims based on the individual misconduct of a shareholder. But see Bates Energy Oil & Gas v. Complete Oilfield Services, 361 F. Supp. 3d 633, 672–73 (W.D. Tex. 2019) (Texas law) (arguing that the "history of [section 21.223] and the statutory language indicate that it applies to veil piercing theories … but not to direct liability claims for an individual's own tortious conduct").

4 Tex. Bus. Orgs. Code Ann. § 21.225.

5 Sarratt v. Alamo Square, Inc., 1997 WL 271702, *4 (Tex. App.—Amarillo 1997, no writ).

6 See Howell v. Hilton Hotels Corp., 84 S.W.3d 708, 714 n.5 (Tex. App.—Houston [1st Dist.] 2002, pet. denied); Aluminum Chemicals (Bolivia), Inc. v. Bechtel Corp., 28 S.W.3d 64, 68 n.4 (Tex. App.—Texarkana 2000, no pet.); Puri v. Mansukhani, 973 S.W.2d 701, 713, 135 Lab. Cas. (CCH) P 58403 (Tex. App.—Houston [14th Dist.] 1998, no pet.); Lucky Ott, Carolyn Ott, William E. Owen v. Sonic Land Corporation, Sonic Restaurants, Inc., 1996 WL 185347, *9 (Tex. App.—Beaumont 1996, writ denied); see also In re Canion, 196 F.3d 579, 587 n.31, 35 Bankr. Ct. Dec. (CRR) 82, Bankr. L. Rep. (CCH) P 78047 (5th Cir. 1999) (Texas law); Sid Richardson Carbon & Gasoline Co. v. Interenergy Resources, Ltd., 99 F.3d 746, 752 n.4 (5th Cir. 1996) (Texas law); Capital Parks, Inc. v. Southeastern Advertising and Sales System, Inc., 30 F.3d 627, 630 n.2, 30 Fed. R. Serv. 3d 184 (5th Cir. 1994) (Texas law); Government of Virgin Islands, Bureau of Internal Revenue v. Lansdale, 172 F. Supp. 2d 636, 648 (D.V.I. 2001) (Texas law); Tidewater Marine, Inc. v. Sanco Intern., Inc., 2001 WL 474272, *1 (E.D. La. 2001) (Texas law); McCabe v. Kroger Co., 895 F. Supp. 124, 126 (E.D. Tex. 1994) (Texas law).
See, e.g., Saltworks Ventures, Inc. v. Residences at Spoke, LLC, 2018 WL 2248274, at *10 (Tex. App.—Austin 2018, no pet.).
The statutory limitations on *Castleberry* do not apply to claims that do not arise from a contractual obligation. See United States v. Lothringer, 2020 WL 4677406 (W.D. Tex. 2020) (Texas law); see also Argent Holdings, LLC v. East El Paso Physicians Medical Center, LLC, 2018 WL 548676, at *2 (W.D. Tex. 2018) (Texas law) (noting that the statutory limitations on *Castleberry* do not operate to relieve a corporate officer from liability for his own fraud).

7 See Hinkle v. Adams, 74 S.W.3d 189 (Tex. App.—Texarkana 2002, no pet.); Wallace v. Ramon, 82 S.W.3d 501 (Tex. App.—San Antonio 2002) (abrogated by, Dolgencorp of Texas, Inc. v. Lerma, 288 S.W.3d 922 (Tex. 2009)); Elite Towing, Inc. v. Hernandez, 2001 WL 294552 (Tex. App.—Dallas 2001, no pet.); Hare v. Hearst Corporation-Beaumont Enterprise Div., 1994 WL 103380 (Tex. App.—Beaumont 1994, no writ). But see Valley Mechanical Contractors, Inc. v. Gonzales, 894 S.W.2d 832 (Tex. App.—Corpus Christi 1995, no writ) (citing *Castleberry* extensively and concluding that the facts warranted finding that a corporation was the alter ego of the defendant).

By contrast, in BSG Clearing Solutions North America, LLC v. Durham Technology, LLC, 2018 WL 6219812, at *7–8 (W.D. Tex. 2018) (Texas law), the court cited section 21.223 but appeared to apply *Castleberry* to a case involving veil-piercing allegations in a contractual context.

8 See Willis v. Donnelly, 199 S.W.3d 262 (Tex. 2006); Phillips v. United Heritage Corp., 319 S.W.3d 156 (Tex. App.—Waco 2010, no pet.); McCarthy v. Wani Venture, A.S., 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); Solutioneers Consulting, Ltd. v. Gulf Greyhound Partners, Ltd., 237 S.W.3d 379 (Tex. App.—Houston [14th Dist.] 2007, no pet.); Gollin v. Hoard Gainer Industry Co., Ltd., 2005 WL 110374 (Tex. App.—Houston [1st Dist.] 2005, pet. denied); see also Shandong Yinguang Chemical Industries Joint Stock Co., Ltd. v. Potter, 607 F.3d 1029 (5th Cir. 2010) (Texas law); Rimade Ltd. v. Hubbard Enterprises, Inc., 388 F.3d 138 (5th Cir. 2004) (Texas law); In re SMTC Mfg. of Texas, 421 B.R. 251, 324 (Bankr. W.D. Tex. 2009) (Texas law).

See Endsley Elec., Inc. v. Altech, Inc., 378 S.W.3d 15, 27 (Tex. App.—Texarkana 2012, no pet.); Widner Product Finishing Co. v. Southwood Door Co., 2012 WL 677495, at *4 (Tex. App.—Austin 2012, pet. denied); see also Lonrho PLC v. Starlight Invs., LLC, 2012 WL 4215754, at * 3 (S.D. Tex. 2012) (Texas law); Overseas Carriers, Inc. v. Team Ocean Services-Dallas, Inc., 2011 WL 3875369, at *1 (S.D. Tex. 2011) (Texas law); Anglin v. Ceres Gulf, Inc., 2011 WL 13350077, at *4 (S.D. Tex. 2011) (Texas law); In re Antone's Records, Inc., 445 B.R. 758, 774–75 (Bankr. W.D. Tex. 2011) (Texas law); In re Drinks Unique, Inc., 2010 WL 3491184, at *12–14 (Bankr. E.D. Tex. 2010) (Texas law).

In TecLogistics, Inc. v. Dresser-Rand Group, Inc., 527 S.W.3d 589, 597–98 (Tex. App.—Houston[14th Dist.] 2017, no pet.), the court found that section 21.223(a)(2) of the Business Organizations Code was triggered by a claim that a company provided fabricated documents pursuant to a contractual obligation. See also Hidden Values, Inc. v. Wade, 2012 WL 1836087, at *10 (N.D. Tex. 2012) (Texas law) (section 21.223(a)(2) was triggered by fraud claims relating to a franchise agreement); Target Strike, Inc. v. Marston & Marston, Inc., 2011 WL 1486568, at *3 (W.D. Tex. 2011) (Texas law) (section 21.223 applies to tort claims relating to or arising from contractual obligations).

In S-Line LLC v. B2B Supply, 2015 WL 4745069, at *5 (N.D. Tex. 2015) (Texas law), the court declined to apply the actual fraud requirement to a patent infringement claim that did not arise from a contractual relationship. As a consequence, the court applied *Castleberry's* alter ego and sham-to-perpetuate-fraud theories in denying defendants' motion for summary judgment.

9 See Priddy v. Rawson, 282 S.W.3d 588 (Tex. App.—Houston [14th Dist.] 2009, pet. denied); Solutioneers Consulting, Ltd. v. Gulf Greyhound Partners, Ltd., 237 S.W.3d 379 (Tex. App.—Houston [14th Dist.] 2007, no pet.); Bates v. de Tournillon, 2006 WL 265474 (Tex. App.—Amarillo 2006, no pet.); see also Goodman Sales Co. v. ASHA Distributing, Inc., 2006 WL 2469357 (S.D. Tex. 2006) (Texas law); In re HRM Holdings, LLC, 421 B.R. 244, 52 Bankr. Ct. Dec. (CRR) 185 (Bankr. N.D. Tex. 2009) (Texas law).

See In re Tegeler, 586 B.R. 598, 688 (Bankr. S.D. Tex. 2018) (Texas law) (transfers of a corporation's assets to another entity in which the transferor received a 50% ownership interest constituted a direct personal benefit sufficient to justify veil piercing); Zhang v. Monroe, 2017 WL 108311, at *9 (E.D. Tex. 2017) (Texas law); In re Ritz, 567 B.R. 715, 760 (Bankr. S.D. Tex. 2017) (Texas law) (fraudulent transfers to entities in which the shareholder owned an interest constituted a direct personal benefit); K-Solv, LP v. McDonald, 2013 WL 1928798 (Tex. App.—Houston[1st Dist.] 2013, no pet.); Ocram, Inc. v. Bartosh, 2012 WL 4740859, at *4 (Tex. App.—Houston[1st Dist.] 2012, no pet.). In Metroplex Mailing Services, LLC v. RR Donnelley & Sons Co., 410 S.W.3d 889, 897 (Tex. App.—Dallas 2013, no pet.), the court held that an entity's use of a deposit as operating funds did not constitute a direct personal benefit to an owner sufficient to justify veil piercing. See also Hong v. Havey, 551 S.W.3d 875, 886–88 (Tex. App.—Houston[14th Dist.] 2018, no pet.) (corporation's allegedly fraudulent promise to pay a real estate commission without intent to perform did not involve a direct personal benefit to a shareholder); AvenueOne Properties, Inc. v. KP5 Limited Partnership,

540 S.W.3d 643, 650–51 (Tex. App.—Amarillo 2018, no pet.) (no evidence of a direct personal benefit to a shareholder where a corporation allegedly obtained a lease through fraud); Viajes Gerpa, S.A. v. Fazeli, 522 S.W.3d 524, 534–35 (Tex. App.—Houston[14th Dist.] 2016, pet. denied) (noting that, to allow veil piercing, any personal benefit received by a shareholder must be directly related the fraud in question); Morgan v. Fuller, 2016 WL 2766106, at *3 (Tex. App.—Amarillo 2016, no pet.) (payment of a corporation's obligations did not constitute a direct personal benefit to a shareholder). Cf. Clement v. Blackwood, 2018 WL 826856, at *6 (Tex. App.—Eastland 2018, pet. denied) (holding that payment of an LLC's mortgage constituted a direct personal benefit to members where the LLC was created for estate planning purposes rather than for any business purpose and paying the mortgage allowed the members to continue living on the LLC's ranch).
In Stover v. ADM Milling Co., 2018 WL 6818561 (Tex. App.—Dallas 2018, pet. denied), the court summarized the law on what constitutes a direct personal benefit for a shareholder:

> [C]ourts have concluded that evidence showing that funds derived from the corporation's fraudulent conduct were pocketed by or diverted to the individual defendant is sufficient to demonstrate the requirement of a direct personal benefit. On the other hand, evidence showing that the fraudulently procured funds were used for the corporation's financial obligations refutes the notion that the fraud was perpetrated for the direct personal benefit of an individual.

Stover v. ADM Milling Co., 2018 WL 6818561 at *8 (Tex. App.—Dallas 2018, pet. denied) (internal quotations and citations omitted).

10 This limitation has been interpreted to mean that failure to follow corporate formalities may not be any factor in the veil-piercing analysis. See Western Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65, 68 (5th Cir. 1994)l e(Texas law); In re Ryan, 443 B.R. 395, 407 (Bankr. N.D. Tex. 2010) (Texas law); Penhollow Custom Homes, LLC v. Kim, 320 S.W.3d 366, 372 (Tex. App.—El Paso 2010, no pet.); Sparks v. Booth, 232 S.W.3d 853, 868–69 (Tex. App.—Dallas 2007, no pet.); Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294, 296 (Tex. App.—El Paso 1991, no writ).
See TMX Finance Holdings, Inc. v. Wellshire Financial Services, LLC, 515 S.W.3d 1, 11 (Tex. App.—Houston[1st Dist.] 2016, pet. denied); TransPecos Banks v. Strobach, 487 S.W.3d 722, 735–36 (Tex. App.—El Paso 2016, no pet.); Burchinal v. PJ Trailers-Seminole Management Co., LLC, 372 S.W.3d 200, 217 (Tex. App.—Texarkana 2012); see also Lonrho PLC v. Starlight Invs., LLC, 2012 WL 4215754, at * 3 (S.D. Tex. 2012) (Texas law); Driving Force Technologies, Inc. v. Panda Distribution, Inc., 2012 WL 1645634, at *5 (E.D. Tex. 2012) (Texas law).
In Ocram, Inc. v. Bartosh, 2012 WL 4740859, at *4 (Tex. App.—Houston[1st Dist.] 2012, no pet.), the court held that the temporary forfeiture of a corporation's charter for failure to pay franchise taxes was a formality that could not be relied upon in connection with a veil-piercing claim.

