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Corporations

Alan W. Tompkins

Theodore S. O'Neal

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CORPORATIONS

Alan W. Tompkins*
Theodore S. O'Neal**

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I. INTRODUCTION

SEVERAL interesting corporation law cases were decided by Texas courts during the Survey period,¹ and these cases have been divided into the general categories of corporate disregard and corporate fiduciary duties. Most of the corporate disregard cases discussed in Section II involve an application of the alter ego analysis set forth in *Castleberry v. Branscum*,² as subsequently modified by the Texas Legislature.³ These cases indicate that Texas courts are appropriately reluctant to disregard the corporate form except when faced with compelling circumstances. The fiduciary duty cases covered in Section III involve breaches of the duty of loyalty and illustrate the bad judgment of a few self-interested officers and directors.

Although the Texas Legislature was not in session during the Survey period and there were no legislative developments to report, a bill that will make many significant amendments to the Texas Business Corporation Act (TBCA) is expected to pass early in the 1997 legislative session. A summary of the significant provisions of the bill is available in last year's Survey article.⁴

II. CORPORATE DISREGARD

In *Sims v. Western Waste Industries*,⁵ the Beaumont Court of Appeals

* M.B.A., J.D., Southern Methodist University; Certified Public Accountant, Texas. Alan Tompkins practices at Secore & Waller, L.L.P. in Dallas, where he concentrates on corporate, securities, and federal income tax matters.

** A.B., Princeton University; J.D., Southern Methodist University. Ted O'Neal practices at Jones, Day, Reavis & Pogue in Dallas, where he concentrates on business transactions, mergers and acquisitions, structured finance, and lending matters.

1. October 1, 1995 through September 30, 1996.

2. 721 S.W.2d 270, 271 (Tex. 1986).

3. See TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon 1980 & Supp. 1997).

4. See Alan W. Tompkins & Theodore S. O'Neal, *Corporations, Annual Survey of Texas Law*, 49 SMU L. REV. 821, 835 (1996).

5. 918 S.W.2d 682 (Tex. App.—Beaumont 1996, writ denied).

addressed the issue of whether a parent corporation could voluntarily disregard the corporate existence of its subsidiary in order to obtain statutory workers' compensation immunity from the claims of a subsidiary corporation's employee. Sims was injured while working as a trash collector for Western Waste Industries of Texas, Inc. (WWIT). Sims sued WWIT's parent, Western Waste Industries, Inc. (WWI), because of WWI's role in the design and manufacture of the garbage truck involved in Sims' injury. In its defense, WWI asserted that WWIT was merely its alter ego and that the immunity granted to WWIT by the Texas workers' compensation statute should be extended to WWI.

In rejecting WWI's reverse veil-piercing theory, the court reasoned that because the separate and distinct nature of parent and subsidiary corporations is generally respected under Texas law,⁶ this division should similarly be respected when a parent corporation is sued by an employee of a subsidiary corporation.⁷ The court, citing *Stoddard v. Ling-Temco-Vought, Inc.*,⁸ found that Texas law does not permit a parent corporation to obtain statutory immunity as a result of the voluntary disregard of the subsidiary's corporate veil.⁹

In reaching its conclusion, the *Sims* court reviewed the status of the corporate disregard doctrine in Texas. Quoting *Castleberry*,¹⁰ the court stated that the corporate form will be disregarded when it has been used as an "unfair device to achieve an inequitable result."¹¹ The doctrine was modified by the Texas Legislature such that the failure to observe corporate formalities and constructive fraud is not generally considered in proving alter ego status with respect to claims grounded in contract law.¹² The focus of the doctrine is to prevent the use of the corporate formality "as a cloak for fraud or illegality or to work an injustice . . ."¹³ The court noted that "when the corporate form is used as an essentially unfair device—when it is used as a sham—courts may act in equity and disregard the usual rules . . ."¹⁴ The court pointed out that veil-piercing is an equitable relief, therefore, courts will require those seeking relief to have clean hands.¹⁵ For example, Texas courts have refused a director's alter ego claim because he personally participated in disregarding the corporation's formalities,¹⁶ and the courts have found it inequitable to allow one who has chosen the corporate form to "pick and choose" when to be

6. *Id.* at 684.

7. *Id.*

8. 513 F. Supp. 314, 325-26 (C.D. Cal. 1980) (applying Texas law).

9. *Sims*, 918 S.W.2d at 684.

