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## Corporations

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# CORPORATIONS

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## I. INTRODUCTION

**T**HIS is the tenth consecutive year that this Survey article has sought to provide practitioners with a clear understanding of the latest judicial developments related to the practice of corporate law in Texas.<sup>1</sup> In each of the Corporations Surveys published during the last decade, our goal has been to promote “certainty and predictability” in Texas corporate law.<sup>2</sup> Through this Survey article, we hope to do the same.

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1. See generally Glenn D. West & W. Benton Lewis, Jr., *Corporations*, 61 SMU L. REV. 743 (2008); Glenn D. West & Emmanuel U. Obi, *Corporations*, 60 SMU L. REV. 885 (2007); Glenn D. West & Benton B. Bodamer, *Corporations*, 59 SMU L. REV. 1143 (2006); Glenn D. West & Sarah E. Stansy, *Corporations*, 58 SMU L. REV. 719 (2005); Glenn D. West & Adam D. Nelson, *Corporations*, 57 SMU L. REV. 799 (2004); Glenn D. West & Susan Y. Chao, *Corporations*, 56 SMU L. REV. 1395 (2003); Glenn D. West & Brandy L. Treadway, *Corporations*, 55 SMU L. REV. 803 (2002); Glenn D. West, *Corporations*, 54 SMU L. REV. 1221 (2001), Glenn D. West & Christopher M. Fairman, *Corporations*, 53 SMU L. REV. 773 (2000).

2. See Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 514 (2001) (citing *Harff v. Kerkorian*, 324 A.2d 215, 220 (Del. Ch. 1974) (“It is obviously important that the Delaware corporate law have stability and predictability.”)).

“Prediction” is the business in which we actually are engaged as corporate lawyers; i.e., in providing our clients advice, we are effectively predicting how a court might decide a particular set of facts facing our clients should our clients be required to defend their actions or enforce their rights.<sup>3</sup> And, to the extent that Texas corporate lawyers “cannot confidently advise” their clients as to the liability-limiting effect of the corporate form or the enforceability of the liability-limiting contract provisions entered into by corporations in Texas, corporate lawyers cannot effectively do their job and “the effectiveness of [the] law [as a tool to regulate society’s behavior] is seriously diminished. . . .”<sup>4</sup> As a result, our prior Corporations Surveys have typically focused on the reliability in Texas of: (i) the corporate form to protect corporate shareholders and affiliates from the obligations and liabilities created by that corporation, and (ii) contractual liability-limiting provisions aimed at protecting the expectations of corporate counterparties (and their officers, shareholders, and affiliates), particularly from obligations imposed by tort law. While these appear to be unrelated topics (one is a statutory protection and the other is a contractual one), they are actually two sides of the same liability-limiting coin with respect to which all corporate lawyers should be concerned.<sup>5</sup> After all, liability limitation is one of the primary purposes for the formation of the corporation in the first instance.<sup>6</sup>

The equitable doctrines<sup>7</sup> underlying the theories upon which courts premise their corporate disregard have been frequently criticized as being “characterized by ambiguity, unpredictability, and even a seeming degree of randomness.”<sup>8</sup> Texas courts have been particularly prone to this

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3. See Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 457 (1897).

4. See *Perre v. Apand Pty Ltd.* (1999) 198 C.L.R. 180, 215 (Austl.) (“the effectiveness of law . . . is seriously diminished when legal practitioners believe they cannot confidently advise what the law is . . .”).

5. And, a case decided during this Survey period shows how the two sides of this liability-limiting coin can intersect and, at least as to that case, lead to unfortunate results. See generally *Dick’s Last Resort of the West End, Inc. v. Market/Ross, Ltd.*, 273 S.W.3d 905 (Tex. App.—Dallas 2008, pet. filed) (discussed *infra* notes 52-92). Legal theorists have also noted that the liability limitation regime statutorily created to benefit the corporate form is actually just a built-in default rule of a larger “contract” between society and the corporation. See e.g., J. William Callison, *Rationalizing Limited Liability and Veil Piercing*, 58 BUS. LAW. 1063, 1065 (2003); Bainbridge, *supra* note 2, at 484-86.

6. See Steven L. Schwarcz, *Collapsing Corporate Structures: Resolving the Tension Between Form and Substance*, 60 BUS. LAW. 109, 111-12 (2004); Douglas C. Michael, *To Know A Veil*, 26 J. CORP. L. 41, 55 (2000); James Gerard Gaspard, II, *A Texas Guide To Piercing and Preserving the Corporate Veil*, 31 BULL. BUS. L. SEC. ST. B. TEX. 24, 25 (1994); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89-90 (1985).

7. There is a debate as to whether corporate avoidance doctrines are equitable theories or common law theories. See e.g., Michael, *supra* note 6, at 56; *WM. Passalacqua Builders, Inc. v. Resnick Developers S., Inc.*, 933 F.2d 131, 135-37 (2d Cir. 1991). As confirmed by the declaration of the Texas Supreme Court, the authors believe these doctrines have been applied in a clearly equitable manner. See *Castelberry v. Branscum*, 721 S.W.2d 270, 273 (Tex. 1986) (“disregarding the corporate form is an equitable doctrine”) (emphasis added).

8. Bainbridge, *supra* note 2, at 507.

charge in the past.<sup>9</sup> Indeed, in past Surveys, we have criticized the seeming eagerness of some Texas courts to “do justice”<sup>10</sup> by adopting vague theories that fail to provide clear guidance to the Texas practitioner as to the behavior our clients should avoid in order to maintain the sanctity of the corporate form.<sup>11</sup> With specific regard to advising clients on the intended consequences to expect from carefully crafted contractual arrangements negotiated at arms-length by sophisticated parties, we have also questioned the willingness of some Texas courts to similarly “do justice” by judicially grafting tort law remedies where parties have expressly contracted around and disclaimed any reliance on the same.<sup>12</sup> While there continued to be a few troubling decisions in these areas during this Survey period, we are pleased to report that the Texas Supreme Court produced two significant opinions that we believe address our prior criticisms of many decisions of the Texas courts in these areas. We discuss these decisions in Part II and Part III of this Survey article.

## II. THE CURRENT STATE OF THE CORPORATE FORM IN TEXAS

Texas courts have long recognized that a corporation is separate and distinct from its shareholders.<sup>13</sup> It follows, then, that just as the assets of a corporation belong to the corporation, not to the shareholders,<sup>14</sup> the liabilities and obligations of a corporation are similarly those of the corporation, not its shareholders.<sup>15</sup> Indeed, there is absolutely nothing

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9. See e.g., West & Lewis, *supra* note 1, at 755; West & Obi, *supra* note 1, at 896; West & Nelson, *supra* note 1, at 817, 820 n.106; West & Chao, *supra* note 1, at 1416.

10. Michael, *supra* note 6, at 55.

11. See e.g., West & Lewis, *supra* note 1, at 753-54 (criticizing PHC-Minden v. Kimberly-Clark Corp., 235 S.W.3d 163, 175 (Tex. 2007) as creating trouble for practitioners in identifying potential liability pitfalls for their clients); West & Obi, *supra* note 1, at 893 (criticizing the holding of Formosa Plastics Corp. USA v. Kajima Int'l, Inc., 216 S.W.3d 436, 463 (Tex. App.—Corpus Christi 2006, pet. denied) as “[casting] doubt on the continued efficacy of the corporate shield in Texas . . .”); West & Bodamer, *supra* note 1, at 1144 (noting the “bewildering array of ‘veil piercing’ theories with indeterminate elements” that had developed in Texas courts); see also Michael, *supra* note 6, at 41-42 (“Indeterminate standards wreak havoc on the life of the lawyer as counselor, a fact never mentioned in court cases. Individuals set up corporations, frequently on the advice of counsel, with the idea that they will face no personal liability for corporate obligations. What counsel does not wince when telling her client that liability is limited except in certain unspecified and unpredictable situations when it is not?”).

12. West & Lewis, *supra* note 1, at 755-65; West & Obi, *supra* note 1, at 895-910.

13. See West, *supra* note 1, at 1221-22.

14. Aransas Pass Harbor Co. v. Manning, 94 Tex. 558, 563, 63 S.W. 627, 629 (1901). See also William Meade Fletcher, *The Nature of the Corporate Entity*, 1 FLETCHER CYC. CORP. § 31 (2008).