11 Latham v. Burgher, 320 S.W.3d 602 (Tex. App.—Dallas 2010, no pet.).

12 *Latham*, 320 S.W.3d at 606. A number of courts have equated fraud in the veil-piercing context with common-law fraud. See Cass v. Stephens, 156 S.W.3d 38, 59, 160 O.G.R. 27 (Tex. App.—El Paso 2004), cert. denied, 522 U.S. 819, 128 S. Ct. 115, 169 L. Ed. 2d 26 (2007); see also In re Ryan, 443 B.R. 395, 408 n.17 (Bankr. N.D. Tex. 2010) (Texas law); In re HRM Holdings, LLC, 421 B.R. 244, 250, 52 Bankr. Ct. Dec. (CRR) 185 (Bankr. N.D. Tex. 2009) (Texas law).
In Simplified Development Corp. v. Garfield, 2008 WL 399433, *5 (Tex. App.—Houston [14th Dist.] 2008, pet. denied), the court assumed without deciding that the elements of fraud in the veil-piercing context are the same as the elements of common-law fraud. The court was able to indulge this assumption because it held that the facts before were sufficient to establish common-law fraud.
See Clement v. Blackwood, 2018 WL 826856, at *3 (Tex. App.—Eastland 2018, pet. denied); Restrepo v. Alliance Riggers & Constructors, Ltd., 538 S.W.3d 724, 750 (Tex. App.—El Paso 2017, no pet.).
In TransPecos Banks v. Strobach, 487 S.W.3d 722, 731 (Tex. App.—El Paso 2016, no pet.), the court equated "actual fraud" under the veil-piercing statute with common law fraud and affirmed a directed verdict for the defendant. The court held that a corporation's president and sole shareholder did not perpetrate an actual fraud on a lender by creating a corporation to obtain a loan to refinance her father's debt where: (a) the lender agreed to the creation of the corporation as the recipient of the loan; (b) the lender was aware that it was

accepting highly encumbered land as collateral; and (c) the president did not make any misrepresentations that might have led the lender to believe that the corporation had any assets other than such land or that the corporation intended to acquire any other assets. The court also held that the failure to pay franchise taxes, which resulted in forfeiture of the corporation's charter, did not constitute an actual fraud on the lender. The contract between the corporation and the lender required the corporation to be "duly organized and validly existing in all jurisdictions" in which it was doing business. However, the corporation's president and shareholder had the ability to pay the corporation's franchise taxes and reinstate its charter. Therefore, the court reasoned that the corporation had legal existence at the time of default on the loan.

13 Common-law fraud is discussed in § 37:2.

In Afshani v. Spirit Realty Capital, Inc., 2020 WL 1139884, at *4 (N.D. Tex. 2020) (Texas law), Martagon v. Murillo, 2019 WL 3731900, at *3 (N.D. Tex. 2019) (Texas law), and Luppino v. York, 2017 WL 8161008, at *2 (W.D. Tex. 2017) (Texas law), the courts applied the heightened pleading requirements applicable to fraud claims to the actual fraud element of a veil-piercing claim.

14 Latham v. Burgher, 320 S.W.3d 602, 607 (Tex. App.—Dallas 2010, no pet.). The court of appeals had previously approved the same charge in Dick's Last Resort of West End, Inc. v. Market/Ross, Ltd., 273 S.W.3d 905, 908 (Tex. App.—Dallas 2008, pet. denied). In re SMTC Mfg. of Texas, 421 B.R. 251, 324 (Bankr. W.D. Tex. 2009) (Texas law), the court concurred that "actual fraud" requires a showing of "dishonesty of purpose" or "intent to deceive."

In In re Carmelita, Inc., 2009 WL 2356488, *5 (S.D. Tex. 2009) (Texas law), a plaintiff advanced the following argument to show actual fraud: "the criteria for piercing the veil are evidence that the corporate entity, the way it was operated, amounts to a fraud, promotes an injustice, or is relied upon to justify a wrong." The court granted summary judgment for the defendant. This ruling must be correct, because if the effects of corporate actions are the sole basis for piercing the corporate veil, there is no difference between constructive fraud and actual fraud.

In In the Matter of Ritz, 832 F.3d 560, 566–67 (5th Cir. 2016) (Texas law), the Fifth Circuit held that "actual fraud" does not require a misrepresentation and may be satisfied by a fraudulent transfer. See also In re Tegeler, 586 B.R. 598, 673 (Bankr. S.D. Tex. 2018) (Texas law) (fraud sufficient to justify veil piercing may be proved by circumstantial evidence that a debtor intended to hinder, delay, or defraud a creditor); In re Technicool Systems, Inc., 2018 WL 920013, at *3 (Bankr. S.D. Tex. 2018) (Texas law) ("The requirement that an actual fraud was perpetrated involves 'dishonesty of purpose or intent to deceive' rather than the higher standard imposed on the tort of fraud.") (quoting In the Matter of Ritz, 832 F.3d 560, 567 (5th Cir. 2016)); Stover v. ADM Milling Co., 2018 WL 6818561, *8 (Tex. App.—Dallas 2018, pet. denied) ("In the context of veil piercing, actual fraud is not equivalent to the tort of fraud.… [A]ctual fraud involves 'dishonesty of purpose or intent to deceive.'") (quoting Martin v. U.S. Merchants Financial Group, Inc., 2014 WL 6871392, at *5 (Tex. App.—Dallas 2014, no pet.)).

15 Castleberry v. Branscum, 721 S.W.2d 270, 273 (Tex. 1986).

16 In Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294, 296 (Tex. App.—El Paso 1991), the court stated that "the various doctrines for disregarding the corporate entity, including alter ego and a sham to perpetrate a fraud, are still very much alive," but these doctrines must be supported by facts showing "actual fraud."

In AvenueOne Properties, Inc. v. KP5 Limited Partnership, 540 S.W.3d 643, 649 (Tex. App.—Amarillo 2018, no pet.), the court noted that it would be incongruous to apply *Castleberry's* "dishonesty of purpose or intent to deceive standard" because the *Castleberry* court equated this standard with constructive rather than actual fraud.

17 See Dick's Last Resort of West End, Inc. v. Market/Ross, Ltd., 273 S.W.3d 905, 911–12 (Tex. App.—Dallas 2008, pet. denied) (a shareholder used a corporation lacking assets to evade obligations under a contract and concealed the corporation's lack of assets and operations); Simplified Development Corp. v. Garfield, 2008 WL 399433, *6 (Tex. App.—Houston [14th Dist.] 2008, pet. denied) (president and chief executive officer of a corporation committed fraud because he did not intend to honor a promise to grant stock options to the corporation's chief financial officer and benefitted from the fraud when the corporation obtained the CFO's consent to transfer its assets to a limited liability company); Cass v. Stephens, 156 S.W.3d 38, 59, 160 O.G.R. 27 (Tex. App.—El Paso 2004, pet. denied), cert. denied, 522 U.S. 819, 128 S. Ct. 115, 169 L. Ed. 2d 26 (2007) (a shareholder misallocated certain expenses from one set of oil and gas wells in which he held a larger interest to another set in which he held a smaller interest); Signal Peak Enterprises of Texas, Inc. v.

Bettina Investments, Inc., 138 S.W.3d 915, 924–26, 8 A.L.R.6th 761 (Tex. App.—Dallas 2004, pet. stricken) (jury returned alter ego and fraud findings); see also S.E.C. v. Resource Development Intern., LLC, 487 F.3d 295 (5th Cir. 2007) (Texas law) (a shareholder/director used a corporation to advance funds that should have been frozen pursuant to a previous court order (an illegal purpose) and operate a trading program that amounted to a Ponzi scheme (the perpetration of fraud)); JNS Aviation, Inc. v. Nick Corp., 418 B.R. 898, 908 (N.D. Tex. 2009), aff'd, 395 Fed. Appx. 127 (5th Cir. 2010) (Texas law) (corporation transferred assets to another entity with same owners to avoid the impact of a default judgment); DDH Aviation, L.L.C. v. Holly, 2005 WL 770595, *7 (N.D. Tex. 2005) (Texas law) (a shareholder/owner (Deason) "pillaged DDH in order to provide for his lavish personal lifestyle" and "treated DDH like a personal checking account and in a manner that prevented DDH from operating for the purpose for which it was founded"); In re Morrison, 361 B.R. 107 (Bankr. W.D. Tex. 2007), subsequently aff'd, 555 F.3d 473, 51 Bankr. Ct. Dec. (CRR) 23, 61 Collier Bankr. Cas. 2d (MB) 435, Bankr. L. Rep. (CCH) P 81399 (5th Cir. 2009) (Texas law) (principal stockholder and president of a corporation provided false financial statements so that the corporation could obtain a subcontract).

By contrast, in Sparks v. Booth, 232 S.W.3d 853 (Tex. App.—Dallas 2007, no pet.), the court was generous in allowing a veil-piercing judgment to stand. The court affirmed an alter ego judgment in a contract case based on the following evidence: (a) a defendant was the president, secretary, sole shareholder, and sole director of a corporation whose veil was pierced; (b) the corporation had no assets; (c) the corporation was a subchapter S corporation; and (d) the defendant personally rented the building to the corporation. The really problematic fact is the corporation's failure to have any assets. However, if *Sparks* is correctly decided, most cases of undercapitalization would seem sufficient to satisfy the law's requirement of actual fraud directly benefitting the defendant. This result seems to drain the actual fraud requirement of much of its significance. See Shaw v. Maddox Metal Works, Inc., 73 S.W.3d 472 (Tex. App.—Dallas 2002, no pet.) (granting summary judgment for a defendant despite evidence of undercapitalization and noting that whether actual fraud is involved is "a step removed" from whether other factors relating to alter ego (such as inadequate capitalization) might be present).