10. *Castleberry*, 721 S.W.2d at 271.

11. *Sims*, 918 S.W.2d at 684.

12. *Id.*; see TEX. BUS. CORP. ACT ANN. art. 2.21A(2), (3).

13. *Sims*, 918 S.W.2d at 684.

14. *Id.* (quoting *Matthews Constr. Co. v. Rosen*, 796 S.W.2d 692, 693 (Tex. 1990)).

15. *Sims*, 918 S.W.2d at 685.

16. *Id.* (citing *Southwest Livestock & Trucking Co. v. Dooley*, 884 S.W.2d 805, 810 (Tex. App.—San Antonio 1994, writ denied)).

treated as a corporation.¹⁷ Therefore, the *Sims* court was not inclined to grant WWI the relief it sought.¹⁸

In *Kasprzak v. American General Life & Accident Insurance Co.*,¹⁹ the plaintiff policyholders attempted to pierce the corporate veil of a subsidiary life insurance company and to establish an alter ego relationship with the subsidiary's parent corporation. The plaintiffs' objective was to defeat a removal to federal court based on diversity jurisdiction.

American General Corporation (AmGen) owns AGC Life Insurance Company, which owns American General Life & Accident Insurance Company (AGL&A). The plaintiffs sued AmGen and AGL&A, claiming misrepresentation in the sale of certain life insurance policies. The defendant corporations removed the case to federal court, and the plaintiffs moved to remand the case to state court. Although the plaintiffs sued both AmGen and AGL&A, AmGen contended that AGL&A alone sold and marketed the policies in question and that the plaintiffs had fraudulently joined AmGen in order to destroy diversity jurisdiction. The plaintiffs sought to prove that AGL&A was the alter ego of AmGen, and therefore, was properly joined in the case.²⁰

In its analysis, the court cited *Castleberry*²¹ for the proposition that the corporate fiction generally will not be disregarded unless the subsidiary is used as a sham to perpetrate a fraud, to avoid the effect of a statute, or in other exceptional circumstances when the corporate form is being used to achieve an inequitable result.²² The court stated, however, that there must be something more than mere unity of financial interest, ownership, and control before a court will treat a subsidiary as the alter ego of the parent and make the parent liable for the subsidiary's actions.²³ A showing that there is a confluence of activities between the parent and subsidiary, such as having some or all of the same officers or directors, filing consolidated income tax returns, sharing a corporate logo, or conducting intercorporate business, is not sufficient to make the parent liable for the subsidiary.²⁴

In making their case, the plaintiffs presented evidence that executives were transferred between AmGen and AGL&A and that AmGen had mentioned its reliance on the profitability of its subsidiaries. In response, AmGen presented proof of the separate existence and operation of AmGen.²⁵ Based upon AmGen's evidence, the court declined to disregard AGL&A's separate existence and affirmed the removal of the

17. *Sims*, 918 S.W.2d at 685; see, e.g., *Adams v. Big Three Indus., Inc.*, 549 S.W.2d 411, 413 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.); *Eastwood Model Market v. State*, 359 S.W.2d 294, 296 (Tex. Civ. App.—Austin 1962), *aff'd*, 365 S.W.2d 781 (Tex. 1963).

18. *Sims*, 918 S.W.2d at 686.

19. 914 F. Supp. 144 (E.D. Tex. 1996).

20. *Id.* at 145.

21. *Castleberry*, 721 S.W.2d at 272.

22. *Kasprzak*, 914 F. Supp. at 146.

23. *Id.* at 147.

24. *Id.*

25. *Id.*

case.²⁶

*Amoco Chemical Co. v. Tex Tin Corp.*²⁷ involved a CERCLA²⁸ action in which the federal district court in Galveston also addressed issues involving the fiduciary shield doctrine. The doctrine provides that the acts of a corporation will be attributed to individuals for jurisdictional purposes only if the corporate form can be disregarded in order to impose personal liability on the individuals.²⁹ The court noted that it looks to the law of the state of incorporation of each corporate defendant in determining whether the corporate form should be disregarded.³⁰ Under the laws of New York, Texas, and Delaware, which were applicable in this case, the liabilities of the corporation will not reach its directors, officers, or shareholders unless the corporate privilege has been abused or the corporation has been dominated for personal use.³¹