15. See e.g., Castelberry v. Branscum, 721 S.W.2d 270, 271 (Tex. 1986) (“The corporate form normally insulates shareholders, officers, and directors from liability for corporate obligations . . .”); Pabich v. Kellar, 71 S.W.3d 500, 507 (Tex. App.—Fort Worth 2002, pet. denied) (“A corporation is a separate legal entity that normally insulates its owners or shareholders from personal liability”); Aluminum Chems. (Bol.), Inc. v. Bechtel Corp., 28 S.W.3d 64, 67 (Tex. App.—Texarkana 2000, no pet.) (“[A] major purpose of the corporate structure is to shield its shareholders from liabilities of the corporation.”); Nat'l Hotel Co. v. Motley, 123 S.W.2d 461, 465 (Tex. Civ. App.—Eastland 1938, writ dism'd judgm't cor.) (“[A]n individual whose business is authorized to be incorporated may incorporate such

wrong with forming a corporation specifically and intentionally for the purposes of limiting liability for the actions and contracts of that corporation to the assets of that corporation alone.<sup>16</sup> As was noted almost eighty years ago, “it is legitimate for a man or group of men to stake only a part of their fortune on an enterprise.”<sup>17</sup> The Fifth Circuit has similarly acknowledged that:

[m]any wholly-owned subsidiaries and closely-held corporations are not factually distinct from their owners. Many are in fact controlled and operated in close concert with the interests of the owners, and do not have a distinct factual existence . . . . Such conduct is perfectly natural and proper and provides no basis for ignoring legal independence.<sup>18</sup>

Nevertheless, as we have reported in past Corporations Surveys, certain Texas courts have, on occasion, ignored these principles and, in order to prevent a perceived injustice, imposed corporate obligations and liabilities on certain shareholders of the affected corporations. The willingness of certain Texas courts to avoid the corporate form in order to correct a perceived inequity reached its zenith in the Texas Supreme Court’s 1986 decision in *Castleberry v. Branscum*.<sup>19</sup> In *Castleberry*, the Texas Supreme Court pierced the corporate veil by using an “alter ego” theory and unfortunately suggested that the corporate form could be avoided and shareholders exposed to liability for a corporation’s contractual obligations anytime “the separate corporate existence would bring about an inequitable result.”<sup>20</sup>

In response to the outcry of the Texas Bar to this expansive and unpredictable basis of avoiding the corporate form, particularly in contractual arrangements and any claims related thereto, the Texas Legislature promptly adopted Article 2.21 of the Texas Business & Commerce Code (Article 2.21).<sup>21</sup> In Texas, a shareholder’s personal liability for contractu-

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business for the sole purpose of escaping individual liability of the owner for the debts of the corporation.”).

16. *Sparks v. Booth*, 232 S.W.3d 853, 868 (Tex. App.—Dallas 2007, no pet.) (stating that it is a “bedrock principle of corporate law [in Texas] . . . that an individual can incorporate a business and thereby . . . shield himself from personal liability for the corporation’s contractual obligations.”).

17. Marilyn Blumberg Cane & Robert Burnett, *Piercing the Corporate Veil in Florida: Defining Improper Conduct*, 21 NOVA L. REV. 663, 665 (1997) (quoting William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L. J. 193, 193-94 (1929)).

18. *Gibraltar Sav. v. LDBrinkman Corp.*, 860 F.2d 1275, 1287 (5th Cir. 1988); see also *Mims v. Brunswick Homes, LLC (In re Moore)*, 379 B.R. 284, 289 (Bankr. N.D. Tex. 2007) (noting the “general principle, long imbedded in our corporate laws, that a parent corporation (or shareholder) is not liable for the acts of its subsidiary.”).

19. See generally *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986).

20. *Id.* at 272-73; see also West & Lewis, *supra* note 1, at 745.

21. TEX. BUS. CORP. ACT ANN. art. 2.21.A(2) (Vernon 2003). Note that for corporations formed on or after January 1, 2006, for corporations formed prior to January 1, 2006 that self-elect, and as of January 1, 2010, for all corporations, section 21.223-225 of the Texas Business Organizations Code (the “TBOC”) replaces Article 2.21 as the controlling law. Because the requirements of the TBOC are identical to those of Article 2.21, the

ally related obligations of a Texas corporation is now governed by Article 2.21, which, following several amendments, now states that a shareholder or affiliate of a corporation:

shall be under no obligation to the corporation or to its obligees with respect to . . . any contractual obligation of the corporation or *any matter relating to or arising from* the obligation on the basis that [the shareholder or affiliate] is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, *or other similar theory*, unless the obligee demonstrates that the [shareholder 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 [that shareholder or affiliate].”<sup>22</sup>

This statutory rule makes clear that, at least as to contractually related liability, plaintiffs may no longer rely on the lower standard set forth in *Castleberry* in order to avoid the corporate form. Rather, since the 1993 amendments, the sole method for piercing the corporate veil and imposing contractually related liability on shareholders and affiliates is found in Article 2.21. Further, to do so, Article 2.21 requires a showing that an “actual fraud,” rather than some lower threshold of wrongful conduct, has been perpetrated through use of the corporate form for the direct personal benefit of the corporation’s shareholder or affiliate that is sought to be charged with liability. Where Article 2.21 applies, it is “the exclusive standard that must be met in order to pierce the corporate veil.”<sup>23</sup> So strong is the legislative pronouncement that courts have cautioned against expanding liability under traditional veil piercing theories *even when Article 2.21 may not apply*.<sup>24</sup> Notwithstanding this strong legislative commitment to the corporate form in Texas, in our 2006 Survey article we cautioned that the corporate form in Texas remained in jeopardy due to what we perceived to be the continued willingness of some Texas courts to ignore or circumvent the plain reading of Article 2.21 and to otherwise expand the theories of corporate avoidance in both contract and tort cases, most notably through the “single business enterprise” theory.<sup>25</sup>

In that regard, in our last Survey article, we encouraged the Texas Supreme Court to clarify the legitimacy of the single business enterprise doctrine in order to provide guidance to corporate planners seeking to legitimately limit the liabilities of affiliated corporate entities.<sup>26</sup> As set forth below, that helpful guidance was provided during this Survey period.

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change does not effect the substance of the current law. *See also* *Formosa Plastics Corp. v. Kajima Int’l, Inc.*, 216 S.W.3d 436, 461 n.6 (Tex. App.—Corpus Christi 2006, pet. denied).

22. TEX. BUS. CORP. ACT ANN. art. 2.21.A(2) (emphasis added).

23. TEX. BUS. CORP. ACT ANN. art. 2.21 cmt. at 176-78.

24. *See e.g., In re Moore*, 379 B.R. at 296.

25. West & Bodamer, *supra* note 1, at 1143.

26. *Id.* at 114; West & Lewis, *supra* note 1, at 753.

A. THE GOOD NEWS: THE DEMISE OF THE  
SINGLE BUSINESS ENTERPRISE

The single business enterprise doctrine, like other corporate avoidance theories, is a mechanism used to “pierce the corporate veil” between affiliated corporations in order to hold one liable for the liabilities and obligations of the other when businesses integrate resources.<sup>27</sup> In Texas, the doctrine did not require any wrongful act or inequitable result to have occurred through the use of the corporate form; rather, the Texas form of the doctrine simply required that when businesses “integrate their resources to achieve a common business purpose, each business may be held liable for wrongful acts done in pursuit of that purpose.”<sup>28</sup> In our previous Survey articles we highlighted key Texas cases considering the doctrine, as well as considerable disagreement among Texas appellate courts regarding adoption of the same.<sup>29</sup> The problem with the doctrine, of course, is that most affiliated corporate groups in one way or another “integrate their resources to achieve a common business purpose,” i.e., making profits for the holding company parent to distribute to their shareholders. And, there is nothing inherently wrong with limiting liability through the formation of subsidiaries to pursue specific businesses within the overall corporate group.<sup>30</sup>

By way of background, the doctrine first appeared on the Texas stage in *Paramount Petroleum Corporation v. Taylor Rental Center*.<sup>31</sup> *Paramount* was decided in 1986, the same year as *Castleberry*. While based on a questionable legal and business foundation, the *Paramount* precedent thereafter gained momentum and was used by numerous lower Texas

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27. See *PHC-Minden, L.P. v. Kimberly-Clark Corp.*, 202 S.W.3d 193, 200-02 (Tex. 2007); *Acceptance Indem. Ins. Co. v. Maltez*, No. H-04-2222, 2007 WL 2908433, at \*6-7 (S.D. Tex. Oct. 3, 2007); see also West & Lewis, *supra*, note 1, at 750-754; West & Obi, *supra* note 1, at 891-93; West & Bodamer, *supra* note 1, at 1146-48.