See R & M Mixed Beverage Consultants, Inc. v. Safe Harbor Benefits, Inc., 2019 WL 2443071, at *8 (Tex. App.—El Paso 2019, no pet.) (finding no actual fraud where a company that procured an insurance policy sold its assets to another company and the insurer failed financially; the court found it significant that the insurer maintained an A- rating for a year and a half after the sale); U.S. KingKing, LLC v. Precision Energy Services, Inc., 555 S.W.3d 200, 217–19 (Tex. App.—Houston[1st Dist.] 2018, no pet.) (submission of allegedly inflated financial statements to obtain credit did not satisfy the actual fraud requirement where there was insufficient evidence that the party submitting the statements was aware of falsity at the time of submission or that the party extending credit relied on the statements); Weaver & Tidwell, L.L.P. v. Guarantee Co., 427 S.W.3d 559, 575 (Tex. App.—Dallas 2014, pet. denied) (evidence that one corporation paid another's expenses and controlled its revenues and unfinished projects was insufficient to establish actual fraud); Metroplex Mailing Services, LLC v. RR Donnelley & Sons Co., 410 S.W.3d 889, 897 (Tex. App.—Dallas 2013, no pet.) (alleged diversion of an entity's funds to an owner insufficient to establish actual fraud); Ocram, Inc. v. Bartosh, 2012 WL 4740859, at *3–5 (Tex. App.—Houston[1st Dist.] 2012, no pet.) (holding that actual fraud requires "intentional dishonesty or deception," that the fraud must be related to the harm suffered by the plaintiff, and that undercapitalization is not relevant to the actual fraud inquiry); Tryco Enterps., Inc. v. Robinson, 390 S.W.3d 497, 510 (Tex. App.—Houston[1st Dist.] 2012, pet. dism.) (judgment debtor forfeited a corporation's charter and transferred assets to another entity after the judgment was rendered); see also Spring Street Partners-IV v. Lam, 730 F.3d 427, 445 (5th Cir. 2013) (Texas law) (affirming a finding of actual fraud based on fraudulent transfers that were designed to avoid liability); Choice Ltd. v. Epicentre Development Assocs. LLC, 2016 WL 3911123, at *19 (S.D. Tex.) (magistrate report), adopted, 2016 WL 3763268 (S.D. Tex. 2016) (Texas law) (denying a motion to dismiss a veil-piercing claim where the plaintiff pled that a limited liability company "was organized as a sham to perpetrate a fraud" and that "defendants misled Plaintiff regarding the structure of [the LLC] and that [the LLC] was formed without its knowledge and without a legitimate purpose in order to hide information from Plaintiff"); Fisher v. Blue Cross & Blue Shield of Texas, Inc., 2015 WL 5603711, at *7 (N.D. Tex. 2015) (Texas law) (denying summary judgment where plaintiff produced evidence that certain entities were "mere instrumentalities to facilitate a fraudulent billing scheme" and these entities "were nothing more than the alter ego of [their owner] and each other"); In re Arnette, 454 B.R. 663, 695 (Bankr. N.D. Tex. 2011) (Texas law) (following the *Latham* case described in the main volume); Lilani v. Noorali, 2011 WL 13667, at *13 (S.D. Tex. 2011) (Texas law) (actual fraud would exist if the defendant procured a loan for a corporation knowing that the money would not be repaid); Allied Chemical Carriers, Inc. v. National Biofuels, LP, 2011 WL 2672512, at *3–5 (S.D. Tex. 2011) (Texas law) (applying the *Latham* standard and granting summary judgment dismissing a veil-piercing claim).

18 In *Latham*, the jury found Latham responsible for the debts of Roofing Inc. based on the following evidence: (a) Latham was the president, and his wife was the secretary of Roofing Inc.; (b) Latham and his wife were Roofing Inc.'s sole shareholders; (c) from 2003 to 2006, all of Roofing Inc.'s profits were distributed to Latham and his wife; (d) there was no documentary evidence that Latham had ever paid back a $51,000 loan he received from Roofing Inc.; and (e) in anticipation of the lawsuit, Latham dissolved Roofing Inc. and distributed its assets to its shareholders without setting aside any funds to satisfy a potential judgment. See Latham v. Burgher, 320 S.W.3d 602, 609 (Tex. App.—Dallas 2010, no pet.).

End of Document

46 SMU L. Rev. 1171

SMU Law Review
Spring, 1993

Annual Survey of Texas Law

Part I

Robert F. Gray, Jr.[a1] *Gregory J. Sergesketter*[aa1] *John M. Welge*[aaa1]

CORPORATIONS

Texas courts rendered several noteworthy decisions in the area of Texas corporation law during the current Annual Survey period. In particular, the decisions addressed corporate disregard, dissolution, shareholder agreements, corporate opportunity and shareholder derivative actions, and the application of the Texas Securities Act. Although not as pronounced as in past years, several decisions have attempted to suppress the ability of Texas to foster an otherwise favorable corporate law environment.

I. CORPORATE DISREGARD

In *Superior Derrick Services, Inc. v. Anderson,*[1] a Texas court of appeals found both Superior Derrick Services, Inc. (Superior) and Champion Manufacturing Industries, Inc. (Champion) jointly and severally liable for payment of the purchase price of three oil rig masts on the "single business enterprise" theory.[2] Four oil rig masts were ordered from Anderson. Although listing Champion as the "ship to" address, the purchase order was on a Superior pre-printed form with Champion's name handwritten next to Superior's. Three of the four masts were delivered to Champion and partially paid for by Superior before Champion canceled the remainder of the purchase order.

The court of appeals affirmed the trial court findings under the Texas Business & Commerce Code that title had passed as to the first three masts since each was found to have been accepted by Champion as conforming goods.[3] As such, Champion and Superior were in breach of contract when ***1172** the contract as related to the fourth mast was anticipatorily repudiated.[4] The trial court based damages awarded to Anderson for the fourth mast upon a sworn account, which requires title to pass, rather than upon a breach of contract. The fourth mast, however, was never completed, inspected, accepted or shipped and, contrary to the finding of the trial court, had not been wholly identified to the contract.[5] Based on those findings, no title could have passed; therefore, Anderson was denied recovery under sworn account for the fourth mast.[6]

The court used the "single business enterprise" theory to hold both Superior and Champion jointly and severally liable.[7] The court reviewed the factual sufficiency of the evidence showing that Champion and Superior integrated their resources to achieve a common business purpose. To use the "single business enterprise" theory, the court of appeals had to determine whether the two corporations had not been maintained as separate entities.[8] The court considered the following factors: "(1) common employees; (2) common offices; (3) centralized accounting; (4) payment of wages by one corporation to another corporation's employees; (5) common business name; (6) services rendered by the employees of one corporation on behalf of another corporation; (7) undocumented transfers of funds between corporations; and (8) unclear allocation of profits and losses between corporations."[9]

Although the court of appeals did not find the evidence sufficient to support some of the trial court's findings, sufficient evidence existed to support the findings that: (1) Champion and Superior had interlocking officers and shareholders; (2) Superior paid

Champion's bills, expenses and employee salaries; and (3) Superior purchased inventory used by Champion. The finding of interlocking officers and shareholders was supported only by evidence that one person was a stockholder and an officer of both Superior and Champion.[10] No directors were interlocking and no other contemporaneous officers or shareholders existed between Champion and Superior. The court found that Superior paid Champion's bills based on evidence that Champion had no checking account and that Superior paid Champion's employees salaries and other debts directly.[11] While the two companies considered these transactions to be loans, no documentation of the loans was adduced. The finding that Superior purchased inventory used by Champion was supported by evidence that Champion used Superior's purchase order forms and Superior paid Anderson for the masts.

The court of appeals found these facts sufficient to support the "single business enterprise" theory even though no evidence existed supporting the other trial court findings of: (1) common offices; (2) common employees; (3) ***1173** centralized accounting; and (4) services rendered on behalf of the other corporation.[12] The trial court based its finding of common offices on the fact that Champion and Superior had offices in the same building, but the court of appeals rejected such finding since Champion paid rent to Superior and also had its own shop facility.[13] Further, the court of appeals rejected the trial court's finding of centralized accounting based on evidence that the two companies had separate accountants, tax returns and records.[14] Finally, the trial court finding of services rendered on behalf of the other corporation was overturned because the evidence only showed that services were rendered by Superior for Champion, not on behalf of Champion.[15]

Notwithstanding the encouraging failure of the court of appeals to follow the rationale espoused by the Texas Supreme Court in *Castleberry v. Branscum,*[16] the court inappropriately emphasized the failure of Superior and Champion to observe certain corporate formalities, pursuant to the obscure "single business enterprise" theory, for the purpose of piercing the corporate veil. The utility of the "single business enterprise" theory should have been effectively emasculated by the 1989 amendments to the Texas Business Corporation Act (TBCA), which provide in relevant part that, with respect to the liability of shareholders of the corporation for the contractual obligations of the corporation,

> [a] holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted shall be under no obligation to the corporation or to its obligees with respect to . . . (3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe *any corporate formality . . . .*[17]

The "single business enterprise" theory appears to have originated in dicta only and not under any fact situation similar to the one presented.[18] Most of the case law on the "single business enterprise" theory refers to relationships ***1174** between parent corporations and their subsidiaries.[19] In *Paramount*[20] (the case cited by the court for the "single business enterprise" theory), both companies held liable were owned by the same shareholder.[21] Such was not the case in *Superior.* In addition, the court found liability based on the alternative theory of partner by estoppel,[22] rendering the "single business enterprise" theory unnecessary to the disposition of the case.

Two cases were cited by the court of appeals in *Paramount.*[23] In *Allright Texas, Inc. v. Simons,*[24] the defendants had stipulated at trial that in the event that a final judgment was entered, all named defendants who were not named as judgment defendants therein would jointly and severally guarantee the prompt payment of such judgment.[25] Therefore, the finding of a single business enterprise was not required for the disposition of the case. Similarly in *Murphy Brothers Chevrolet Co., Inc. v. East Oakland Auto Auction,*[26] the court found that all things of value inuring from the transaction belonged to and went to the corporation, which was held jointly and severally liable.[27] The corporation had an interest to protect, was totally involved in the transaction, and protected its interest by receiving and cashing drafts.[28] As such, the disposition of the case did not require examining any theory of corporate disregard. Even if corporate disregard was an issue, the court found the corporation to be liable as a joint adventurer, which factor thereby obviates any reason to consider the “single business enterprise” theory.[29]

The elements of the “single business enterprise” theory were not met in *Superior*. The “single business enterprise” theory is a subset of the “alter ego” theory.[30] One element of the “alter ego” theory requires that one of the entities own stock in the other.[31] No indication exists that either Superior ***1175** or Champion owned stock of the other. Only two theories should have been available to hold Superior liable. The first theory would require a finding that the contractual loss was the result of actual fraud by Superior upon Anderson.[32] To satisfy this requirement, the court would have to elicit evidence that Anderson detrimentally relied upon a Superior representation that (1) Superior and Champion were one and the same or (2) Superior's financial wherewithal would be available if Champion did not pay. The second theory is “partner by estoppel.”[33] Similarly, the fact basis for this theory would have been that: (1) Superior represented that Superior and Champion were partners in purchasing the masts; and (2) relying upon such representation, Anderson provided credit to the apparent partnership.

Many of the reasons that the “single business enterprise” theory was required were obviated by the codification in 1961 of the theory of partner by estoppel, and today, any basis for the “single business enterprise” theory has ceased to exist. The theory has outlived any usefulness that it once might have had.

In *Mancorp, Inc. v. Culpepper*,[34] Mancorp, Inc. (Mancorp), as contractor, sued Culpepper Properties, Inc. (CPI), as owner, and John C. Culpepper, Jr. (Culpepper), as the sole shareholder of CPI, on the basis of alter ego. The suit alleged breach of a construction contract under which Mancorp built the First Bank Galleria for CPI. The jury found against CPI and, by piercing the corporate veil on the basis of alter ego, held Culpepper jointly liable. The trial court, however, rendered judgment notwithstanding the verdict on the finding of alter ego, which judgment was affirmed by the court of appeals.[35] The Texas Supreme Court reversed the decision and remanded the alter ego finding for further consideration.[36] On remand the court of appeals held that the evidence did not support the conclusion that failing to pierce ***1176** the corporate veil would promote injustice since the corporation had sufficient assets to pay the claim.[37] The court of appeals therefore remanded the matter to the trial court.[38]

The court of appeals explained that on the original submission of the case it did not consider whether holding Culpepper liable would promote an injustice or inequity, the second element required for disregarding the corporate entity under the alter ego theory, since it originally did not find factually sufficient evidence of the first element -- that there exists such unity between corporation and individual that the separateness of the corporation has ceased.[39] On remand the court of appeals found sufficient evidence of the unity between corporation and individual after consideration of the Texas Supreme Court opinion, but it did not find sufficient evidence that failing to hold Culpepper liable would promote injustice.[40] While the Texas Supreme Court found that the element of injustice was supported by the jury's possible inference that Mancorp might not get paid on its claim based on the facts that two of CPI's creditors were left unpaid and the construction lender foreclosed on the mortgage, the court of appeals focused on the ability of CPI to pay the Mancorp claim and not on CPI's ability to pay other claims.[41]

The court of appeals further noted evidence of the extent of CPI's assets and that the judgment in favor of Mancorp was for $318,000. The court reasoned that, although CPI was unable to pay an $11,000,000 construction loan, it may have been able to pay the $318,000 judgment to Mancorp.[42] Mancorp's brief stated that CPI “failed to pay Mancorp although it apparently had the funds to do so at one time,”[43] and the uncontroverted testimony of Culpepper was to the same effect. The court of appeals found a lack of factually sufficient evidence of injustice and remanded to the district court.[44]

As previously mentioned by the authors, the disregard of the corporate entity by Texas courts based upon theories of injustice or inequity is extremely dangerous for precedential purposes. Such reasoning effectively leads to a court providing the equivalent of a shareholder's personal guarantee to those who contract with the shareholder's corporation and have not bargained or paid for the added credit enhancement of such a guarantee.[45] However, it is significant and encouraging to note that the court of appeals ignored the Texas Supreme Court decision in *Castleberry v. Branscum* and instead relied upon pre-*Castleberry* common law for the proposition that courts should be reluctant to pierce the corporate veil and hold an individual shareholder liable for the corporation's debts because to do so would "destroy ***1177** an important fiction under which so much of the business of the country is conducted."[46]

In *Fidelity & Deposit Co. v. Commercial Casualty Consultants, Inc.,*[47] the two shareholders of Commercial Casualty Consultants, Inc. (Commercial) appealed a judgment holding them personally liable for Commercial's debt to Fidelity & Deposit Company of Maryland (Fidelity). The district court found liability on the bases of corporate disregard and breach of fiduciary duty under an agency agreement. The court of appeals reversed the finding as to corporate disregard, but affirmed for Fidelity under the tort theory of a breach of the shareholders' fiduciary duty owed to Fidelity.