Here, the plaintiff sued both the defendant corporations and their individual shareholders. The court found that the defendants had submitted evidence that none of the circumstances generally permitting the court to pierce the corporate veil existed and that the plaintiffs had failed to submit evidence that any non-corporate defendants personally benefitted from an abuse of the corporate privilege.³² The only evidence produced by the plaintiffs suggested that the corporate defendants had common directors and officers. The court pointed out that this evidence might support an argument that the veils of the corporate defendants could be pierced to reach each corporation, but not to reach the individuals in question.³³ Consequently, the court held that the actions of the corporate defendants did not warrant the exercise of jurisdiction over the individuals.³⁴

The alter ego relationship between corporations was also at issue in *Old Republic Insurance Co. v. EX-IM Services Corp.*³⁵ In this case, the Houston Court of Appeals employed the "single business enterprise" doctrine to impose joint and several liability on several corporations in-

26. *Id.* The court later dismissed the plaintiffs' case altogether. See Kasprzak v. American Gen. Life & Accident Ins. Co., 942 F. Supp. 303 (E.D. Tex. 1996).

27. 925 F. Supp. 1192 (S.D. Tex. 1996).

28. Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. §§ 9601-75 (1995).

29. *Id.* at 1201 (citing *Stuart v. Spademan*, 772 F.2d 1185, 1197 (5th Cir. 1985) (holding that an individual's transaction of business within the state solely as a corporate officer does not create personal jurisdiction over that individual)).

30. *Amoco*, 925 F. Supp. at 1201.

31. *Id.* at 1202; see, e.g., *Thrift v. Hubbard*, 44 F.3d 348, 353 (5th Cir. 1995) (holding that Texas law allows the corporate form to be pierced only against individuals who personally benefit from abusing the corporate privilege); *Castleberry*, 721 S.W.2d at 271-73 (shareholders, officers, and directors are normally insulated from corporate liabilities unless they have abused the corporate privilege).

32. *Amoco*, 925 F. Supp. at 1202.

33. *Id.*; but see *Hargrave v. Fibreboard Corp.*, 710 F.2d 1154, 1160 (5th Cir. 1983) (stating that 100% stock ownership and commonality of officers and directors alone is not sufficient to establish an alter ego relationship between two corporations).

34. *Amoco*, 925 F. Supp. at 1202.

35. 920 S.W.2d 393 (Tex. App.—Houston [1st Dist.] 1996, no writ).

tertwinced in a customs house brokerage and freight forwarding business.³⁶ Old Republic Insurance sold customs bonds to Refugio Gonzales and the corporations owned by him and his family, including Jetero International, EX-IM Services Corp., and EX-IM Group. Gonzales, as a sole proprietor, and the corporations conducted various import-export businesses. Old Republic sued Gonzales and the corporations to recover amounts paid under the customs bond after Jetero International failed to pay certain duties assessed by the United States Customs Service. Old Republic alleged that the separate existence of the businesses should be disregarded because a single enterprise existed between Gonzales and the corporations, and the jury agreed.³⁷ The trial court, however, entered judgment n.o.v. in favor of Gonzales and the corporations, and Old Republic appealed.³⁸

In reviewing the j.n.o.v., the court of appeals cited *Castleberry*³⁹ for the proposition that the corporate form will be disregarded when a corporation is "operated as a mere tool or business conduit of another corporation, or when the corporate fiction is resorted to as a means of evading an existing legal obligation."⁴⁰ According to the court, the single business enterprise doctrine provides 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 the debts incurred in pursuit of that business purpose."⁴¹ The evidence indicated that the entities conducted similar businesses under similar names at the same addresses.⁴² Gonzales founded most of the companies, served as the president of the EX-IM entities, and ran most of the operations of each company. Employees testified that they performed identical functions for each company. Old Republic presented proof that bills for one of the companies were paid by another. Based on this evidence, the court reversed the j.n.o.v. and rendered judgment in favor of Old Republic.⁴³

In *Gundle Lining Construction Corp. v. Adams County Asphalt, Inc.*,⁴⁴ the Fifth Circuit examined whether the alter ego doctrine supported personal jurisdiction over certain non-resident defendants in a suit involving a payment bond for a large waste disposal project. Adams County Asphalt, Inc. (ACA) agreed to work on the project for the City of Harrisburg, Pennsylvania. ACA was owned by Robert Mumma II (Mumma), who also owned Kimbob, Inc. (Kimbob). ACA obtained a bond from United States Fidelity & Guaranty Company (USF&G) to secure payment for its subcontractors. Mumma and Kimbob both agreed to indem-

36. *Id.* at 395-97.