28. *Acad. of Skills & Knowledge, Inc. v. Charter Schs., USA, Inc.*, 260 S.W.3d 529, 538 (Tex. App.—Tyler 2008, no pet.) (also noting the differences between the single business enterprise theory and the alter ego theory of piercing the corporate veil in that the alter ego theory requires proof of fraud, but the single business enterprise theory does not).

29. See, e.g., *PHC-Minden*, 202 S.W.3d at 200-02 (applying the single business enterprise theory in a claim based on a violation of a duty of care); *Formosa Plastics Corp., USA v. Kajima Int'l, Inc.*, 216 S.W.3d 436, 463 (Tex. App.—Corpus Christi 2006, pet. denied) (holding that proof of actual fraud on contractor was not required to find that project owner and subsidiary constituted a single business enterprise that could be held liable to contractor for fraud arising from contracts, where project owner, and not subsidiary, signed contracts, and jury found project owner guilty of its own fraud); *Acceptance Indem. Ins. Co.*, 2007 WL 2908433, at \*6-7 (noting that the application of the single business enterprise doctrine for indemnification issues is uncertain.). See also West & Lewis, *supra* note 1, at 750-754; West & Obi, *supra* note 1, at 891-93; West & Bodamer, *supra* note 1, at 1146-48.

30. See *Sparks v. Booth*, 232 S.W.3d 853 (Tex. App.—Dallas 2007, no pet.); *Gibraltar Sav. v. LDBrinkman Corp.*, 860 F.2d 1275, 1287 (5th Cir. 1988).

31. 712 S.W.2d 534, 536 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.) (stating “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.”); see *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 452 (Tex. 2008).

courts to justify avoidance of the corporate form.<sup>32</sup>

In 2003, the Texas Supreme Court made its first effort to contain the spread of the single business enterprise doctrine. In *Southern Union Company v. City of Edinburg*, the court held that liability under the single business enterprise doctrine was inconsistent with Article 2.21.<sup>33</sup> However, in the wake of this decision, it remained unsettled whether the single business enterprise doctrine could be used to pierce the corporate veil in other contexts where Article 2.21 was not applicable.<sup>34</sup> As evidence of the confusion surrounding the applicability of the doctrine, in 2008, notwithstanding the Texas Supreme Court's unwillingness to declare the doctrine unavailable in Texas in all contexts<sup>35</sup> and the many lower courts' willingness to embrace it outside of the Article 2.21 context,<sup>36</sup> the Tyler Court of Appeals explicitly held that the single business enterprise doctrine was *not* recognized in Texas.<sup>37</sup>

Providing clarity to lower courts and practitioners, in *SSP Partners v. Gladstrong Investment (USA) Corporation*,<sup>38</sup> decided during this Survey period, the Texas Supreme Court explicitly rejected the single business enterprise doctrine as a recognized theory for piercing the corporate veil in Texas on any basis.<sup>39</sup> *SSP Partners* involved a products liability action brought by the parents of a child killed in a house fire. The parents claimed that the house fire was started by defective lighters sold by SSP, but imported and distributed by Gladstrong USA.<sup>40</sup> Both SSP Partners (SSP) and Gladstrong Investments (USA) Corporation (Gladstrong

32. See Robert W. Hamilton, Elizabeth S. Miller, & Robert A. Ragazzo, *TEXAS PRACTICE: BUSINESS ORGANIZATIONS* § 26.22, at 422 (2d ed. 2004).

33. *S. Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87-90 (Tex. 2003).

34. *Id.* at 87 (stating that Article 2.21 controls in the context of liability for contractual debts, but reserved its holding on the issue of whether the single business enterprise applied in other contexts). See West & Nelson, *supra* note 1, at 809 (discussing this case).

35. *City of Edinburg*, 129 S.W.3d at 86-87 (noting that the Texas Supreme Court has "never considered the 'single business enterprise' concept in any detail" and declining to decide "whether a theory of 'single business enterprise' is a necessary addition to Texas law regarding the theory of alter ego for disregarding corporate structure").

36. See e.g., *Nat. Plan Admins, Inc. v. Nat. Health Ins. Co.*, 150 S.W.3d 718, 744 (Tex. App.—Austin 2005), *rev'd*, 235 S.W.3d 695 (Tex. 2007); *PHC Minden, L.P. v. Kimberly Clark Corp.*, 202 S.W.3d 193, 200, 203 (Tex. App.—Tyler 2005), *rev'd*, 235 S.W.3d 163 (Tex. 2007); *Packard v. Guerra*, 252 S.W.3d 511, 517 (Tex. App.—Houston [14th Dist.] 2008, pet. denied); *Country Village Homes, Inc. v. Patterson*, 236 S.W.3d 413, 434-35 (Tex. App.—Houston [1st Dist.] 2007, pet. judgm't w.r.m.).

37. *Acad. of Skills & Knowledge, Inc. v. Charter Schs., USA, Inc.*, 260 S.W.3d 529, 539 (Tex. App.—Tyler 2008, no pet.). The Tyler court also noted the existence of a split in the circuits on this issue by citing several decisions allowing the use of the doctrine. *Id.* (citing *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 169 S.W.3d 27, 43 (Tex. App.—Corpus Christi 2005), *aff'd*, 275 S.W.3d 444 (Tex. 2008); *El Puerto de Liverpool, S.A. de C.V. v. Servi Mundo Llantero S.A. de C.V.*, 82 S.W.3d 622, 636 (Tex. App.—Corpus Christi 2002, pet. dismiss'd w.o.j.); *N. Am. Van Lines, Inc. v. Emmons*, 50 S.W.3d 103, 121 (Tex. App.—Beaumont 2001, pet. denied)).

38. *SSP Partners v. Gladstrong Inv. (USA) Corp.*, 275 S.W.3d 444 (Tex. 2008).

39. *SSP Partners*, 275 S.W.3d at 456. See also Nancy J. Brown, *Texas High Court Rejects Single Business Enterprise Theory*, Legal Backgrounder, Washington Legal Found., (Jan. 16, 2009) available at <http://www.wlf.org/Publishing/results.asp?Search=Single+Business+Enterprise&Year=&Topic=&Format=>

40. *SSP Partners*, 275 S.W.3d at 447.



USA) were named as defendants. SSP sought indemnity from Gladstrong USA not based on a contract, but based, in part, upon the Texas statute requiring manufacturers of defective products to indemnify the seller of those products unless the seller itself caused the loss.<sup>41</sup> Gladstrong USA moved for summary judgment on SSP's indemnity claim asserting that statutory indemnity was only required of "manufacturers" and the Texas Civil Practice and Remedies Code defines "manufacturer" as "a designer, formulator, constructor, rebuilder, fabricator, producer, compounder, processor, or assembler of any product."<sup>42</sup> Gladstrong USA argued it was merely a distributor and, as such, not subject to the statutory indemnity provisions. SSP responded by asserting, among other things, that Gladstrong USA should be viewed as a manufacturer for the purposes of statutory indemnity because it was a single business enterprise with the actual manufacturer, Gladstrong USA's parent company, Gladstrong Hong Kong. According to SSP, therefore, Gladstrong USA should be held liable for the debts of the manufacturer, Gladstrong Hong Kong. The trial court granted Gladstrong USA's summary judgment motion, SSP appealed and the appellate court reversed the case in part and remanded, noting that "one entity cannot be liable as part of a single business enterprise if the other entities in the enterprise are not parties to the case."<sup>43</sup>

After exploring the shaky history of the single business enterprise doctrine, the Texas Supreme Court completely rejected the doctrine as a valid corporate veil piercing mechanism in Texas.<sup>44</sup> Specifically, the court noted that:

[a]buse and injustice are not components of the single business enterprise theory stated in *Paramount Petroleum*. The theory applies to corporations that engage in any sharing of names, offices, accounting, employees, services, and finances. There is nothing abusive or unjust about any of these practices in the abstract. Different entities may coordinate their activities without joint liability.<sup>45</sup>

We have made this same point on many occasions in the past.<sup>46</sup> Thus, we applaud the Texas Supreme Court's long-overdue decision.

It is important to note that the Texas Supreme Court also used *SSP Partners* as an opportunity to clarify its much criticized language from *Castleberry*, wherein it held that the corporate veil could be disregarded under traditional veil piercing theories whenever "recognizing the separate corporate existence would bring about an inequitable result."<sup>47</sup> In

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41. *Id.*; TEX. CIV. PRAC. & REM. CODE ANN. § 82.001(4) (Vernon 2005).