The court of appeals reviewed the evidence used to support corporate disregard under the theory of sham to perpetrate a fraud. Fidelity produced evidence that one or both of the shareholders (1) drew on the Commercial bank account to pay personal debts and never reimbursed Commercial, (2) did not pay premiums on insurance policies issued to them by Commercial, (3) wrote Commercial checks on accounts with insufficient funds in exchange for checks drawn on Commercial's account, and (4) pledged Commercial's accounts receivable as collateral for a personal loan.[48] To support the sham to perpetrate a fraud theory, however, Fidelity had to demonstrate its specific reliance on the financial backing of the shareholders.[49] Fidelity's representative did not deal with the shareholders in negotiating the contract with Commercial, no evidence existed that Fidelity was aware of the share-holders' financial condition or the extent of their involvement with Commercial, nor did Fidelity specifically rely upon the shareholders to personally segregate and forward Fidelity's premiums and property when due or to personally guarantee Commercial's performance thereof. As such, sufficient evidence did not exist to establish that Fidelity relied on the credit of the shareholders of Commercial and, therefore, the shareholders could not be held personally liable under the sham to perpetrate a fraud theory.

While the result of the case and the court's recognition that Art. 2.21A of the TBCA[50] has superseded *Castleberry*[51] are proper, the court's analysis as to corporate disregard strays in melding sham to perpetrate a fraud with specific reliance on a shareholder's financial backing. A shareholder of a Texas corporation is not liable for any contractual obligation of such corporation unless the shareholder (1) has expressly agreed by means of a guarantee ***1178** or similar contractual arrangement to be liable for the obligation, (2) has perpetrated an actual fraud[52] upon the obligee primarily for the shareholder's direct personal benefit,[53] or (3) is expressly liable for the obligation under another statute.[54] To pierce the corporate veil through the basis of "sham to perpetrate a fraud," a shareholder has to commit, primarily for the shareholder's direct personal benefit, an actual fraud against the person seeking to disregard the corporate entity. While the evidence produced by Fidelity did not support a finding that the shareholders perpetrated an actual fraud upon Fidelity primarily for the shareholders' direct personal benefit, the evidence does suggest that Fidelity might have been able to reach the shareholders pursuant to the fraudulent transfer provisions of the Texas Business & Commerce Code.

In *Dae Won Choe v. Chancellor, Inc.,*[55] the Dallas court of appeals improperly used the Texas Tax Code to hold a corporate officer liable for general obligations of the corporation.[56] The case involved a suit on a sworn account. On March 15, 1988, the same day that Chancellor, Inc.'s (Chancellor) franchise tax report was due, Dae Won Choe entered into a contract to perform services for Chancellor. The services were performed between March 15 and June 24, 1988. On June 24, 1988, Chancellor's corporate right to do business was forfeited based on the corporation's failure to file a franchise tax report and pay franchise taxes, and its corporate charter was forfeited on December 5, 1988.

Dae Won Choe sued Janell Hatley, who was president and chief executive officer of Chancellor, individually, under the provisions of section 171.255 of the Texas Tax Code.[57] The trial court granted summary judgment for Hatley on the grounds that section 171.255 imposes liability on corporate officers and directors only after a corporation's forfeiture of its right to do business.[58] The court of appeals reversed stating that corporate officers and directors are liable for debts of a corporation that has forfeited its corporate charter to the extent that those debts are incurred after the date the franchise tax report is due.[59]

The court sets a dangerous precedent by using the tax code to hold directors and officers personally liable for the debts of the corporation incurred ***1179** after the failure of the corporation to timely file its last franchise tax report where such debts are not tax obligations created by the tax code. The court emphasized the language of section 171.255, which creates partnership liability for corporate directors and officers after the date the franchise tax report is due,[60] but failed to consider the intent of the statute as evidenced by the very next sentence of section 171.255, which specifies that the liability includes franchise taxes and penalties imposed by the franchise tax chapter of the tax code. The intent of the statute is to limit liabilities to those taxes and penalties imposed by all chapters of the tax code, thus assuring the collection of taxes by the state. This intent is apparent when one considers that this statute must be strictly construed to protect those individuals against whom liability is sought.[61] Although section 171.255(c) excepts from a director's liability those debts created or incurred over a director's objection and without the director's actual or imputed knowledge, no such exceptions exist for officers. For corporate debts other than state taxes, the proper method of piercing the corporate veil is by use of applicable statutory[62] and case law, not the tax code.

II. DISSOLUTION

In *Motorola Communications and Electronics, Inc. v. Shareholders of Lowery Communications, Inc.*,[63] the United States District Court for the Southern District of Texas correctly applied the provisions of the TBCA to deny a creditor recovery from directors and minority shareholders of a dissolved corporation.[64] Motorola Communications and Electronics, Inc. (Motorola) was a creditor of Lowery Communications, Inc. (Lowery), whose account with Motorola was continually in arrears. Actions taken by Motorola to collect the debt included: demand letters; attempted enforcement of guarantees by the majority shareholder; and a default judgment against Lowery and the majority shareholder, both of which subsequently sought protection under the federal bankruptcy laws.

Lowery was dissolved on December 30, 1986, and this action against all of the former shareholders was brought one day less than three years after that date. The court found that Motorola had knowledge in early 1987 that articles of dissolution were filed by Lowery.[65] Motorola made a claim against the minority shareholders of Lowery based on the "equitable trust fund theory."[66] Specifically, Motorola claimed that the distribution to the minority ***1180** shareholders upon dissolution of Lowery was a conversion of money owed to it as a creditor.

The two year statute of limitations found in the Texas Civil Practices and Remedies Code Section 16.003[67] expressly applies to actions for conversion and the court noted that such statute is not extended to the three-year period during which the *corporation* may prosecute and defend claims as provided by Article 7.12 of the TBCA.[68] Motorola improperly tried to assert that Article 7.12 of the TBCA was the appropriate statute of limitations, thus making their claim timely since it was made within three years of the date of dissolution of Lowery. Article 2.41A(3) of the TBCA is the appropriate section of the TBCA for claims brought against a director of a dissolved corporation and it imposes a two year statute of limitations.[69] Importantly, the district court found that the claims against minority shareholders were also barred by the two year statute of limitations found in Article 2.41A(3) of the TBCA.[70] This conclusion was based upon the court's determination that, since no direct authority permitting claims against minority shareholders exists, their liability can only be derived from the directors' liability authorized by Article 2.41E of the TBCA, which is subject to the two year statute of limitations.

In addition to the statute of limitations, the court barred Motorola's claims based upon the doctrines of laches and stale demand.[71] The court noted the legislative policy of Article 7.12 "to . . . protect shareholders, officers and directors of a dissolved corporation from prolonged and uncertain liability."[72] The court held that (i) Motorola's delay in bringing this action was unjustified based on its knowledge of Lowery's dissolution in 1987, and (ii) holding the shareholders liable would be an injustice, so the action would also be barred by laches.[73]

III. SHAREHOLDER AGREEMENTS

In *Dixie Pipe Sales, Inc. v. Perry,*[74] a Texas court of appeals properly interpreted Article 2.22 of the TBCA to apply to transfers of stock made from an executor to a beneficiary under a will.[75] Perry and Thompson each received a certificate representing stock in Dixie Pipe Sales, Inc. (Dixie) from the executor of the estate of an original owner of the stock. They delivered the stock certificates to Dixie and requested that the stock be transferred into ***1181** their names. Dixie refused to transfer the stock, citing provisions of its bylaws, and tendered checks for the stock's book value. The bylaws of Dixie contained provisions granting Dixie the right of first refusal to buy the stock upon any transfer of the stock, but did not expressly make the restrictions applicable to testamentary transfers.

The court of appeals held that restrictions that are reasonable and noted conspicuously on the stock certificate are enforceable pursuant to the TBCA against the successor or transferee of the holder, and that such restrictions applied equally to executors, since they are included in the terms “successor” and “transferee” found in Article 2.22.[76] The court noted that the restrictions on transfer in this case were valid under Section 2.22 of the TBCA because they were noted conspicuously on the face of the security and the restrictions were reasonable.[77] The court based the finding that the restrictions were reasonable on the small number of shareholders of Dixie and the fact that all of the shareholders were related.[78] As the court correctly noted, to hold otherwise would give a shareholder greater transfer rights after death than while alive.[79]

IV. CORPORATE OPPORTUNITY AND SHAREHOLDER DERIVATIVE ACTIONS

In *Accent Energy Corp. v. Gillman,*[80] the Amarillo court of appeals held that corporate officers and directors are not required to disclose a corporate opportunity to the minority shareholders.[81] Gillman and Windle were minority shareholders, while Johnson was the president and sole director, and Waters was the majority shareholder and secretary of Accent Energy Corporation (Accent). In 1983, while travelling by plane from Dallas to Amarillo to attend Gillman's Fourth-of-July party, Waters met a personal acquaintance who gave him an offering circular soliciting prospective investors in a well in Oklahoma. Waters informed Johnson of the prospective investment but did not inform the minority shareholders. With his own money, Waters then bought an interest in the well, which turned out to be very profitable. Accent was dissolved in 1984 and Gillman brought suit in 1985 in Hutchinson County based on: (1) the failure of Waters and Johnson to fully disclose corporate opportunities; and (2) Water's unfair usurpation of a corporate opportunity. Gillman further contended that venue was proper in Hutchinson County based on the fact that Hutchinson County was the first place that Waters had an opportunity to inform the minority shareholders of the prospective investment. Motions to change venue to Dallas County, the county of Water's residence, were denied and the jury awarded damages of $286,732.87 plus interest and expenses to the corporation and attorneys' fees ***1182** and expenses to Gillman and Windle.[82]

On appeal, the court reversed on the venue issue and remanded to the trial court.[83] Although the Texas Civil Practice & Remedies Code[84] allows suit against a private corporation in the county where the cause of action arose, the court found that Hutchinson County was not the proper venue for this case.[85] Accent was named as a defendant along with Waters, but the suit was primarily brought against Waters for the benefit of the corporation as a derivative action. Gillman and Windle, therefore, could not use the corporate venue statute to fix venue as to Waters, who was entitled to be sued in the county of his residence.[86]

The jury found that the disclosure Waters made to Johnson failed to be reasonably calculated to give full disclosure to Accent of an investment opportunity.[87] In reversing the district court, the court of appeals was not persuaded that as minority shareholders

Gillman and Windle had a right to be informed of the investment opportunity, stating that although officers and directors are fiduciaries of the corporation, they are not duty-bound to disclose a corporate investment opportunity to the minority shareholders.[88] The court noted that an ordinary private corporation formed under the TBCA that is not a close corporation operates under the direction of the board of directors and not the shareholders. Reiterating the well-settled precept of Texas corporate law that shareholders are not entitled to participate in, either individually or collectively, or to control, the business and affairs or management of the ordinary private corporation, the court of appeals correctly found that a corporation's officers and directors have no duty to disclose corporate investment opportunities to minority shareholders.[89]

In *Brunswick Corp. v. Bush,*[90] the Fort Worth court of appeals correctly reversed a class certification by the trial court that included minority shareholders.[91] The case was originally before the Fort Worth court of appeals[92] on appeal from a trial court ruling striking the original class certification based on the breach of a merger agreement since the seven major shareholders were not parties to the merger agreement.[93] In that opinion, the court held that the shareholders were intended third party beneficiaries of the merger agreement due to a shareholder agreement, signed at the same time as the merger agreement, in which certain shareholders made certain representations and warranties.[94] On remand the trial court certified a class including ***1183** all shareholders, regardless of whether or not they signed the shareholder agreement.