37. *Id.* at 395.

38. *Id.*

39. *Castleberry*, 721 S.W.2d at 271-72.

40. *Old Republic*, 920 S.W.2d at 395.

41. *Id.* at 395-96.

42. *Id.* at 396.

43. *Id.* at 396-97.

44. 85 F.3d 201 (5th Cir. 1996).

nify USF&G for any amounts paid under the bond. ACA entered into an agreement with Houston-based Gundle Lining Construction Company (Gundle) for part of the work to be done on the project. When a dispute over payment arose, Gundle sued USF&G to recover payment under the bond. USF&G filed third-party complaints against ACA, Kimbob, and Mumma, seeking indemnification, and settled with Gundle. ACA, Kimbob, and Mumma, all non-residents of Texas, filed motions to dismiss for lack of personal jurisdiction. The district court denied the motions and granted summary judgment in favor of USF&G; the defendants appealed.

In its *de novo* review of the personal jurisdiction issue, the Fifth Circuit found that because of the agreement between ACA and Gundle, Texas courts could properly exercise personal jurisdiction over ACA.⁴⁵ Regarding Mumma and Kimbob, the court stated that "under Texas law, a finding by the district court that Mumma and [Kimbob] were alter egos of [Adams] would have permitted the lower court to disregard the corporate fiction and pierce the corporate veil, thereby attributing [Adams'] contacts to its co-defendants."⁴⁶ The only evidence offered to support USF&G's alter ego assertion was financial evidence relating to Kimbob and ACA.⁴⁷ The court applied the factors established in *United States v. Jon-T Chemicals, Inc.*⁴⁸ to determine whether Kimbob was an alter ego of ACA.⁴⁹ The *Jon-T* factors are whether:

- (1) the parent and the subsidiary have common stock ownership;
- (2) the parent and the subsidiary have common directors or officers;
- (3) the parent and the subsidiary have common business departments;
- (4) the parent and subsidiary file consolidated financial statements and tax returns;
- (5) the parent finances the subsidiary;
- (6) the parent caused the incorporation of the subsidiary;
- (7) the subsidiary operates with grossly inadequate capital;
- (8) the parent pays the salaries and other expenses of the subsidiary;
- (9) the subsidiary receives no business except that given to it by the parent;
- (10) the parent uses the subsidiaries property as its own; [and]
- (11) the daily operations of the two corporations are not kept separate.⁵⁰

The court reviewed the evidence, found it insufficient to support USF&G's alter ego claim, and held that the alter ego claim against Kimbob failed.⁵¹

45. *Id.* at 207.

46. *Id.* at 208.

47. *Id.*

48. 768 F.2d 686, 691-92 (5th Cir. 1985), *cert. denied*, 475 U.S. 1014 (1986).

49. The court noted that although the *Jon-T* factors were developed to determine whether a subsidiary is the alter ego of its parent, the factors are also applicable to situations involving a claim that an individual is an alter ego of a corporation. *Gundle*, 85 F.3d at 208 n.3. The court further noted that because the Texas Legislature amended the TBCA to remove the failure to observe corporate formalities from the list of factors to be used in proving alter ego claims, that factor would not be used in the court's analysis. *Id.* at 209 n.4.

50. *Id.* at 208-09.

51. *Id.* at 209.

As to the alter ego claim against Mumma, the court noted that in addition to the previously mentioned factors, an alter ego determination must also be based on a consideration of "[1] the total dealings of the corporation and the individual, [2] the amount of financial interest the individual has in the corporation, [3] the ownership and control that the individual maintains over the corporation, and [4] whether the corporation has been used for personal purposes."⁵² The only evidence in support of the alter ego claim against Mumma was his signature on the indemnity agreement and his signature on checks from ACA to Gundle. According to the court, this evidence was insufficient to support the alter ego claim against Mumma.⁵³ Because USF&G failed to produce evidence that Mumma and Kimbob were the alter egos of ACA, the Fifth Circuit dismissed the actions against Mumma and Kimbob based on a lack of personal jurisdiction.⁵⁴