42. *SSP Partners*, 275 S.W.3d at 447.

43. *Id.* at 449; see also *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 169 S.W.3d 27, 38 (Tex. App.—Corpus Christi 2005, no pet.).

44. *SSP Partners*, 275 S.W.3d at 456.

45. *Id.* at 454.

46. See West & Lewis, *supra* note 1, at 753-54; West & Obi, *supra* note 1, at 891-93; West & Bodamer, *supra* note 1, at 1146-48.

47. *Castleberry v. Branscum*, 721 S.W.2d 270, 272-73 (Tex. 1986).

rejecting the single business enterprise doctrine in Texas, the supreme court clarified that that the “inequitable result” concept described in *Castleberry* was not intended to:

mean a subjective perception of unfairness by an individual judge or juror; rather, these words are used in *Castleberry* as shorthand references for the kinds of abuse, specifically identified, that the corporate structure should not shield—fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct, and the like.<sup>48</sup>

It was in part because the single business enterprise theory was inconsistent with the requirement that there be some actual abuse of the kind described by the supreme court, that the supreme court held that the single business enterprise theory “will not support the imposition of one corporation’s obligations on another.”<sup>49</sup>

While this is a welcome clarification of *Castleberry* and the application of traditional corporate avoidance doctrines, like alter ego, it should have no bearing on the requirements set forth in Article 2.21. In other words, the laundry list of abuses that will justify an alter ego or other veil piercing claim when Article 2.21 is *not* applicable simply is irrelevant when that statute is applicable, i.e., anytime a plaintiff seeks to impose upon a corporation’s shareholder or affiliate that corporation’s contractual obligations or “any matter relating to or arising from the obligation.” To the extent Article 2.21 is applicable, the use of the corporate form to perpetuate an “actual fraud” for the personal benefit of the shareholder or affiliate sought to be charged with such obligations or liabilities must be proved. Indeed, in reaching its decision in *SSP Partners*, the Texas Supreme Court was not relying upon Article 2.21 as a basis for its decision; the supreme court had previously held in *Southern Union* that where Article 2.21 is applicable, the single business enterprise doctrine is one of the many theories that is completely preempted by the exclusive provisions of Article 2.21.<sup>50</sup> But the supreme court did reference Article 2.21 in *SSP Partners*, declaring that “[t]he single business enterprise liability theory is fundamentally inconsistent with the approach taken by the Legislature in article 2.21.”<sup>51</sup> As will be seen in our discussion of *Dicks Last Resort* in Part II B below, this reference to Article 2.21 in *SSP Partners* may have been unfortunate.

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48. *SSP Partners*, 275 S.W.3d at 455.

49. *Id.* at 456.

50. *S. Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87 (Tex. 2003). Presumably the reason the Texas Supreme Court did not rely upon Article 2.21 in *SSP Partners* is that neither a statutory nor a common-law indemnity claim is a contractual obligation “or any other matter related to or arising from” a contractual obligation.

51. *SSP Partners*, 275 S.W.3d at 456.

B. THE BAD NEWS: *DICK'S LAST RESORT* GLOSSES  
OVER ARTICLE 2.21

*Dick's Last Resort of Texas, Inc. v. Market/Ross, Ltd.*<sup>52</sup> involved the successful efforts of a landlord to impose liability for a defaulted lease obligation upon non-party affiliates of the tenant corporation. In affirming the trial court's judgment in favor of the landlord against a variety of non-party affiliates of the actual corporate party tenant to the lease agreement, the Dallas Court Appeals held that proof of the elements of common law fraud was *not* required to prove "actual fraud" under Article 2.21.<sup>53</sup> Rather, seemingly relying upon the Texas Supreme Court's clarification of *Castleberry* in *SSP Partners*, the court of appeals held that all that was required to prove "actual fraud" under Article 2.21 was any "conduct involving either dishonesty of purpose or intent to deceive," whether or not the other elements of actual common law fraud are present.<sup>54</sup> While "dishonesty of purpose or intent to deceive" is a fundamental requirement of "actual" fraud, as opposed to "constructive" fraud, all six required elements of a cause of action for common law fraud in Texas should *not* have been ignored, including "reasonable reliance" by the "defrauded" party.<sup>55</sup> In superseding *Castleberry's* "inequitable conduct" threshold through the enactment of Article 2.21, the Texas legislature expressly rejected *Castleberry* where contractually related liability is at issue. Because the landlord only sought contractual damages under a lease agreement, Article 2.21 clearly controlled, not *Castleberry*.<sup>56</sup> As a result, the authors believe this decision establishes potentially dangerous precedent, however much the court may have wished to "do justice."

Market/Ross Ltd. ("Market/Ross") was the landlord, and Dick's Last Resort of Dallas, Inc. ("Dick's Dallas") was the tenant of a lease agreement for restaurant space. In 1999, the lease agreement was extended for an additional term of ten years, ending on December 31, 2009. However, as part of the negotiations for the lease extension Dick's Dallas bargained to have Dick's Last Resort of West End, Inc. ("Dick's West End") become the substitute tenant under the lease, completely removing Dick's

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52. 273 S.W.3d 905 (Tex. App.—Dallas 2008, pet. filed).

53. *Id.* at 909.

54. *Id.*

55. Reasonable reliance is a required element of any fraud claim, whether "actual" or "constructive." See West & Nelson, *supra* note 1, at 815; see also Saenz v. Martinez, No. 04-07-00339-CV, 2008 WL 4809217, at \*7 (Tex. App.—San Antonio Nov. 5, 2008, no pet.) (requiring proof of reliance to establish constructive fraud); Avery Pharm. Invs., Inc. v. Haynes and Boone, L.L.P., No. 2-07-317-CV, 2009 WL 279334, at \*10-12 (Tex. App.—Fort Worth Feb. 5, 2009, no pet.) (mem. op.) (reviewing the elements required for fraud by nondisclosure, conspiracy to defraud, and misrepresentation in Texas).

56. We have previously noted, of course, that Article 2.21 applies not only to contractual obligations, but also to "any other matter related to or arising from" a corporate contractual obligation. See, e.g., West & Lewis, *supra* note 1, at 746; West & Obi, *supra* note 1, at 888; West & Bodamer, *supra* note 1, at 1149; West & Nelson, *supra* note 1, at 807; see also Lincoln Gen Ins. Co. v. US Auto Ins. Serv., Inc., No. 3:07-CV-1985-B, 2009 WL 1174641, at \*4 (N.D. Tex. Apr. 29, 2009).

Dallas as a party responsible for the tenant's obligations.<sup>57</sup> Indeed, in Paragraph 7 of the lease amendment substituting Dicks' West End as the tenant, the landlord agreed that it would "look solely to [the] New Tenant [Dick's West End] for the performance of the Tenant's obligations hereunder."<sup>58</sup> The lease amendment also provided in Paragraph 13 that "there are no written or oral inducements, promises, agreements, or conditions made or offered in connection therewith that are not specifically stated in writing."<sup>59</sup> But, the case does not indicate that Market/Ross asked for, or obtained, financial statements from, or any other evidence of the creditworthiness of, Dick's West End.<sup>60</sup>

At the same time that Dick's West End became the tenant under the lease, however, Dick's West End apparently sublet the premises back to the successor by merger of Dick's Dallas, Dick's Last Resort of Texas, Inc ("Dick's Texas), without the landlord's knowledge or consent. The subletting of the premises by Dick's West End to Dick's Texas apparently was in violation of the lease amendment because the landlord's consent was required for such subletting under the lease amendment, and a provision of the original lease required that the landlord be paid 1% of the total gross sales from the restaurant in the event of any subletting or assignment of the lease. Dick's West End never paid the 1% of gross sales to Market/Ross, and Market/Ross presumably did not know it was owed the 1% because Dick's West End failed to inform them of, or obtain their consent to, the subletting by Dick's West End to Dick's Texas. The sublease between Dick's West End and Dick's Texas provided that Dick's Texas could terminate the sublease at anytime upon 30-days prior written notice to Dick's West End.<sup>61</sup>

In 2000, Dick's West End obtained a release of the landlord's lien from Market/Ross on the furniture, fixtures, and equipment in the leased premises; and in exchange for the release Market/Ross bargained for, and obtained, a guaranty of Dick's West End's obligations under the lease for up \$45 million from another of Dick's West End's affiliates, Dick's Last Resort of Chicago, Inc. ("Dick's Chicago"). Significantly, although Market/Ross obviously knew how to demand and obtain the guaranty of Dick's Chicago, they never demanded (or obtained) the guaranty of Dick's Texas or any of the other non-party affiliates ultimately charged with liability for Dick's West End's breach of the lease.<sup>62</sup> And, even in obtaining the guaranty of Dick's Chicago, the case does not suggest that

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57. Dick's Dallas became Dick's Texas by merger, thus Dick's Texas was the successor to Dick's Dallas. See Appellants' Brief at 3, *Dick's Last Resort*, 273 S.W.3d 905 (Tex. App.—Dallas Mar. 12, 2008, pet. filed).