Brunswick Corporation (Brunswick) then appealed, arguing that the appellate court's prior opinion should not be controlling as to all shareholders. Brunswick took the position that all of the shareholders are not third-party beneficiaries under the merger agreement because not all shareholders signed the shareholder agreement. Brunswick argued that minority shareholders who did not sign the shareholder agreement were only incidental beneficiaries as opposed to third-party beneficiaries, and as such, they had no enforceable rights.

Noting the presumption against third-party beneficiary agreements,[95] and the importance of the intent of contracting parties when determining whether parties are third-party beneficiaries to a contract,[96] the court of appeals looked at the intent of the parties to the merger agreement as evidenced by the language in the merger agreement. It specifically noted section 10.8 of the merger agreement, which stated, "This Merger Agreement . . . is not intended to confer upon any other person any rights or remedies hereunder."[97] The court correctly agreed with Brunswick and noted that the shareholders who did not sign a shareholder agreement were only incidental beneficiaries to the merger agreement, with no enforceable rights with respect to the merger agreement.[98] The linking of the shareholders' agreement executed by the major shareholders with the merger agreement, however, has the unfortunate result of allowing certain shareholders to bring separate and independent causes of action for injuries presumably suffered by them individually. Such actions are more appropriately brought by the corporation as a result of the depreciation in the value of its shares.[99] An individual shareholder does not have a separate and independent cause of action for injuries suffered by the corporation.[100] In Texas, a separate cause of action for a shareholder exists only for personal damages as a result of the breach of a duty owed directly by a person *to the shareholder,* whether arising from contract or otherwise.[101] In this case however, without finding that Brunswick breached the shareholders' agreement, the court of appeals incorrectly found that by executing the shareholders' agreement, the seven major shareholders were, in the court's own words, "integral participants in the merger, meaning that without their performance as set forth in the Shareholder Agreement, the merger would not go through."[102] The court ***1184** held that the injuries suffered by them as shareholders were separate from the injuries suffered by the corporation and all other shareholders.[103]

V. SECURITIES REGULATION

In *Lutheran Brotherhood v. Kidder Peabody & Co.,*[104] the Texarkana court of appeals reversed a take-nothing summary judgment in favor of Kidder Peabody & Company (Kidder) and remanded the cause for trial.[105] The suit was based on allegations that Kidder, as a corporation's placement agent, "sold" worthless bonds by negligently and deliberately making misrepresentations of material facts in connection with an institutional private placement. The investors in a private placement of subordinated corporate bonds of All American Bottling Company (AABC) brought a securities action against the placement agent of the bonds, Kidder, after the bonds became worthless. Prior to the private placement, Kidder distributed a private placement memorandum that contained a disclaimer and warnings about the risk of an investment in the bonds. The subordinated bonds were then sold pursuant to purchase agreements between AABC and the purchasers that contained certain representations and warranties, including the representation that there were no material facts concerning AABC that were not disclosed by AABC to the purchasers. When AABC could not maintain its financial covenants on its senior debt, payments on AABC's junior debt were barred and the bonds became worthless.

The appellate court noted several fact issues that precluded the summary judgment.[106] The first issue involved the adequacy of the disclosure concerning the statement in the private placement memorandum that the senior lender had a strong interest in additional lending. The statement was removed in a supplemental private placement memorandum but the language of the supplement dealing with such additional lending was not clear about the fact that the senior lender had actually refused to make further loans. The court found that since liability can be based on material omissions as well as false statements, a fact issue existed concerning the proper disclosure of the senior lender's intentions and, therefore, summary judgment on the issue was inappropriate.[107]

Kidder argued that the bonds were sold by AABC and not by Kidder; therefore, Kidder asserted that it had no privity with plaintiffs and was not a "Seller" within the meaning of the Texas Securities Act (TSA).[108] The court followed the reasoning of the United States Supreme Court in *Pinter v. Dahl,*[109] noting that "one who 'offers or sells' a security is not limited to *1185 those who pass title."[110] The court further stated that Article 581-33(A)(2) of the TSA applies to "any link in the chain of the selling process."[111] The court went on to take the expansive view that Kidder was a "Seller" within the meaning of the TSA since Kidder acted as an agent for AABC in preparation of the private placement memorandum.[112]

Kidder also argued that plaintiffs could only obtain rescission and not recover damages based upon certain specific exclusionary language in the TSA[113] and the fact that the plaintiffs still owned the bonds. Despite cases[114] that permit suit under a similar federal provision only for rescission when the buyer still owns the security, the court refused to interpret the TSA to limit the buyers' remedies to rescission, despite the fact that the buyers still held the securities.[115] The court allowed a suit for damages basing its reasoning on the language of the TSA that a buyer may recover at law or in equity.[116] Specifically the court of appeals stated:

> We are of the opinion that the statute did not intend to limit the buyer to rescission only if he still owns the security, but that it used the phrase "if the buyer no longer owns the security" simply to emphasize that the buyer did not lose his right of action for damages if he no longer owned the security. Any other construction would render meaningless the phrase in the statute that the buyer may sue "at law or in equity," because rescission is exclusively an equitable remedy.[117]

The court further stated that proof of a buyer's reliance on a seller's misrepresentation or omission is not required to maintain an action under article 581-33 of the TSA, but that the misrepresentation must be material.[118] Since the materiality of a misrepresentation or omission is determined by whether the statement or omission influenced the buyers' actions to the extent that the buyers would not have entered into the transaction had the representation not been made,[119] the affidavit by the plaintiffs concerning reliance on the statements contained in the private placement memorandum concerning AABC's cash flow and the availability of additional loans was sufficient evidence to preclude summary judgment.[120]

The private placement that is the subject of the instant decision was made only to sophisticated and accredited investors who warranted in the purchase agreement that they performed an independent investigation. Importantly, ***1186** the court pointed out that a plaintiff cannot recover either for misrepresentations that he knows are false or when he has relied *solely* on his own investigation of such facts.[121] The fact that the plaintiffs performed independent investigations does not necessarily preclude reliance on the private placement memorandum.[122] The amount of reliance placed on independent investigation should be weighed by the trier of fact in light of the sophistication of the investor.[123] Stating that the Texas rule is that of the Restatement (Second) of Torts § 552 (1977),[124] the court also noted that Kidder may be liable for negligent misrepresentation, based on the duty not to negligently supply false information to others for use in their business transactions.[125] In sum, the court found that, in light of the material issues of fact as to the existence of materially misleading facts, and the knowledge of the defendants of and the justifiability of the reliance by the plaintiffs on those facts, the summary judgment was improper and must be reversed and the cause remanded for trial on those issues of fact.[126]

As previously noted by the authors,[127] Section 27A of the Securities and Exchange Act of 1934 (Exchange Act) was enacted on December 19, 1991, in an effort to reverse the retroactive application of the United States Supreme Court's one-year/three-year limitations rule for federal securities claims under the anti-fraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder as espoused in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*[128] and pursuant to the retroactivity rule of *James B. Beam Distilling Co. v. Georgia.*[129] The constitutionality of Section 27A, based on separation of judicial and legislative powers, is still at issue. More than two dozen federal district court opinions have upheld the constitutionality of Section 27A, while at least a dozen more have ruled against it.[130] One of the latter opinions was delivered by a Texas federal district court finding Section 27A to be unconstitutional.[131] Unfortunately, Section 27A has only replaced the ancillary question in federal securities law claims of the appropriate limitations period with the now ancillary question of its constitutionality.

Footnotes

a1 B.B.A., M.B.A., The University of Michigan; J.D., The University of San Diego; LL.M., New York University; Attorney at Law, Fulbright & Jaworski L.L.P., Houston, Texas.

aa1 B.B.A., J.D., University of Notre Dame; Attorney at Law, Fulbright & Jaworski L.L.P., Houston, Texas.

aaa1 B.S., University of Illinois; J.D., University of Houston; Attorney at Law, Fulbright & Jaworski L.L.P., Houston, Texas.

1 831 S.W.2d 868 (Tex. App.--Houston [14th Dist.] 1992, writ denied).

2 *Id.* at 875. As enunciated in Paramount Petroleum Corp. v. Taylor Rental Center, 712 S.W.2d 534, 536 (Tex. App.--Houston [14th Dist.] 1986, writ ref'd n.r.e.), the "single business enterprise" theory states that "when corporations are not operated as separate entities but rather integrate their resources to achieve a common business purpose, each constituent corporation may be held liable for debts incurred in pursuit of that business purpose."

3 *Superior,* 831 S.W.2d at 872.

4 *Id.*

5 *Id.* at 874.

6 *Id.*

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.* at 875.

12 *Id.*

13 *Id.* at 874.

14 *Id.* at 875.

15 *Id.*

16 721 S.W.2d 270 (Tex. 1986). *Castleberry* permits disregarding of the corporate fiction (or "piercing the corporate veil")

when the corporate form has been used as part of a basically unfair device to achieve an inequitable result and more specifically:] . . . (1) when the fiction is used as a means of perpetrating fraud [including constructive fraud, which is defined as the breach of some legal or equitable duty]; (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation [the alter ego theory]; (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation; (4) where the corporate fiction is employed to achieve or perpetrate monopoly; (5) where the corporate fiction is used to circumvent a statute; and (6) where the corporate fiction is relied upon as a protection of crime or to justify wrong.

Id. at 271-72. In addition, in a footnote the court listed inadequate capitalization as another basis. *Id.*

17 Tex. Bus. Corp. Act Ann. art. 2.21A (Vernon Supp. 1993) (emphasis added).

18 *See* State v. Lone Star Gas Co., 86 S.W.2d 484, 491 (Tex. Civ. App.--Austin 1935), *rev'd on other grounds,* 304 U.S. 224 (1938).

19 In re Tryit Enter., 121 B.R. 217, 223 (Bankr. S.D. Tex. 1990). In *Tryit,* each of the entities that the court found to be part of a single business enterprise had signed the loan agreement, the terms of which stated that each was liable to repay the entire indebtedness. *Id.* at 220. Since the court found fair consideration, no further analysis should have been necessary to avoid the claim of fraudulent conveyance. Though the court did not pursue the partner by estoppel theory, from the facts presented it appears that the lender entered into the loan agreement on the basis that all signatories' assets would be available for repayment under the loan agreement. As such, partner by estoppel should have provided the basis for the court to hold each entity liable and its assets available for repayment to the borrower.

20 Paramount Petroleum Corp. v. Taylor Rental Center, 712 S.W.2d 534 (Tex. App.--Houston [14th Dist.] 1986, writ ref'd n.r.e.).

21 *Id.* at 536.

22 *Id.* at 537; *see infra* note 33 and accompanying text.

23 *Id.* at 536.

24 501 S.W.2d 145 (Tex. Civ. App.--Houston [1st Dist.] 1973, writ ref'd n.r.e.).

25 *Id.* at 149.

26 437 S.W.2d 272 (Tex. Civ. App.--El Paso 1969, writ ref'd n.r.e.). In holding the corporation liable, the court quoted from an alter ego case. *Id.* at 276.

27 *Id.* at 275.

28 *Id.* at 276.

29 *Id.* at 275.