*Gonzales County Water Supply Corp. v. Jarzombek*⁵⁵ involved a well-drilling contract between Edward Jarzombek, Inc., d/b/a J-B Drilling Company (JBD), and Gonzales County Water Supply Corporation (Gonzales). Gonzales sued JBD and its sole shareholder, Ed Jarzombek, alleging breach of contract and a Deceptive Trade Practices Act violation. Gonzales claimed that Jarzombek had presented inconsistent statements about the organization of his business that led to confusion about whether Jarzombek was operating through a corporation or as a sole proprietorship. Jarzombek moved for summary judgment, alleging that the action against him in his individual capacity was improper and that the contract was solely between the two corporations. Eventually, the district court granted the summary judgment motion.⁵⁶

In addressing Gonzales' claim that JBD was the alter ego of Jarzombek, the Corpus Christi Court of Appeals stated the general rule that the corporate form normally insulates shareholders, officers, and directors from personal liability for corporate obligations and that only when these individuals abuse the corporate privilege will the court disregard the corporate fiction and hold them individually liable.⁵⁷ The court then expressed its willingness to pierce the corporate veil, even if corporate formalities have been observed, when the corporate form has been used unfairly to achieve an inequitable result.⁵⁸

The court reviewed the factors to be considered when determining whether to disregard the corporate veil, noting that the veil will be disregarded:

52. *Id.* (citing *Permian Petroleum Co. v. Petroleos Mexicanos*, 934 F.2d 635, 642 (5th Cir. 1991)).

53. *Gundle*, 85 F.3d at 209.

54. *Id.* at 209, 211.

55. 918 S.W.2d 57 (Tex. App.—Corpus Christi 1996, no writ).

56. *Id.* at 59.

57. *Id.* at 61 (citing *Castleberry*, 721 S.W.2d at 271).

58. *Id.* (citing *Castleberry*, 721 S.W.2d at 272).

(1) when the fiction is used as a means of perpetrating fraud; (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation; (3) where the corporate form is resorted to as a means of evading an existing legal obligation; (4) where the corporate fiction is employed to achieve or perpetuate 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 a wrong.⁵⁹

The court noted that just because an individual owns all or a majority of the stock of a corporation, the corporation is not necessarily the alter ego of the shareholder.⁶⁰ After reviewing the evidence, the court held that the inconsistencies in Jarzombek's representations did not rise to the level of "deception and guile" so as to warrant a finding that JBD was his alter ego.⁶¹ Thus, the court affirmed the summary judgment in Jarzombek's favor.⁶²

*Salazar v. Coastal Corp.*⁶³ involved a suit by Carlos Salazar against Coastal Corporation (Coastal) and its subsidiaries, Coastal States Trading, Inc. (CSTI) and Coastal Petroleum N.V. (CPNV). Salazar had acted as CSTI's Ecuadoran agent since 1986 with respect to the company's business with PetroEcuador, the government-controlled oil company. Under his agreement with CSTI, Salazar was entitled to a commission on each barrel of oil sold to or purchased from PetroEcuador. Salazar sued when CSTI terminated the relationship on the basis that CSTI was winding up its operations in Ecuador. Just one day before CSTI terminated Salazar's agency relationship, Coastal had received permission to substitute CPNV in place of CSTI for Coastal's dealings with PetroEcuador. CPNV began doing business with PetroEcuador after Salazar's agreement was terminated. Salazar alleged that his agreement had been orally modified to allow him to represent any of the Coastal entities doing business in Ecuador, that the termination was a charade to avoid payment of compensation, and that each of the Coastal entities were alter egos of one another.⁶⁴ The trial court granted summary judgment in favor of Coastal, and Salazar appealed.

In reviewing the alter ego claim, the Houston Court of Appeals, citing *Castleberry*,⁶⁵ noted that the alter ego doctrine is available when one corporation is operated as a business conduit for another.⁶⁶ Alter ego status is established by evidence demonstrating a blurring of the lines of distinction between corporations,⁶⁷ and key factors to be considered include (1) the identity of directors, officers, and employees and (2) any failure to

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. 928 S.W.2d 162 (Tex. App.—Houston [14th Dist.] 1996, no writ).

64. *Id.* at 165.

65. *Castleberry*, 721 S.W.2d at 272.

66. *Salazar*, 928 S.W.2d at 169.