58. *Id.* at 915.

59. *Id.*

60. *Id.*

61. *Id.* at 912. The thirty-day cancellation provision was apparently added to the sublease specifically to permit Dick's Texas to cancel the sublease and avoid further liability should a breach of the main lease between Market/Ross and Dick's West End occur. *Id.*

62. *Id.* at 908.

Market/Ross sought any financial information concerning the ability of Dick's Chicago to perform under its guaranty.

In 2005 (four years before the end of the lease term), the restaurant was relocated, operations ceased on the leased premises, and Dick's West End ceased paying rent.<sup>63</sup> Market/Ross then sued Dick's West End for breach of the lease and Dick's Chicago for breach of the guaranty. In addition, based on both the single business enterprise doctrine and other traditional theories of corporate veil piercing, Market/Ross alleged that Dick's Texas, Dick's Holding Company, Inc. ("Dick's Holding Company"), and Steven Schiff ("Schiff"), the manager and partial owner of Dick's Holding Company,<sup>64</sup> were all responsible for the contractual damages arising from Dick's West End's breach of the lease. Following the Texas Supreme Court's holding in *SSP Partners*, the Dallas Court of Appeals rejected the finding of liability pursuant to the single business enterprise doctrine. However, the court ultimately upheld the corporate avoidance holding pursuant to other veil piercing claims.<sup>65</sup>

In making its veil piercing claims, Market/Ross pled no direct cause of action against any of the non-party affiliates of Dick's West End, nor did it specifically claim that it was fraudulently induced to enter into the lease amendment substituting Dick's West End as the tenant.<sup>66</sup> As the court correctly noted, veil piercing claims "are not substantive causes of action; rather they are means of imposing on an individual [or affiliated corporation] a corporation's liability for an underlying cause of action."<sup>67</sup> The court thought this fact to be crucial; i.e., Market/Ross was simply seeking "to impose the *contractual liability* of Dick's West End and Dick's Chicago on Dick's Holding Company, Dick's Texas, and Schiff because they allegedly used the contracting entities to perpetuate an actual fraud."<sup>68</sup> Indeed, based on this distinction, the court dismissed as essentially irrelevant Market/Ross's disclaimers of reliance in Paragraphs 7 and 13 of the lease amendment, suggesting that although these contractual provisions may have defeated a direct claim for fraud against the non-party affiliates of Dick's West End, they provided no protection from a veil piercing claim.<sup>69</sup> As set forth below, the authors believe that this conclusion, as well as related conclusions that corporate avoidance under Article 2.21 does not in fact require a finding of each of the requisite elements of an actual common law fraud or a showing of "direct personal benefit," was

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63. Apparently Dick's Texas was actually paying rent directly to the landlord pursuant to the sublease (not a particularly unusual fact). But the landlord apparently was unaware of this fact.

64. Appellants' Brief at 23, *Dick's Last Resort*, 273 S.W.3d 905 (Tex. App.—Dallas, March 12, 2008, pet. filed).

65. *Dick's Last Resort*, 273 S.W.3d at 910.

66. *Id.* at 909, 913.

67. *Id.* at 909.

68. *Id.* (emphasis added).

69. *Id.* at 913.

incorrect.<sup>70</sup>

In support of its veil piercing claims, Market/Ross offered evidence that Schiff deliberately intended to substitute a no-asset company as the tenant under the lease in order to avoid liability being incurred by Dick's Texas in the event of a future breach of the lease.<sup>71</sup> Interestingly, Schiff admitted this fact and claimed that, had Market/Ross not agreed to the substitution of what was effectively a shell company as the tenant, he would not have entered into the ten-year extension of the lease in 1999. Indeed, Schiff claimed that had the substitution of a Dick's West End as tenant not been agreed to by Market/Ross, he would have moved the restaurant to Addison in 1999, at the end of the then current lease term. In other words, Schiff readily admitted that Dick's West End had no assets, and that his purpose in having Dick's West End as the tenant was to avoid exposing the assets of Dick's Texas to any liability for a breach of that lease over the new ten-year term. The only dispute, then, was whether Schiff's failure to disclose the financial condition of Dick's West End, his "plan" to put in place a shell company to avoid future exposure for Dick's Texas in the event of a breach of the lease, his alleged misrepresentation that Dick's West End was going to be the actual operator of the restaurant,<sup>72</sup> and his "avoidance" of the 1% provision, constituted

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70. *Id.* at 909. Under common law fraud by misrepresentation (as opposed to nondisclosure), a plaintiff must prove that: (1) a material misrepresentation was made; (2) the representation was false; (3) when the representation was made the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion; (4) the speaker made the representation intending that the other party act upon it; (5) the party acted in reliance on the representation; and (6) the party thereby suffered injury. *See Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998); *Cardinal Health Solons, Inc. v. Valley Baptist Med. Ctr.*, No. 1:07-CV-111, 2009 WL 150942, at \*18 (S.D. Tex. Jan. 21, 2009). Common law fraud can also occur in cases of non-disclosure, but the circumstances are very limited. *See West & Bodamer, supra* note 1, at 1159; *see also Cronus Offshore, Inc. v. Kerr McGee Oil & Gas Corp.*, 369 F. Supp. 2d 848, 858 (E.D. Tex. 2004). *Dick's Last Resort* is not the first case to suggest that "actual fraud" for purposes of Article 2.21 is something less than the "actual fraud" that would constitute a common law tort, and we are concerned that this low, vague standard of "actual fraud" means that Article 2.21 really offers no additional protection beyond the current requirements applicable to veil piercing claims generally when Article 2.21 is not applicable. *See Country Village Homes, Inc. v. Patterson*, 236 S.W.3d 413, 432 (Tex. App.—Houston [1st Dist.] 2007, pet. granted, judgment vacated w.r.m.) (rejecting contention that Article 2.21 requires submission of common law fraud as an independent ground of recovery in a veil-piercing action based on alter ego).

71. *Dick's Last Resort*, 273 S.W.3d at 911.

72. Although a great deal has been raised by the landlord regarding the sublease of the restaurant's operations to Dick's Texas, it may be much ado about nothing. Even according to the landlord's own brief, had Dick's West End not subleased the premises and operated the restaurant itself (as it allegedly represented), the primary asset of Dick's West End would have only been the ongoing operating profits (if any) from the restaurant (it would not have included the assets of Dick's Texas or Dick's Holding Company). *See Appellees' Brief* at 3 n.8, *Dick's Last Resort*, 273 S.W.3d 905 (Tex. App.—Dallas May 5, 2008). Thus, even if Dick's West End had not subleased the restaurant operations to Dick's Texas, and had actually been the operator of the restaurant, the landlord still may have gotten nothing in a breach of contract claim against Dick's West End once operations ceased because Dick's West End could have made dividends of any operating profit to its holding company parent throughout the lease term. Thus, it is not clear to the authors that there was any actual damage to the landlord from the claimed fraud.

“actual fraud” for the “direct personal benefit” of each of the entities sought to be charged with liability.<sup>73</sup> And, more specifically, the only relevant issues on appeal were whether the jury had been properly instructed on what was necessary to find an “actual fraud,” and whether there was sufficient evidence to support those findings.