30 *See* Hideca Petroleum Corp. v. Tampimex Oil Int'l, Ltd., 740 S.W.2d 838, 843-44 (Tex. App.--Houston [1st Dist.] 1987, no writ); Robert F. Gray, Jr. et al., *Corporations and Partnerships, Annual Survey of Texas Law,* 43 Sw. L.J. 221, 229-30 (1989).

31 *See* Permian Petroleum Co. v. Petroleos Mexicanos, 934 F.2d 635, 643 (5th Cir. 1991); Robert F. Gray, Jr. et al., *Corporations, Annual Survey of Texas Law,* 45 Sw. L.J. 1525, 1543-44 (1992).

32 The elements of common law fraud in Texas are as follows: (1) a material representation was made; (2) the material representation was false; (3) when the speaker made the material representation, he knew it was false or made it recklessly without any knowledge of its truth and as a positive assertion; (4) the speaker made the material representation with the intention that it should be acted upon by the party to whom it was made; (5) the party acted in reliance upon the material misrepresentation; and (6) the party thereby suffered injury. Trenholm v. Ratcliff, 646 S.W.2d 927, 930 (Tex. 1983).

33 When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:
(a) When a partnership liability results, he is liable as though he were an actual member of the partnership;
(b) When no partnership liability results, he is liable jointly with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately. Tex. Rev. Civ. Stat. Ann. art. 6132b, § 16(1) (Vernon 1970).

34 836 S.W.2d 844 (Tex. App.--Houston [1st Dist.] 1992, no writ).

35 *Id.* at 845.

36 *See* Robert F. Gray, Jr. & Gregory J. Sergesketter, *Corporations, Annual Survey of Texas Law,* 45 Sw. L.J. 227, 231 (1991).

37 *Mancorp,* 836 S.W.2d at 845-46.

38 *Id.* at 848.

39 *Id.* at 846.

40 *Id.* at 847.

41 *Id.* at 846.

42 *Id.*

43 *Id.*

44 *Id.* at 848.

45 *See* Gray & Sergesketter, *supra* note 36, at 233.

46 *Mancorp,* 836 S.W.2d at 847. The court further cited the decision in Hickman v. Ralls, 638 S.W.2d 100, 102 (Tex. App.--Dallas 1982, writ ref'd n.r.e.), which recognizes the overriding public policy, embodied in art. 2.21 of the TBCA, that disregard for the corporate entity must be subjected to more stringent standards in contract cases than in tort cases because in contract cases the parties have an opportunity to select those with whom they are dealing. Hopefully, the *Mancorp* case reflects the beginning of a trend away from the *Castleberry* line of cases, and toward a recognition of the existence of article 2.21 of the TBCA.

47 976 F.2d 272 (5th Cir. 1992).

48 *Id.* at 274.

49 *Id.* at 275. "Without reliance, the contract claimant cannot avoid the risk of insolvency that it originally accepted as part of the bargain." *Id.* (quoting from Pan E. Exploration Co. v. Hufo Oils, 855 F.2d 1106, 1133 (5th Cir. 1988)).

50 Tex. Bus. Corp. Act Ann. art. 2.21A (Vernon Supp. 1993).

51 *Fidelity,* 976 F.2d at 275 (5th Cir. 1992).

52 *See supra* note 32 for the elements of common law fraud in the State of Texas.

53 Tex. Bus. Corp. Act Ann. art. 2.21A(2) (Vernon Supp. 1993).

54 Such other statutes would presumably include the express provisions of the Deceptive Trade Practices Act, the fraudulent transfer provisions of the Texas Business & Commerce Code, and the Texas Securities Act.

55 823 S.W.2d 740 (Tex. App.--Dallas 1992, no writ).

56 *Id.* at 743.

57 Tex. Tax Code Ann. § 171.255(a) (Vernon 1992).

58 If the corporate privileges of a corporation are forfeited for the failure to file a report or pay a tax or penalty, each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived. The liability includes liability for any tax or penalty imposed by this chapter on the corporation that becomes due and payable after the date of the forfeiture.
Tex. Tax Code Ann. § 17.255(a) (Vernon 1992); *see Dae Won Choe,* 823 S.W.2d at 743.

59 *Dae Won Choe,* 823 S.W.2d at 743.

60 *Id.*

61 Rogers v. Adler, 696 S.W.2d 674, 677 (Tex. App.--Dallas 1985, writ ref'd n.r.e.).

62 Tex. Bus. Corp. Act Ann. art. 2.41 (Vernon Supp. 1993).

63 771 F. Supp. 823 (S.D. Tex. 1991).

64 *Id.* at 828-29.

65 *Id.* at 826.

66 *Id.* This theory has been abolished pursuant to amendments to the TBCA shortly after this case was decided. To impose liability on directors for paying, or on shareholders for receiving, illegal distributions from Texas corporations, the remedies now are exclusively contained in Article 2.41 of the TBCA, the Uniform Fraudulent Transfer Act, and the United States Bankruptcy Code. *See* Robert F. Gray, Jr. et al., *Corporations, Annual Survey of Texas Law,* 45 Sw. L.J. 1525, 1529 (1992).

67 Tex. Civ. Prac. & Rem. Code Ann. § 16.003 (Vernon 1986).

68 Tex. Bus. Corp. Act Ann. art. 7.12 (Vernon Supp. 1993).

69 "An action may not be brought against a director for liability imposed by this section after two years after the date on which the act alleged to give rise to the liability occurred." Tex. Bus. Corp. Act Ann. art. 2.41A(3) (Vernon Supp. 1993).

70 *Motorola,* 771 F. Supp. at 828-29.

71 *Id.* at 829.

72 *Id.* (quoting Hunter v. Forth Worth Capital Corp., 620 S.W.2d 547, 551 (Tex. 1981)); *see* Robert F. Gray, Jr. et al., *Corporations, Annual Survey of Texas Law,* 45 Sw. L.J. 1525, 1533 (1992).

73 *Motorola,* 771 F. Supp. at 829.

74 834 S.W.2d 491 (Tex. App.--Houston [14th Dist.] 1992, writ denied).

75 *Id.* at 494.

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.*

80 824 S.W.2d 274 (Tex. App.--Amarillo 1992, writ denied).

81 *Id.* at 278.

82 *Id.* at 276.

83 *Id.* at 278.

84 Tex. Civ. Prac. & Rem. Code Ann. § 15.036 (Vernon Supp. 1993).

85 *Accent,* 824 S.W.2d at 277-78.

86 *Id.* at 277.

87 *Id.* at 276.

88 *Id.* at 278.

89 *Id.*

90 829 S.W.2d 352 (Tex. App.--Fort Worth 1992, no writ).

91 *Id.* at 356.

92 Bush v. Brunswick Corp., 783 S.W.2d 724 (Tex. App.--Fort Worth 1989, writ denied).

93 *See* Gray & Sergesketter, *supra* note 36, at 234-35.

94 *Bush,* 783 S.W.2d at 731.

95 *Id.* at 354.

96 *Id.*

97 *Id.* at 355.

98 *Id.* at 356.

99 *See* Gray & Sergesketter, *supra* note 36, at 234-35.

100 Massachusetts v. Davis, 140 Tex. 398, 407, 168 S.W.2d 216, 221 (Tex. 1942), *cert. denied,* 320 U.S. 210 (1943).

101 Faour v. Faour, 789 S.W.2d 620, 621 (Tex. App.--Texarkana 1990, writ denied). While most courts have viewed this as an exception to the general rule, it is an otherwise separate cause of action that is not dependent upon the relationship of the parties to the corporation. *See* Gray & Sergesketter, *supra* note 36, at 233.

102 *Brunswick,* 829 S.W.2d at 356.

103 *Id.*

104 829 S.W.2d 300 (Tex. App.--Texarkana 1992), judgment set aside, 840 S.W.2d 384 (Tex. 1992) (dismissed as moot).

105 *Id.* at 303.

106 *Id.* at 305.

107 *Id.* at 306.

108 Tex. Rev. Civ. Stat. Ann. art. 581-1 - 581-41 (Vernon 1964 & Supp. 1993); *Lutheran,* 829 S.W.2d at 306.

109 *Lutheran,* 829 S.W.2d at 306 (citing Pinter v. Dahl, 486 U.S. 622 (1988)).

110 *Id.*

111 *Id.*

112 *Id.*

113 *Id.* at 307. The TSA states that the buyer "may sue either at law or in equity for rescission or for damages if the buyer no longer owns the security." Tex. Rev. Civ. Stat. Ann. art. 581-33(A)(2) (Vernon Supp. 1993).

114 *Lutheran,* 829 S.W.2d at 307 (citing Randall v. Loftsgaarden, 478 U.S. 647 (1986)); Wigand v. Flo-Tek, Inc., 609 F.2d 1028 (2d Cir. 1979).

115 *Lutheran,* 829 S.W.2d at 307.

116 *Id.*

117 *Id.*

118 *Id.*

119 *Id.* (citing H.W. Broaddus Co. v. Binkley, 126 Tex. 374, 88 S.W.2d 1040 (Tex. 1936)); Adickes v. Andreoli, 600 S.W.2d 939 (Tex. Civ. App.--Houston [1st Dist.] 1980, writ dism'd).

120 *Lutheran,* 829 S.W.2d at 307.

121 *Id.* at 308.

122 *Id.*

123 *Id.*

124 *Id.* at 309.

125 *Id.*

126 *Id.* at 310.

127 Robert F. Gray, Jr., et al., *Corporations, Annual Survey of Texas Law,* 45 Sw. L.J. 1525, 1551 (1992).

128 111 S. Ct. 2773 (1991).

129 111 S. Ct. 2439, 2447-48 (1991).

130 In addition, two federal circuit courts have found Section 27A to be constitutional. Anixter v. Home-Stake Production Co., 1992 Fed. Sec. L. Rep. (CCH) ¶ 96,968 (10th Cir. Aug. 24, 1992); Henderson v. Scientific-Atlanta, Inc., 971 F.2d 1567 (11th Cir. 1992).

131 Pacific Mut. Life Ins. Co. v. First Republicbank Corp., 806 F. Supp. 108 (N.D. Tex. 1992).

46 SMULR 1171

End of Document

20 Tex. Prac., Business Organizations § 29:4 (3d ed.)

Texas Practice Series TM November 2020 Update

Business Organizations
Elizabeth S. Miller[a0], Robert A. Ragazzo[a1]

Part V. For-Profit Corporations

Chapter 29. Piercing the Corporate Veil

§ 29:4. The legislative responses to *Castleberry*

The Castleberry decision and the state law cases that followed it raised grave concerns in the business community. It appeared that shareholders' protection against liability on corporate obligations had become entirely dependent on some jury's after-the-fact determination that the transaction met some undefined (and undefinable) abstract standard of fairness. The Castleberry decision raised the basic concern of persons in the business community that it might no longer be safe to conduct business using Texas corporations. The broad language used by the court in Castleberry appeared to increase significantly the possibility that individual shareholders unexpectedly (and unintentionally) might in effect become guarantors or sureties of corporate obligations. To the extent that the piercing doctrines articulated in Castleberry would create inadvertent guarantors or sureties, they would be exposed to a significant risk.[1] There were informal discussions among sophisticated Texas attorneys about recommending incorporation in other states, particularly Delaware or Nevada, and qualifying to transact business in Texas. However, it was decided to first pursue less radical (and less expensive) solutions. Following a failed attempt to overrule Castleberry legislatively in 1987,[2] a more concerted effort was made in 1989 with a somewhat positive outcome.