67. *Id.* at 170.

establish demarcation between different entities in ordinary business matters.⁶⁸ At trial, Salazar introduced evidence that when PetroEcuador required financial information from CSTI, Coastal's financial information was provided. Letters concerning the different Coastal entities' dealings with PetroEcuador were produced, demonstrating that the same employees wrote on behalf of Coastal, CSTI, and CPNV. Further, one man testified that he concurrently served as an officer of several Coastal entities but was paid by only one of them.⁶⁹ Based on this proof, the court found some evidence that Coastal had failed to maintain a distinction between its entities and held that the summary judgment in favor of Coastal was improperly granted.⁷⁰

III. CORPORATE FIDUCIARY DUTIES

The summary judgment appeal in *GNG Gas Systems, Inc. v. Dean*⁷¹ gave the Amarillo Court of Appeals an opportunity to address the novel issue of whether an agreement arising from a breach of fiduciary duty by the parties to the agreement was legal.⁷² Aptly-named E.F. Gouge, one of the initial shareholders and directors of Natural Gas Gathering Company of Texas, Inc. (NGGC), became the chief executive officer of the company in 1988. Harry Dean and O.J. King were part of the management team responsible for NGGC's operations. NGGC had contracts with Graham Royalty, Ltd., Graham Energy, Ltd., and Graham Resources, Inc. (collectively, Graham) regarding the operation of gas pipelines in Utah and Garza County, Texas. Gouge negotiated the contracts on behalf of NGGC, and Dean and King were in charge of various operations covered by the contracts.

Apparently dissatisfied with life at NGGC, Gouge made plans to form his own company. As part of his entrepreneurial planning process, Gouge negotiated an unwritten understanding with Graham that when Gouge went out on his own, Graham would terminate the NGGC contracts and sign permanent contracts with Gouge's new enterprise.⁷³ In order to divert attention from his departure and the corresponding loss of the Graham contracts, Gouge agreed with Dean and King that shortly after he resigned, Dean and King would also resign and form their own company. When Gouge's company got the Graham contracts, the two companies would split the profits.

The plan was effected in early 1990 when Gouge, Dean, and King resigned from NGGC. Gouge formed GNG Gas Systems, Inc., and Dean

68. *Id.*

69. *Id.*

70. *Id.*

71. 921 S.W.2d 421 (Tex. App.—Amarillo 1996, writ denied).

72. *Id.* at 425. The court noted that the defendants had not cited, nor had the court's research revealed, any "decision adjudicating the question of the legality, as between the parties, of an agreement founded upon the parties' violation of their fiduciary duty to their principal." *Id.* at 427.

73. *Id.* at 423.

and King formed Northstar Gas Co., Inc. Graham's legal staff decided to name only Northstar as a party to the contracts, rather than to name Northstar and GNG jointly, so that Gouge's involvement would be less apparent to NGGC. Unfortunately for Gouge, the omission caused Dean and King to conclude that the profits from the Graham contracts belonged exclusively to Northstar and that neither Gouge nor GNG was entitled to a share. According to Gouge's deposition testimony, Dean and King "were able to starve me out since they controlled all the money and[,] because of threats of lawsuits made to Graham by NGGC, they have taken the business opportunities of NGGC for themselves and excluded me."⁷⁴

Gouge and GNG filed suit against Northstar, Dean, and King alleging breach of contract, conversion, and unjust enrichment.⁷⁵ In a *tour de force* of alternative pleading, the defendants denied the allegations and claimed that the agreement with Gouge did not exist, was rescinded or abandoned, was too vague or indefinite to be enforced, or was illegal and unenforceable as a matter of law.⁷⁶ The trial court granted summary judgment and ordered that Gouge and GNG take nothing.⁷⁷

On appeal, Dean, King, and Northstar argued that because the transaction by which Gouge diverted the business opportunities of NGGC to himself was a breach of fiduciary duty and presumptively void, the agreement for the sharing of revenues between the parties was, in turn, illegal and unenforceable.⁷⁸ The appellate court pointed out that although Gouge openly admitted his breach of fiduciary duty, he did not say that the agreement with Dean and King was illegal.⁷⁹ The court further noted that NGGC, the party with standing to challenge the agreement, did not seek to have the agreement declared illegal but instead sought damages stemming from the breaches of fiduciary duty.⁸⁰ In fact, the agreement between Gouge, Dean, and King was "to engage in a lawful enterprise, i.e. the operation of a gas pipeline transportation system and the marketing of gas . . ."⁸¹ The court held that "[t]he fact that the agreement arose from the parties' violation of their fiduciary duty to their principal is not alone sufficient to show the agreement is illegal as to them."⁸² Therefore, Dean, King, and Northstar were not entitled to summary judgment on that point.⁸³ The court overruled the other points raised by Dean, King, and Northstar and reversed and remanded the case.⁸⁴

Two other cases decided during the Survey period involving breaches

74. *Id.* at 424.