While the court acknowledged that Article 2.21 was the exclusive basis for any veil piercing claim involving a contractual obligation or related matter, the subsequent analysis by the court seemingly disregarded Article 2.21 in favor of the *Castleberry* decision it superseded and the Texas Supreme Court’s clarification of *Castleberry* in *SSP Partners*.<sup>74</sup> As previously noted, *SSP Partners* involved an analysis of traditional veil piercing claims where Article 2.21 was not otherwise directly applicable. Accordingly, neither *SSP Partners* nor *Castleberry* should have been directly relevant. Nevertheless, the court relied on both to determine that the evidence supported the jury’s conclusion that “Schiff, Dick’s Texas, and Dick’s Holding Company [Appellants] caused Dick’s West End to be used for the purpose of perpetrating, and did perpetrate an actual fraud on Market/Ross primarily for direct personal benefit,”<sup>75</sup> as required by Article 2.21:

Appellants planned to use the corporations to ensure the landlord could not recover any assets in the event the tenant decided to vacate before the end of the lease term, and concealed the plan from Market/Ross while committing to a ten-year lease term. They evaded the contractual obligations to pay rent for the full term of the lease and to make payment under the guaranty and the 1% provision.<sup>76</sup>

While “actual fraud” can certainly arise from nondisclosure where a duty to disclose exists, Texas law only imposes a duty to disclose in limited circumstances where: (i) there is a fiduciary relationship, (ii) a partial disclosure of information has been voluntarily made that is misleading (or any earlier disclosure voluntarily made is now false), or (iii) the undisclosed facts could not have been discovered by the other party “exercising ordinary care and diligence.”<sup>77</sup> These limited circumstances were ignored by the trial court and the court of appeals.

There was nothing in the facts described by the court to indicate that the relationship between Market/Ross and any of the Dick’s Holding Company affiliates was anything other than arm’s-length, nor was there any suggestion by the court that Schiff made any disclosures of any kind regarding Dick’s West End’s financial condition such that a duty would have arisen to make that disclosure complete. And, it is hard to imagine

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73. *Dick’s Last Resort*, 273 S.W.3d at 911.

74. *Id.* at 910 (“These are the considerations both the legislature and the supreme court have emphasized and required.”).

75. *Id.* at 912.

76. *Id.* at 912-13.

77. See West & Bodamer, *supra* note 1, at 1159; see also *Cronus Offshore, Inc. v. Kerr McGee Oil & Gas Corp.*, 369 F. Supp. 2d 848, 858 (E.D. Tex. 2004).

how even the most basic diligence or investigation of Dick's West End's financial condition would have failed to uncover its lack of assets. Moreover, the mere failure to pay rent, pay the guaranty or honor the 1% provision are breaches of contract, not an actual fraud.<sup>78</sup> In this regard, even the "evasion of existing obligations" is not "actual fraud;" rather it is one of the laundry list of abuses that *SSP Partners* recognized as justifying veil piercing when Article 2.21 is *not* applicable.

More importantly, a misrepresentation or nondisclosure is simply one of the elements of an actual fraud. For example, to prove fraud by nondisclosure, a claimant must show the following:

- (1) a deliberate failure to disclose material facts, (2) by one who had a duty to disclose such facts, (3) to another who was ignorant of the facts and did not have an equal opportunity to discover them, (4) with the intent the listener act or refrain from acting, and (5) the listener relies on the nondisclosure resulting in injury.<sup>79</sup>

Thus, a party claiming fraud by omission or non-disclosure will not be able to establish that claim if that party also had an opportunity to discover for themselves the undisclosed facts.<sup>80</sup> Moreover, a party negotiating at arm's length may reasonably assume that the other party has made his own investigation of the facts, drawn his own conclusions and negotiated with the aim of protecting himself.<sup>81</sup> Further, a mere failure to perform a contract is also not fraud and does not establish an intent not to perform.<sup>82</sup> And, even where an intent not to perform is established, it is only established as a means to show that a false representation was made at the time of contracting.<sup>83</sup> The other elements of fraud must still be proven, including the element of reliance on that false statement.<sup>84</sup> In-

78. Of course, fraud can occur with the right facts where a party enters into a contract while specifically representing that such party would perform certain specific obligations under that contract, with no present intention of performing those obligations. *See West & Obi, supra* note 1, at 896. But entering into a contract with an entity that may not be able to answer for all of the counterparty's damages in the event of a breach is not the same as intent not to perform the contract. Indeed, rent was paid on the lease in the case for approximately six years of the ten year term. And, the failure to disclose the sublease (and the fact that the rent would ultimately be coming from Dick's Texas) is not fraud unless there was a duty to disclose; it is simply a breach of contract. And if there was no duty to disclose the sublease, why would the failure to honor the one percent provision constitute fraud?

79. *Avery Pharm. Inv., Inc. v. Haynes and Boone, L.L.P.*, No. 2-07-317-CV, 2009 WL 279334, at \*10 (Tex. App.—Fort Worth Feb. 5, 2009, no pet.) (mem. op.); *see also* 7979 *Airport Garage L.L.C. v. Dollar Rent A Car Sys., Inc.*, 245 S.W.3d 488, 507 n.27 (Tex. App.—Houston [14th Dist.] 2007, pet. denied); *Bradford v. Vento*, 48 S.W.3d 749, 754-55 (Tex. 2001).

80. *See Bradford*, 48 S.W.3d at 756.

81. *See id.* (citing RESTATEMENT (SECOND) OF TORTS § 551, cmt k. (1977)).

82. *Friedman v. Powerell Electrical*, 456 S.W.2d 758, 763 (Tex. 1970); *Turner v. Biscoe*, 171 S.W.2d 118, 118-19 (Tex. Comm'n App. 1943, judgm't adopted); *Walker v. Comdata Network Inc.*, 730 S.W.2d 769, 772 (Tex. App.—Dallas 1987, writ dism'd by agr.); *Manziel v. Williams*, 262 S.W.2d 437, 438 (Tex. Civ. App.—Houston [1st Dist.] 1953, no writ).

83. *See* 456 S.W.2d at 763; *Turner*, 171 S.W.2d at 118.

84. *See Comdata*, 730 S.W.2d at 772; *Manziel*, 262 S.W.2d at 439; *see also Winkins v. Frank Winther Invs., Inc.*, 881 S.W.2d 557 (Tex. App.—Houston [1st Dist.] 1994, no pet.) ("where the basis of a plaintiff's claim of fraud is a promise, the elements of actionable



deed, regardless of whether an affirmative representation or an omission is present, reliance is an element of *any* common law fraud claim, including fraud by non-disclosure, conspiracy to defraud, fraudulent inducement and misrepresentation.<sup>85</sup> Paragraphs 7 and 13 of the lease amendment should have been clearly relevant to the issue of reasonable or justifiable reliance in this regard.

Important for purposes of Article 2.21, the court also did not analyze or even discuss the requirement of a showing of “direct personal benefit.”<sup>86</sup> If an actual fraud was perpetrated on the landlord through the use of Dick’s West End, for whose direct personal benefit was that fraud perpetrated? Dick’s West End was allegedly used to perpetrate a fraud, the purpose of which was to shield Dick’s Texas from liability for the lease. If that is the case, how does this make Dick’s Holding Company or Schiff liable under Article 2.21? Had Dick’s West End never been substituted as the tenant, Dick’s Texas would have been the entity on the lease and no liability would have been imposed on Schiff or Dick’s Holding Company as a result. What was the direct personal benefit they received from the use of Dick’s West End? Thus, allowing a veil piercing claim to reach these parties, even if there had been an actual fraud, allowed the landlord to get a better outcome than the landlord would have obtained had none of the claimed acts of fraud occurred.

The jury instructions described by the court, while referencing the requirements of Article 2.21 generally, also reference traditional alter-ego, sham to perpetuate a fraud and evasion of existing legal obligation questions.<sup>87</sup> The wrongful acts required to establish these theories of liability are irrelevant when Article 2.21 is applicable because the statute declares that no piercing of the corporate veil may occur based on “alter ego,” “actual or constructive fraud,” a “sham to perpetrate a fraud,” or any other “*similar theory*,” unless the corporation was used to perpetuate an actual fraud for the direct personal benefit of the entity or individual

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fraud are (1) a promise to perform in the future; (2) made without a present intent to perform; (3) for the purpose of inducing a party to act; (4) in reliance upon which the party does act; (5) and as a result of which, the party suffers damage”) (citing *Dowling v. NADW Mktg. Inc.*, 631 S.W.2d 726, 728 (Tex. 1982)).

85. *Avery Pharm. Inv. v. Haynes and Boone, L.L.P.*, No. 2-07-317-CV, 2009 WL 279334, at \*10-12 (Tex. App.—Fort Worth Feb. 5, 2009, no pet.) (mem. op.) (reviewing the elements required for fraud by nondisclosure, conspiracy to defraud, and misrepresentation in Texas); *Haase v. Glazner*, 62 S.W.3d 795, 798-99 (Tex. 2001) (providing that “with a fraudulent inducement claim, the elements of fraud must be established as they relate to an agreement between the parties”); see also *Formosa Plastics Corp., USA, v. Presidio Eng’rs and Contractors, Inc.*, 960 S.W.2d 41, 47-48 (Tex. 1998).