Effective August 28, 1989, Article 2.21 of the Texas Business Corporation Act was amended in an effort to address the problems created by Castleberry. The amended statute read as follows:

> A. A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted shall be under no obligation to the corporation or to its obligees with respect to:
>
> (1) such shares other than the obligation to pay to the corporation the full amount of the consideration, fixed in compliance with Article 2.15 of this Act, for which such shares were or are to be issued;
>
> (2) any contractual obligation of the corporation on the basis of actual or constructive fraud, or a sham to perpetrate a fraud, unless the obligee demonstrates that the holder, owner, or subscriber caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, or subscriber; or
>
> (3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.
>
> B. Nothing contained in this article shall limit the obligation of a holder, owner, or subscriber to an obligee of the corporation when:

(1) the holder, owner, or subscriber has expressly assumed, guaranteed, or agreed to be personally liable to the obligee for the obligation; or

(2) the holder, owner, or subscriber is otherwise liable to the obligee for the obligation under this Act or another applicable statute.[3]

This is not the first time that the legislature has made legislative corrections to judicial opinions in the business area that have adverse effects on the State.[4]

The amendments to Article 2.21 were optimistically intended to reverse the three most serious problems perceived to arise from the decision in Castleberry. The principal amendments were designed to: (a) eliminate “constructive” fraud as a basis for veil piercing; (b) require proof of “actual fraud on the obligee primarily for the direct personal benefit of the” shareholder/defendants to justify veil piercing;[5] and (c) provide that contract liability was not to be visited on shareholders under the “alter ego” doctrine solely because there was a failure to follow formalities. If the failure to follow formalities contributed to or was part of a scheme that involved the commission of actual fraud, however, the statutory limitation presumably would not apply.

For practical reasons, the revised Article 2.21 did not address several potential problems. For example, it did not address potentially the most dangerous aspect of Castleberry, the holding that ultimate issues of piercing the corporate veil should be issues of fact solely for the jury rather than questions of law for the court. The ad hoc committee that developed the amendments to Article 2.21 briefly discussed this issue but concluded, first, that an attempt to limit the role of a jury might significantly increase the controversial nature of the bill, and second, that constitutional problems might be created if the legislature rather than the courts attempted to define what are issues of law and issues of fact. In any event, it was felt that the change of the standard to “actual fraud” should have the effect of reducing significantly the power of juries to determine that shareholder liability should exist merely on undefined notions of equity or fairness.

The new amendments were also expressly limited to contractual claims and did not apply to claims against shareholders based on tortious conduct or to other areas of the law in which issues relating to disregard of the corporate fiction may arise (such as attempts to avoid statutory provisions or the classification of marital property as separate or community property). These other areas continued to be governed by Castleberry though it was thought possible that the limitations set forth in amended Article 2.21 might apply by analogy in these areas as well. For example, it was thought that it would be unreasonable to permit a tort claimant to proceed against individual shareholders solely because shareholders or directors failed to hold meetings as required by statute. The test for piercing in that situation should logically be based on economic issues not addressed by the statute such as whether the corporation: (a) was adequately capitalized; (b) used its resources to purchase a reasonable amount of liability insurance in light of the foreseeable risks of the business; and (c) had assets recklessly removed from the reach of tort claimants for the benefit of shareholders.[6]

During the course of the ad hoc committee's deliberations on the 1989 legislation, a considerable amount of attention was also paid to the adequacy of an “actual fraud” standard to cover situations in which the corporate form was used in an inequitable way to defeat creditors' claims. For example, consider a case where the original transaction was not fraudulent, but the corporate affairs thereafter involved payments to shareholders for questionable back salary or repayment of doubtful loans, with the result that the corporation becomes judgment proof and unable to satisfy claims of creditors. An argument may of course be made that the subsequent corporate conduct constituted “actual fraud” or “waste.” However, a more basic point might be considered. While cases of this nature have been almost routinely litigated in Texas under the piercing-the-corporate-veil doctrine in the past, it is not clear that this is the appropriate approach. Such transactions (and a number of similar transactions that arguably may not fall within the “waste” or “actual fraud” categories) may be attacked under modern statutes that were expressly preserved by the language of Article 2.21B(2) (e.g., the Texas Securities Act, the Texas Fraudulent Transfer Act, and the Texas Deceptive Trade Practices Act).[7] Indeed, in the discussions within the ad hoc committee on the Castleberry problem, considerable emphasis was placed on the importance of these statutes. The transactions described above are an example. They might readily be attacked as fraudulent transfers or as preferences under federal bankruptcy law. These transactions might also be viewed as preferential transfers that are subject to subrogation under the equitable powers of a bankruptcy court (the "Deep Rock doctrine").[8]

The first Texas case to arise under the 1989 version of Article 2.21 was Farr v. Sun World Savings Association,[9] which described its understanding of the effect of the amended Article 2.21 as follows:

> As can readily be seen, the amendments to article 2.21A effectively eliminated constructive fraud and the failure to observe corporate formalities and requirements as vehicles for establishing shareholder liability for acts of the corporation in connection with contract claims, but left untouched the effect of constructive fraud on tort claims. Carefully preserved, however, is the right of a person to go behind the corporate entity in order to establish individual shareholder liability by a showing of actual or common law fraud. Where actual fraud primarily for the benefit of the perpetrating shareholder or shareholders can be shown, the various doctrines for disregarding the corporate entity, including alter ego and a sham to perpetrate a fraud, are still very much alive.

The comment that "alter ego" and "sham to perpetuate a fraud" "are still very much alive" resonated with the Texas judiciary and dashed any real hope that the 1989 amendments would rein in Castleberry. The phrases "alter ego" and "sham to perpetuate a fraud" are as broad and subjective as the phrase "constructive fraud," and courts simply substituted one label for another. Indeed, some courts simply ignored the amendments and continued to cite Castleberry as though the 1989 amendments had never been enacted.[10] Thus, despite the high hopes of the draftsmen of the revised Article 2.21, courts quickly found a way to ignore, or at least to minimize the impact of, these amendments.[11]

One commentator, writing in 1995, made the following assessment of the impact of the 1989 legislative revision of Article 2.21:

> The apparent intent of the revisions of Article 2.21 was to leave Castleberry intact regarding the piercing claims made in connection with tort actions against the corporation, but to limit grounds for piercing claims when the dispute stemmed from a contract dispute.[12] Somewhat surprisingly cases decided after the 1989 amendments have muddied the waters substantially regarding applicable standards for piercing the corporate veil in contract disputes.
>
> Some courts have stated that, after the 1989 amendments, a sham to perpetrate a fraud theory may no longer be used for piercing in a contract dispute.[13] In contrast, in a case decided by the Texas Supreme Court after the 1989 amendments, the court affirmed a piercing judgment based on a sham to perpetrate a fraud claim in a contract dispute.[14] It is unclear whether … the Texas Supreme Court believed that "sham to perpetrate a fraud" remained a tenable piercing ground in a contract dispute, even after the 1989 amendments. Also, after the 1989 amendments, the Fifth Circuit affirmed a District Court judgment permitting piercing in a contract dispute, based on a "sham to perpetrate a fraud" theory.[15]
>
> The 1989 amendments to Article 2.21 state that non-compliance with corporate formalities can no longer be a ground for piercing in a contract dispute. Some courts seem reluctant to embrace this portion of the statute. For example, in Mancorp, Inc. v. Culpepper,[16] when discussing piercing in contract cases, the Texas Supreme Court included in a footnote a justification for considering compliance with corporate formalities. Also, a recent court of appeals opinion states, when determining whether alter ego exists in a contract dispute, compliance with corporate formalities is a factor.[17] Other courts concluded that failure to comply with corporate formalities could not be considered in connection with a piercing claim based upon a contract ….[18]

> It does appear that the drafters attempted to prevent sham to perpetrate a fraud and constructive fraud as a basis for a piercing claim in a dispute over a corporate contractual obligation. Some commentators argued that the effect of the 1989 amendments was broader. For example, one writer argued that a piercing claim for a corporate contractual obligation could only be based upon a showing of actual fraud.[19] This assumes a few things not clearly specified in the statute. First, the 1989 statute does not explicitly bar alter ego as an appropriate basis for piercing in a contract case. It only states that non-compliance with corporate formalities should not be considered as a basis for piercing …. [M]ost courts did not conclude that this provision barred alter ego as a ground for piercing in a contract case. In addition to the dispute over the viability of the alter ego ground in contract cases, no court has considered whether the statute restricts other grounds approved in Castleberry and not mentioned in the statute, such as denuding or undercapitalization. So, the scope of the 1989 amendments was less than clear.[20]

The fact that Texas courts had basically gutted the 1989 amendments is evident from decisions such as Chase Manhattan Bank, N.A. v. J.& L. General Contracters, Inc.,[21] which viewed Castleberry as providing the standard for veil piercing and concluded that liability should be imposed because the case involves a “sham to perpetrate a fraud.”[22]

In their 1991 Annual Survey of Texas Law, Gray and Sergesketter describe their impression of the impact of the 1989 amendments:

> The tendency of Texas courts to disregard the corporate entity has long been recognized and appears to have continued unabated, notwithstanding recent legislative pronouncements to the contrary. During the current Survey period many courts have continued to follow the rationale espoused by the Supreme Court in Castleberry v. Branscum, but only one has cited the recent statutory pronouncements, and that cite was contained in a dissenting opinion.[23]

The Texas cases during this period reflect the confusion and problems created by Castleberry and the 1989 legislation. A number of cases applied Castleberry's broad ad hoc equitable principles.[24] Other cases were more cautious.[25] The federal courts, by contrast, tended to take a narrower view of Castleberry and tended to have more respect for the 1989 amendments to Article 2.21.[26]

In 1993, the Texas Legislature revisited Article 2.21.[27] The legislature amended Article 2.21A(2) to provide that veil piercing could not be based on the alter ego theory in a contract case absent proof of actual fraud. Then, out of an abundance of caution, the 1993 amendments included a catch-all provision to make clear that veil piercing could not be based on any theory in a contract case without proof of actual fraud. In addition, the 1993 amendments altered Article 2.21B to provide that the veil-piercing liability limited by Article 2.21A was exclusive except for liabilities that were expressly assumed by a shareholder or liabilities otherwise imposed on a shareholder by statute. The 1993 amendments were designed to close loopholes in Article 2.21 that courts had been using to apply Castleberry despite the 1989 amendments.[28]

In 1997, the Texas Legislature amended Article 2.21 of the Texas Business Corporation Act for the third time following the Castleberry decision.[29] The 1997 amendments made three major changes to Article 2.21. First, Article 2.21A was expanded to provide that the limitations on veil piercing apply to “any affiliate” of a corporation. As a consequence, if the limitations of Article 2.21A otherwise apply: (a) a parent entity cannot be held liable for the debts of a subsidiary corporation; (b) a subsidiary entity cannot be held liable for the debts of a parent corporation; and (c) sibling entities cannot be held liable for the debts of a sister corporation.[30] Second, Article 2.21A(2) was amended to cover not only contractual obligations but also "any matter relating to or arising from" a contractual obligation. For example, there is no veil piercing in connection with a tort claim arising from a contractual obligation (e.g., a negligence claim based on the failure to fulfill a contractual duty) absent proof of actual fraud. Third, the limitation of Article 2.21A(3) to contractual cases was eliminated. Therefore, the failure to follow corporate formalities is not a basis for veil piercing in any type of case.

The cumulative effect of the legislative responses to Castleberry is to limit Castleberry to pure tort cases based on veil-piercing theories other than the failure to follow corporate formalities.[31] The draftsmen of the amendments also hoped that these revisions would circumscribe the application of Castleberry in tort cases by analogy. As the court noted in Menetti v. Chavers:[32]

> Prior to [the 1993] amendments, commentators and courts agreed that all claims that were not contractual were governed by *Castleberry*, which required only a showing of constructive fraud in order to pierce the corporate veil …. Traditionally, Texas cases have attempted to treat contract claims and tort claims differently in determining whether to pierce the corporate veil …. The 1989 amendments to article 2.21 apparently tried to keep this distinction alive …. Under the 1997 amendments, article 2.21(A)(2) appears to blur the distinction between contractual obligations and other claims. The provision now states that it covers all contractual obligations of the corporation "or any matter relating to or arising from the obligation …." For all matters covered by this provision, the corporate veil may not be pierced absent a showing of actual fraud. The commentary following the … amendments suggests that the actual fraud requirement should be applied, by analogy, to tort claims, especially those arising from contractual obligations.[33]

Footnotes

a0 Baylor University School Of Law.

a1 University Of Houston Law Center.

1 This point is made strongly by Robert F. Gray, Gregory J. Sergesketter & John M. Welge, Annual Survey of Texas Law: Corporations, 46 SMU L. Rev. 1171, 1176 (1993).