75. *Id.* at 425.

76. *Id.* at 426.

77. *Id.*

78. *Id.* at 427.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 428.

83. *Id.*

84. *Id.* at 429.

of the duty of loyalty were *General Dynamics v. Torres*⁸⁵ and *In re General Homes Corp.*⁸⁶ At the center of *General Dynamics* was an equipment lease between El Paso Sand, Inc., a lower-tier subsidiary of General Dynamics, and LTM. LTM was a partnership consisting of Richard Levy, president of El Paso Sand, Louis Torres, a manager and purported officer of the corporation, and Donald McCoy, a vice president of El Paso Sand. In 1984, LTM purchased a piece of construction equipment that was useful to El Paso Sand's operations and that LTM expected to quickly sell at a profit. The purchase was financed by Texas Commerce Bank (TCB). When the sale fell through, LTM leased the equipment to El Paso Sand. About a year later, LTM sold the equipment to Desert West, Inc., assigned the lease, and realized a profit of \$100,000. Desert West failed about eighteen months later, so LTM repurchased the equipment and executed a new lease with El Paso Sand. Torres signed the lease for LTM and McCoy signed it for El Paso Sand. LTM's purchase of the equipment from Desert West was also financed by TCB. The lease payment was set equal to the principal and interest payment on the TCB note and was to be paid directly to TCB.

Donald McCoy died in 1988, and shortly thereafter Levy and Torres were terminated from their employment with El Paso Sand. The corporation stopped making the lease payments on the equipment, and TCB made demand on the indebtedness. TCB, Torres, Levy, and McCoy's estate settled the matters involving the indebtedness. In March of 1990, Torres filed suit on behalf of LTM against El Paso Sand seeking damages for the breach of the lease.⁸⁷ The trial court entered judgment in favor of LTM.⁸⁸

In reviewing the matter, the El Paso Court of Appeals noted that when an officer with an interest in a transaction seeks to enforce the transaction against the corporation, the court will scrutinize the transaction closely to see that the officer has met his burden of proving the utmost fairness and good faith of the transaction.⁸⁹ The court found no evidence to support a finding of fairness or good faith in the lease transaction,⁹⁰ and thus held that Torres had failed to meet his burden of proof.⁹¹ Although Torres contended that El Paso Sand had ratified the transaction, the court noted that ratification is only effective if all material facts are disclosed to the directors or shareholders of the corporation.⁹² The court found no evidence to support Torres' assertion of ratification,⁹³ held that the transaction was "done for [the] express purpose of the LTM partners'

85. 915 S.W.2d 45 (Tex. App.—El Paso 1995, writ denied).

86. 199 B.R. 148 (S.D. Tex. 1996).

87. *Torres*, 915 S.W.2d at 48.

88. *Id.*

89. *Id.* at 49.

90. *Id.*

91. *Id.* at 50.

92. *Id.*

93. *Id.*

enrichment,"⁹⁴ and reversed and rendered judgment in favor of El Paso Sand.⁹⁵

*In re General Homes Corp.*⁹⁶ involved the approval of new employment agreements, with significantly increased salaries and severance benefits, for three officers of the bankrupt corporation. The controversy arose because two of the officers also comprised two-thirds of the corporation's three-member board of directors, which approved the agreements without a meeting and after a portion of the services had been provided, and because the agreements did not provide the corporation with any significant additional benefit. The agreements were approved by the bankruptcy court over the creditors' objections, but the creditors appealed the decision to the district court.

In reviewing the issue, the court noted that employment contracts that substantially increase officers' salaries and severance benefits fall outside a corporation's ordinary course of business.⁹⁷ The court reasoned that the business judgment rule did not apply to protect the board's decision in this instance because of the conservatorship context and because "the actions involve self-dealing or agreements outside the ordinary course of business."⁹⁸ The court found that the board had "ignored the best interest of the corporation and the need for uncorrupted business judgment during the reorganization"⁹⁹ and ordered that the excess payments made to the officers be returned to the bankruptcy estate.¹⁰⁰

94. *Id.*

95. *Id.* at 51.

96. 199 B.R. 148.

97. *Id.* at 150.

98. *Id.* at 151.

99. *Id.* at 152.

100. *Id.* at 153.