86. See TEX. BUS. CORP. ACT ANN. § 2.21.A(2) (Vernon 2003). For an analysis of the “personal benefit” requirement, see *Bates v. DeTournillon*, No. 07-03-0257, 2006 WL 265474, at \*3 (Tex. App.—Amarillo, Feb. 3, 2006, no pet.) (reversing the imposition of personal liability on a shareholder because there was no evidence that the shareholder removed property from leased premises for his own personal benefit, comparing to cases finding “direct personal benefit” where a shareholder used money for home or family purchases); see also *West & Obi*, *supra* note 1, at 895.

87. *Dick’s Last Resort*, 273 S.W.3d at 910.

sought to be charged.<sup>88</sup>

There may well have been an “actual fraud” justifying the imposition of liability as proscribed by Article 2.21 in this case; we certainly do not know.<sup>89</sup> But the court should have required the jury to actually find all of the required elements of an actual common law fraud before imposing that liability. And, equally importantly, there should have been a finding of “direct personal benefit” as a result of that actual fraud with respect to each person or entity sought to be charged with liability under Article 2.21.

It is “one of the principal objectives of the formation of corporations . . . to isolate liabilities among separate entities.”<sup>90</sup> As between sophisticated parties, a party should be bound by the agreements that it makes with a separate corporate entity.<sup>91</sup> Paragraphs 7 and 13 of the lease amendment Market/Ross should thus have been relevant to the issue of whether there was “reasonable reliance” by the landlord on any misrepresentation, nondisclosure or purported promise.<sup>92</sup> Moreover, a counterparty to a contract should not be permitted to come back, after the fact, and seek relief from non-contracting, but affiliated, entities through veil-piercing claims based on facts that may not have otherwise supported a direct claim for actual fraud against those parties, at least where Article 2.21 applies. In disregarding these bedrock rules of Texas corporate law, the Dallas Court of Appeals clearly erred.

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88. TEX. BUS. CORP. ACT ANN. § 2.21.A (Vernon 2003).

89. Indeed, the authors are troubled by much of the alleged conduct of the tenant from an ethical and moral perspective, at least based on the way that conduct was characterized by the court. But, we should be cautious in equating potentially unethical business practices with “actual fraud,” least we allow “bad facts” to “make bad law.” Moreover, the authors are equally troubled by the conduct of the landlord in avoiding the landlord’s own contractual undertakings, that there were no oral representations outside the lease amendment, and that it would look solely to Dick’s West End for redress.

90. *Mims v. Brunswick Homes, LLC (In re Moore)*, 379 B.R. 284, 289 (Bankr. N.D. Tex. 2007).

91. See *Wood Motor Co. v. Nebel*, 238 S.W.2d 181, 185 (Tex. 1951); see also Glenn D. West & Emmanuel U. Obi, *Avoiding Fraud and Other Extra-Contractual Claims: There May be More to the Deal than the Contract—2007*, 2007 MERGERS & ACQUISITIONS INST. at 4 (Oct. 4, 2007); Glenn D. West & Benton B. Bodamer, *Avoiding Fraud and Other Extra-Contractual Claims: There May be More to the Deal than the Contract*, 2006 MERGERS AND ACQUISITIONS INST. at 3 (Sept. 7-8, 2006); see generally Glenn D. West, *Avoiding Extra-Contractual Fraud Claims in Portfolio Company Sales Transactions – Is “Walk-Away” Deal Certainty Achievable for the Seller?*, PRIVATE EQUITY ALERT (Weil, Gotshal & Manges, LLP, New York, N.Y.) March 2006, at 1, available at [http://www.weil.com/wgm/cwgmhomep.nsf/Files/PEAMar06/\\$file/PEAMar06.pdf](http://www.weil.com/wgm/cwgmhomep.nsf/Files/PEAMar06/$file/PEAMar06.pdf).

92. There is a difference between a merger clause and a nonreliance provision. See West & Lewis, *supra* note 1, at 763; *A.G. Nichols v. YJ USA Corp.*, No 3:06-CV-02366-L, 2009 WL 722997, at \*21 (N.D. Tex. 2009). But, Paragraph 13 is clearly more than a mere merger clause; and it states categorically that there were no representations made outside of the agreement. When coupled with Paragraph 7 of the lease agreement (which specifically limited landlord’s right to recover under the lease from anyone other than Dick’s West End), it is difficult to imagine how there was reasonable reliance on any representation outside the agreement. And, reasonable reliance is a required element of any fraud.

### III. THE EFFECTIVENESS OF CONTRACTUAL DISCLAIMERS—HELPFUL CLARIFICATION FROM THE TEXAS SUPREME COURT

Breach of contract claims are frequently accompanied by tort claims such as fraud or misrepresentation.<sup>93</sup> By adding these claims, a tort claimant may seek to avoid the contractually agreed limitations on its remedies set forth in the contract, as well seek to rely upon extra-contractual representations not stated in the contract.<sup>94</sup> Moreover, tort-based claims have the advantage of allowing claimants to seek recovery from the individual officers and the entity affiliates of the contracting corporate party who participated in the allegedly tortious behavior, without the necessity of piercing the corporate veil.<sup>95</sup> To avoid these claims, contracting parties often insert non-reliance provisions in their contract. In *Schlumberger Technology Corporation v. Swanson*, the Texas Supreme Court endorsed these provisions, when agreed to among sophisticated parties represented by counsel, holding that “a release that clearly expresses the parties’ intent to waive fraudulent inducement claims, or one that disclaims reliance on representations about specific matters in dispute, can preclude a claim of fraudulent inducement.”<sup>96</sup> As a result of *Schlumberger* and its progeny, “Texas was once considered firmly in the group of states that allowed sophisticated parties to contractually disclaim reliance on extra-contractual representations” and thus negate fraud and misrepresentation claims as a matter of law.<sup>97</sup> Nevertheless, in our 2007 and 2008 Survey articles, we noted the inconsistent application of the *Schlumberger* decision in Texas intermediate appellate courts.<sup>98</sup> The primary area where lower courts differed involved the scope of the *Schlumberger* holding. More specifically, some Texas courts were applying the *Schlumberger* decision only to settlement agreements, while other Texas courts were applying the *Schlumberger* decision to all contracts generally.<sup>99</sup>

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93. West & Obi, *supra* note 1, at 895; West & Bodamer, *supra* note 1, at 1157; West & Stasny, *supra* note 1, at 721.

94. See West & Obi, *supra* note 1, at 896; see also *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 58 (Tex. 2008).

95. See West, *supra* note 1, at 1226-30 (2001); West & Treadway, *supra* note 1, at 811-16; West & Chao, *supra* note 1, at 1403-08; West & Stasny, *supra* note 1, at 726-27; West & Nelson, *supra* note 1, at 804-09.

96. 959 S.W.2d 171 (Tex. 1997).

97. West & Obi, *supra* note 91, at 4.

98. See West & Obi, *supra* note 1, 895-906; West & Lewis, *supra* note 1, at 758.

99. *Compare Steinberg v. Brennan*, No. 3:03-CV-0562, 2005 WL 1837961, at \*5 (N.D. Tex. July 29, 2005) (applying Texas law) (holding that the “idiosyncratic drafting and other characteristic facts of *Schlumberger* are not prerequisite for a finding of clear and unequivocal intent” to disclaim reliance on extra-contractual representations) with *Warehouse Assocs. Corp. Centre II v. Celotex Corp.*, 192 S.W.3d 225, 234 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (narrowly interpreting *Schlumberger* to hold that avoidance of fraud claims via non-reliance clause is only possible when the clause is part of a settlement of a long-standing dispute between the parties, and is specifically tailored to specifically disclaimed representations.). See West & Lewis, *supra* note 1, at 763 (noting a trend of Texas courts to apply *Schlumberger* narrowly); West & Obi, *supra* note 1, at 897-906 (sur-

Consistent with our interpretation of the broad application of *Schlumberger*, and just one month prior to the Texas Supreme Court's *Forest Oil* decision, the Eastland Court of Appeals applied the *Schlumberger* decision broadly and, in *Prudential Insurance Company of America v. Italian Cowboy Partners*,<sup>100</sup> determined that disclaimer of reliance and merger clauses successfully negated the element of reliance in a contract for the lease of a restaurant property. The court found that when a successful restaurateur contracted for the lease of restaurant property while being represented by counsel and a real-estate agent in an arm's length transaction, he disclaimed reliance on any and all extra-contractual representations.<sup>101</sup> The court correctly emphasized that:

[w]hen sophisticated business parties who have fully negotiated a contract and who have been represented by attorneys or other professionals in the field are dealing at arm's length, they should be able to enter a contract in which they effectively disclaim reliance, or in which they agree that there are no representations outside of the written contract, or in which they otherwise provide for merger.<sup>102</sup>

This rule promotes clarity and deal certainty—something we have called for the Texas Supreme Court to reaffirm for many years.<sup>103</sup>

Finally, during this Survey period, the Texas Supreme Court resolved the conflicts among the lower courts as to the breadth of *Schlumberger* in *Forest Oil Corporation v. McAllen*.<sup>104</sup> *Forest Oil* involved a settlement agreement entered into in 1999 between Forest Oil Corporation ("Forest Oil") and James McAllen ("McAllen") regarding disputed oil and gas royalties and leasehold development rights.<sup>105</sup> The settlement agreement was diligently negotiated through mediation and released all claims of any kind relating to the leaseholds, but reserved the right to arbitrate any "claims for environmental liability, surface damages, personal injury, or wrongful death" related to the leaseholds.<sup>106</sup> The agreement contained a disclaimer of reliance upon any statements or misrepresentations not contained in the settlement agreement, as well as an acknowledgment by each party that they were fully advised by counsel prior to executing the agreement.<sup>107</sup> Then, in 2004, McAllen sued Forest Oil claiming that Forest Oil "used its access under the leases to the surface estate to bury highly toxic [materials]" and sought to recover for environmental dam-

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veying Texas decisions that applied *Schlumberger* narrowly and those applying *Schlumberger* broadly).

100. *Prudential Ins. Co. of Am. v. Italian Cowboy Partners*, 270 S.W.3d 192 (Tex. App.—Eastland 2008, pet. filed).

101. *Id.* at 200.

102. *Id.*

103. See West & Lewis, *supra* note 1, at 757; West & Obi, *supra* note 1, at 896; West & Bodamer, *supra* note 1, at 1156; West & Nelson, *supra* note 1, at 812; West & Chao, *supra* note 1, at 1415.

104. *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 58 (Tex. 2008).

105. *Id.* at 53.

106. *Id.* at 53-54.

107. *Id.* at 54.

age.<sup>108</sup> By the terms of the settlement agreement, these kinds of disputes were to be arbitrated rather than litigated, and Forest Oil moved to compel arbitration.<sup>109</sup> McAllen responded by claiming that he was fraudulently induced to enter into the arbitration provision.<sup>110</sup> The trial court denied Forest Oil's motion to compel, and the court of appeals affirmed, but treated the issue as merely evidentiary. However, the Texas Supreme Court stated that "this case fundamentally poses a legal question, not a factual one: does McAllen's disclaimer of reliance on Forest Oil's representations negate the fraudulent-inducement claim as a matter of law?" In reversing the court of appeals decision, the supreme court held, as a matter of law, that the disclaimer of reliance provision set forth in the contested settlement agreement "conclusively defeats McAllen's fraudulent inducement claim."<sup>111</sup>

McAllen argued that the supreme court decision in *Schlumberger* was not applicable to this case citing "material fact differences."<sup>112</sup> The primary argument was that in *Schlumberger*, the parties were back in court regarding the very subject matter of the underlying settlement agreement. Accordingly, unlike the facts in *Schlumberger*, the contested settlement agreement in *Forest Oil* pertained to "royalty underpayment and mineral underdevelopment," whereas the current dispute related to "environmental and personal-injury torts."<sup>113</sup> Thus, McAllen argued, Forest Oil's alleged "misrepresentation here did not concern known disputed matters (which were settled and released) but potential future disputes (which were set aside and reserved)[;]" [a]nd the disclaimer applie[d] solely to representations about the former and not the latter."<sup>114</sup> The supreme court was not convinced by this argument and stated:

Our analysis in *Schlumberger* rested on the paramount principle that Texas courts should uphold contracts negotiated at arm's length by 'knowledgeable and sophisticated business players' represented by 'highly competent and able legal counsel,' a principle that applies with equal force to contracts that reserve future claims as to contracts that settle all claims.<sup>115</sup>

As noted above, many lower courts were confused by *Schlumberger's* apparently limited holding, but the *Forest Oil* case clarifies and expands on the facts of the *Schlumberger* holding, clearly reinforcing the sanctity of contract and the ability of sophisticated parties to rely on the contract terms that they negotiate. Additionally, although the statement was not necessary to the holding of the case, the supreme court indicated its willingness to further expand the holding in the future when it stated, "The

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108. *Id.*

109. *Id.*

110. *Id.* at 55.

111. *Id.* at 56.

112. *Id.* at 57.

113. *Id.*

114. *Id.*

115. *Id.* at 58.

reasoning of the case applies broadly to *contracts generally* . . . .”<sup>116</sup> This statement is indicative of the court’s willingness to apply the *Schlumberger* holding not only to settlement agreements, as some courts have proposed,<sup>117</sup> but to all contracts between knowledgeable parties represented by counsel as we have long championed.<sup>118</sup>

It is important to note, however, that *Forest Oil* did not “adopt a *per se* rule that a disclaimer automatically precludes a fraudulent-inducement claim;” rather the court confirmed that a disclaimer of reliance provision will, as a matter of law, defeat a fraudulent inducement claim if the provision evidences “‘the requisite clear and unequivocal expression of intent necessary to disclaim reliance’ on the specific representations at issue.”<sup>119</sup> In determining whether a particular disclaimer of reliance meets that standard, the court is required to look at each contract and “the totality of the surrounding circumstances[.]”<sup>120</sup> The most relevant factors in finding that a particular disclaimer is binding are:

- (1) the terms of the contract were negotiated, rather than boilerplate, and during negotiations the parties specifically discussed the issue which has become the topic of the subsequent dispute; (2) the complaining party was represented by counsel; (3) the parties dealt with each other in an arm’s length transaction; (4) the parties were knowledgeable in business matters; and (5) the release language was clear.<sup>121</sup>

But, if the contract and “surrounding circumstances” thus evidence a “clear and unequivocal expression of intent necessary to disclaim reliance,” the court will enforce such a disclaimer as a matter of law. To do otherwise would “invite unfortunate consequences for everyday business transactions and the efficient settlement of disputes.”<sup>122</sup> Indeed, according to the supreme court:

After-the-fact protests of misrepresentation are easily lodged, and parties who contractually promise not to rely on extra-contractual statements—*more than that, promise that they have in fact not relied upon such statements*—should be held to their word. Parties should not sign contracts while crossing their fingers behind their backs . . . . It is not asking too much that parties not rely on extra-contractual statements that they contract not to rely on (or else set forth the relied-upon representations in the contract or except them from the disclaimer). If disclaimers of reliance cannot ensure finality and preclude post-deal claims for fraudulent inducement, then freedom of contract, even among the most knowledgeable parties advised by the

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116. *Id.* at 58 n.25 (emphasis added).

117. *See* *Nustrasep, LLC v. TOPC Texas, LLC*, No. A-05-CA-523 LY, 2006 WL 3063432, at \*8 (W.D. Tex. Oct. 27, 2006); *In re Heritage*, 375 B.R. 230, 265 (Bankr. N.D. Tex. 2007).

118. *See* *West & Lewis, supra* note 1, at 760; *West & Obi, supra* note 1, at 897.

119. *Forest Oil*, 268 S.W.3d at 60 (quoting *Schlumberger*, 959 S.W.2d at 179).

120. *Id.*

121. *Id.*

122. *Id.*

most knowledgeable legal counsel, is grievously impaired.<sup>123</sup>

This is indeed welcome clarification of the Texas courts commitment to sanctity of contract between sophisticated parties.

#### IV. CONCLUSION

The seminal cases decided during this Survey period renew our hope that Texas courts are moving back toward an age of contractual certainty in corporate negotiations. We are pleased that the Texas Supreme Court expressly disavowed the single business enterprise doctrine of corporate veil piercing in *SSP v. Gladstrong*. We are equally encouraged by the clarity provided by the court in *Forest Oil* on the proper, broad interpretation of the *Schlumberger* holding that will allow sophisticated contracting parties to agree to waive reliance on extra-contractual representations. While we were troubled by the *Dick's Last Resort* decision, we are hopeful that it does not become precedent for an understanding of the "actual fraud" requirement of Article 2.21 that effectively equates that requirement to the traditional veil piercing analysis of *Castleberry* and its progeny, or a means of end-running the effective use of disclaimers to avoid claims of "actual fraud" based on extra-contractual representations.

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123. *Id.* at 60-61.