2 See § 29:3.

3 Tex. Bus. Corp. Act. Ann. art. 2.21, as amended by Acts 1989, 71st Leg., R.S., ch. 217. Paragraphs B, C, and D of old Article 2.21 were renumbered C, D, and E but were not changed by this amendment.

4 See, e.g., Delaney v. Fidelity Lease Limited, 526 S.W.2d 543 (Tex. 1975) (a decision that was effectively overruled by an amendment to old § 8 of the Texas Uniform Limited Partnership Act); Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.) (a decision that was effectively overruled by an amendment to Article 5.10 of the Texas Business Corporation Act).

5 Two commentators described the effect of the amendment as follows:

> New TBCA article 2.21 makes it clear that a shareholder of a Texas corporation will not be liable for any contractual obligation of a corporation unless the shareholder has expressly agreed by means of a guarantee or similar contractual arrangement to be liable for the obligation, has perpetrated an actual fraud upon the obligee primarily for the shareholder's direct personal benefit, or is expressly liable for the obligation under another statute. Therefore, to pierce the corporate veil and hold the shareholders of a Texas corporation liable for a contractual obligation of the corporation based upon fraud, sham, or alter ego, an obligee now has the burden to prove three onerous elements. First, the obligee must prove that the shareholder caused the corporation to be used for the purpose of perpetrating, and did

> perpetrate, an actual fraud on the obligee. Second, the obligee must prove that the shareholder perpetrated the actual fraud primarily for the personal benefit of the shareholder. Lastly, the obligee must prove that the benefit to the shareholder was direct and personal, rather than for the benefit of the corporation or any third party.

Robert F. Gray & Gregory J. Sergesketter, Annual Survey of Texas Law: Corporations, 44 Sw. L.J. 225, 226–7 (1990).

6 In view of this uncertainty, it is a sensible precaution even today for all closely held corporations to maintain sufficient amounts of liability insurance (with shareholders being named as coinsureds) to protect against possible subrogation claims.

7 See, e.g., Weitzel v. Barnes, 691 S.W.2d 598 (Tex. 1985); Great American Homebuilders, Inc. v. Gerhart, 708 S.W.2d 8 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

8 See § 28:4.

9 Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294, 296 (Tex. App.—El Paso 1991, no writ). The transactions involved in this case took place before the amendment of Article 2.21, but the court held that that statute was "remedial" and should be applied retroactively from the effective date of the statute.

10 See, e.g., Airflow Houston, Inc. v. Theriot, 849 S.W.2d 928 (Tex. App.—Houston [1st Dist.] 1993, no writ). In addition to stating that "it is sufficient for Theriot to prove constructive fraud," the court quoted from Castleberry to the effect that "whether or not to disregard the corporate fiction is a question of fact and common sense. The court must weigh the facts and consequences in each case carefully, and common sense and justice must determine its decision." *Theriot*, 849 S.W.2d at 931.

11 The House Research Organization Bill Analysis of the 1989 amendment stated that the bill was intended to bar piercing on the basis of constructive fraud or failure to observe corporate formalities. See House Research Organization, Bill Analysis, Tex. S.B. 1427, 71st Leg., R.S. (1989). What actually happened, however, is described in Robert F. Gray, Gregory J. Sergesketter, & John M. Welge, Annual Survey of Texas Law: Corporations, 45 Sw. L.J. 1525, 1541 (1992): "Although the 1989 amendments eliminated most of the previously used bases for shareholder liability for the contractual obligations of the corporation, [the cases decided during the survey period] demonstrate that many times courts still mistakenly fail to apply these legislative amendments when piercing the corporate veil." The example cited, Coastal Shutters and Insulation, Inc. v. Derr, 809 S.W.2d 916 (Tex. App.—Houston [14th Dist.] 1991, no writ), held that the president of a corporation was personally liable under an alter ego theory even though the court found that the corporation was not used as a sham to perpetrate a fraud. In the course of its opinion, the court cites and summarizes Castleberry at considerable length.

12 See generally Robert F. Gray & Gregory J. Sergesketter, Annual Survey of Texas Law: Corporations, 45 Sw. L.J. 227 (1991).

13 The author cites Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294 (Tex. App.—El Paso 1991), and Western Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65 (5th Cir. 1994).

14 See Matthews Const. Co., Inc. v. Rosen, 796 S.W.2d 692 (Tex. 1990).

15 See Permian Petroleum Co. v. Petroleos Mexicanos, 934 F.2d 635, 15 U.C.C. Rep. Serv. 2d 666 (5th Cir. 1991) (Texas law).

16 Mancorp, Inc. v. Culpepper, 802 S.W.2d 226, 229 n.2 (Tex. 1990).

17 See Coastal Shutters and Insulation, Inc. v. Derr, 809 S.W.2d 916 (Tex. App.—Houston [14th Dist.] 1991).

18 See Crum & Forster, Inc. v. Monsanto Co., 887 S.W.2d 103 (Tex. App.—Texarkana 1994), vacated pursuant to settlement, 1995 WL 273592 (Tex. App.—Texarkana 1995).

19 See Robert F. Gray & Gregory J. Sergesketter, Annual Survey of Texas Law: Corporations, 44 Sw. L.J. 225, 226 (1990).

20 J. Thomas Oldham, Piercing the Corporate Veil: Recent Developments in Texas Law, Houston Lawyer, May/June, 1995, at 33.

21 Chase Manhattan Bank, N.A. v. J & L General Contractors, Inc., 832 S.W.2d 204, 18 U.C.C. Rep. Serv. 2d 1286 (Tex. App.—Beaumont 1992, no writ).

22 See also Mapco, Inc. v. Carter, 808 S.W.2d 262, 272–73 (Tex. App.—Beaumont 1991), rev'd in part on other grounds, 817 S.W.2d 686 (Tex. 1991) (relying on Castleberry's language for piercing "between

corporations in a contract setting" based on "common sense," "justice," and "equitable result"). In In re Guyana Development Corp., 168 B.R. 892, 907 n.28 (Bankr. S.D. Tex. 1994) (Texas law), the court referred to Castleberry as the "seminal case" in the piercing area and continued: Although the case was partially overruled by Tex. Bus. Corp. Act Ann. art. 2.21 as to contractual obligations of a domestic corporation, it has continued validity regarding piercing the corporate veil for tort and statutory obligations of a corporation. Further, the statute has no applicability to corporations that were not incorporated under its provisions …. Although the court in Villar v. Crowley Maritime Corp., 990 F.2d 1489, 1993 A.M.C. 2697, 25 Fed. R. Serv. 3d 1442 (5th Cir. 1993)] footnotes that Castleberry "was legislatively overruled," this footnote … is undoubtedly unintended dicta ….

23 Robert F. Gray & Gregory J. Segresketter, Annual Survey of Texas Law: Corporations, 45 Sw. L.J. 227, 227–28 (1991); see Mancorp, Inc. v. Culpepper, 802 S.W.2d 226, 233 (Tex. 1990) (Hecht, J., dissenting). In Mancorp, the court applied the erroneous principle that a court should review a finding that a shareholder is liable on an alter ego theory only by considering the evidence tending to support the jury's verdict and disregarding all evidence to the contrary. The court completely ignored the language in Castleberry and other veil-piercing cases that all factors must be considered. In several of these cases, the court quotes language from Castleberry extensively but then concludes that principles set forth in that case were not applicable because the defendant had acted equitably in the specific case.

24 See, e.g., Crum & Forster, Inc. v. Monsanto Co., 887 S.W.2d 103 (Tex. App.—Texarkana 1994), vacated pursuant to settlement, 1995 WL 273592 (Tex. App.—Texarkana 1995); Houston Cable TV, Inc. v. Inwood West Civic Ass'n, Inc., 839 S.W.2d 497 (Tex. App.—Houston [14th Dist.] 1992), judgment set aside, opinion not vacated, 860 S.W.2d 72 (Tex. 1993) and writ withdrawn, (May 19, 1993) and writ granted, (May 19, 1993), vacated pursuant to settlement, 860 S.W.2d 72 (Tex. 1993); Bogorad v. Marjan Intern. Corp., 1991 WL 19826 (Tex. App.—Houston [1st Dist.] 1991, no writ).

25 See, e.g., Southwest Livestock & Trucking Co. v. Dooley, 884 S.W.2d 805 (Tex. App.—San Antonio 1994, writ denied); Promaxima Fitness, Inc. v. Keener, 1994 WL 167999 (Tex. App.—Houston [1st Dist.] 1994, writ denied); FDIC/Manager Fund v. Larsen, 1993 WL 37380 (Tex. App.—Dallas 1993, no writ); Chase Manhattan Bank, N.A. v. J & L General Contractors, Inc., 832 S.W.2d 204, 18 U.C.C. Rep. Serv. 2d 1286 (Tex. App.—Beaumont 1992, no writ).

26 See, e.g., Villar v. Crowley Maritime Corp., 990 F.2d 1489, 1993 A.M.C. 2697, 25 Fed. R. Serv. 3d 1442 (5th Cir. 1993) (abrogated by, Marathon Oil Co. v. Ruhrgas, 145 F.3d 211 (5th Cir. 1998)) (Texas law); Fidelity & Deposit Co. of Maryland v. Commercial Cas. Consultants, Inc., 976 F.2d 272 (5th Cir. 1992) (Texas law). But see Western Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65 (5th Cir. 1994) (Texas law).

27 Tex. Bus. Corp. Act. Ann. art. 2.21, as amended by Acts 1993, 73rd Leg., R.S., ch. 215, § 2.05.

28 See Tex. Bus. Corp. Act. Ann. art. 2.21 (expired), Comment of Bar Committee—1996.

29 Tex. Bus. Corp. Act. Ann. art. 2.21, as amended by Acts 1997, 75th Leg., R.S., ch. 375, § 7.

30 An "affiliate" is currently defined as "a person who controls, is controlled by, or is under common control with another person." Tex. Bus. Orgs. Code Ann. § 1.002(1). In Phillips v. United Heritage Corp., 319 S.W.3d 156, 167 (Tex. App.—Waco 2010, no pet.), the court held that officers and directors are "affiliates" of a corporation whose veil is sought to be pierced.

31 In an opinion involving a motion to remand a case to state court, one court cited Western Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65, 69 (5th Cir. 1994) (Texas law) for the proposition that "while *Castleberry* was partially superceded by statute, the other principles for imposing alter ego liability under *Castleberry* are 'alive and well in Texas.'" Phillips Petroleum Co. v. AIG Technical Services, Inc., 99 F. Supp. 2d 787, 790 (S.D. Tex. 2000) (Texas law); see also JNS Aviation, Inc. v. Nick Corp., 418 B.R. 898, 906 n.4 (N.D. Tex. 2009), aff'd, 395 Fed. Appx. 127 (5th Cir. 2010) (Texas law) (The amendments to Article 2.21 "preserved the right to use actual or constructive fraud to pierce the corporate veil in tort claims."); Wilson v. Davis, 305 S.W.3d 57, 69 n.5 (Tex. App.—Houston [1st Dist.] 2009, no pet.) (the amendments to Article 2.21 do not limit Castleberry's application to tort claims).

In Town Hall Estates-Whitney, Inc. v. Winters, 220 S.W.3d 71 (Tex. App.—Waco 2007), a nursing home employee filed a retaliatory discharge claim against the nursing home and its parent corporation. The plaintiff received a judgment against the parent corporation on a veil-piercing theory. The plaintiff's evidence on this theory was: (a) the nursing home and its parent had two common directors; (b) one sentence in the nursing home's personnel manual referred to "employees of [the nursing home] and [its parent]"; and (c) the parent's president had authority to discipline and terminate a supervisor at the nursing home. The court of appeals held that this evidence was legally insufficient to establish alter ego or single business enterprise claims. Article 2.21 did not apply to this case because it involved a tort rather than a contract claim.

32 Menetti v. Chavers, 974 S.W.2d 168, 173–74 (Tex. App.—San Antonio 1998, no pet.).

33 See Tex. Bus. Corp. Act. Ann. art. 2.21 (expired), Comment of Bar Committee—1996.

End of Document