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Corporations

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CORPORATIONS

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I. INTRODUCTION

EACH year, this Texas Corporations Survey seeks to identify new decisions from the Texas courts¹ addressing important issues of corporate law (other than securities law) or providing valuable drafting guidelines for the corporate attorney respecting agreements entered into by Texas corporations.² The significant corporate law issues

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1. In this Texas Corporations Survey, "Texas courts" includes decisions of the Texas appellate courts, the Texas Supreme Court, the federal district or bankruptcy courts situated within Texas, and the United States Court of Appeals for the Fifth Circuit to the extent it is interpreting Texas law.

2. While the Texas legislature adopted the Texas Business Organizations Code and several other statutes of significance affecting corporations during this Survey period, there

addressed by the Texas courts during this Survey period³ relate to (i) the liability of corporate officers for the obligations of their corporation and (ii) the fiduciary duties owed by the officers and directors of the Texas corporation. In addition, Texas courts handed down a number of decisions during this Survey period that provide important guidance in drafting effective clauses in corporate agreements. The guidance offered by these decisions includes direction in (i) disclaiming reliance upon extra-contractual representations or claims and (ii) ensuring that a preliminary letter of intent is and remains non-binding.⁴

II. LIABILITY OF OFFICERS OF TEXAS CORPORATIONS

As repeatedly reaffirmed during this Survey period, the Texas corporation, like the corporation in every state, is a creature of statute, legally separate and distinct from its officers, directors, and shareholders, but which, as a legally fictitious person, can only act through its officers or agents.⁵ The protection from individual liability provided by this separate and distinct legal existence has traditionally been one of the attractions of the corporate form of organization to its shareholders, officers, and direc-

are already a number of published articles summarizing these developments. *See, e.g.*, Daryl Robertson, *Business Law—Summary of Selected 2003 Texas Legislation*, 66 TEX. B.J. 664 (September 2003).

3. November 1, 2002 through December 1, 2003 (to the extent cases decided during these dates were available prior to the date this Survey was submitted for publication).

4. The Texas courts also addressed a number of other important corporate law issues during this Survey period. *See, e.g.*, *Miga v. Jensen*, 96 S.W.3d 207, 214-16 (Tex. 2002) (finding that the proper measure of damages for breach of stock option agreement was the difference between the exercise price and the value of the stock at the date the employee attempts to exercise the option, not the later increased value at the time of trial); *R.V.K. v. L.L.K.*, 103 S.W.3d 612, 619 (Tex. App.—San Antonio 2003, no pet.) (holding that determination of market value of minority stock ownership must take into account restrictions set forth in the buy/sell agreement instead of simply taking minority's percentage of "enterprise value"); *Walden v. Affiliated Computer Servs., Inc.*, 97 S.W.3d 303, 318-19 (Tex. App.—Houston [14th Dist.] 2003, pet. denied) (holding that options granted by ACS to employees had become vested, based on the terms of the option plan, and therefore additional consideration was needed to amend the option plan; however, the altering of the terms of such plan to allow for exercise of some options without a waiting period might constitute sufficient consideration).

5. *See, e.g.*, *Latch v. Gratty, Inc.*, 107 S.W.3d 543, 545 (Tex. 2003) ("The acts of a corporate agent on behalf of his or her principal are ordinarily deemed to be the corporation's acts."); *Gerjets v. Davila*, 116 S.W.3d 864, 869 (Tex. App.—Corpus Christi 2003, no pet.) (holding that a judgment obtained against corporation cannot be enforced against the corporation's chief executive officer and sole shareholder); *Fraud-Tech, Inc. v. Choice-point, Inc.*, 102 S.W.3d 366, 375 (Tex. App.—Fort Worth 2003, pet. denied) ("[a] corporate entity, [is] separate and apart from its officers and shareholders."); *Landrum v. Thunderbird Speedway, Inc.*, 97 S.W.3d 756, 758-59 (Tex. App.—Dallas 2003, no pet.) (holding that a corporation whose charter has been forfeited and is therefore dissolved is not liable for claims that arose after such dissolution); *Schlueter v. Carey*, 112 S.W.3d 164, 170, 172 (Tex. App.—Fort Worth 2003, pet. filed) (finding that a corporation which was not served with a lawsuit cannot be held liable even though a sole shareholder was served and held to be "alter ego" of the corporation); *KSNB Architects, Inc. v. Beasley*, 109 S.W.3d 894, 896 (Tex. App.—Dallas 2003, no pet.) (noting that as a "person" who can only act through agents, a corporation cannot appear in litigation pro se; it must act through a licensed attorney); *Quest Communications Int'l, Inc. v. AT&T Corp.*, 114 S.W.3d 15, 25 (Tex. App.—Austin 2003, pet. filed) (finding that a corporation can only act through agents).

tors.⁶ This individual protection from liabilities incurred by the corporation derives from basic principles of agency law that view the corporation (rather than its shareholders or directors) as the true principal and its officers or employees as the agents of that corporate principal.

Under Texas law, an "agency" is the relationship established between the agent and the principal pursuant to which the agent agrees to act on behalf of the principal and subject to the principal's control.⁷ An agent owes fiduciary duties to the principal⁸ and may only act within the scope of authority granted by the principal and subject to its control.⁹ As these rules dictate that an agent is under the control of the principal, it follows naturally that it is the principal, not the agent, that is liable for the obligations incurred by such agent in the scope of her agency on behalf of the principal. There are two important exceptions to this rule of agent non-liability for the obligations she incurs on her principal's behalf. First, to claim the benefit of agent non-liability for contractual obligations entered into by the agent in the scope of her agency on behalf of her principal, the agent must clearly disclose the fact of her agency and the identity of her principal to the party with whom she is dealing.¹⁰ Second, notwithstanding the idea that an agent is acting solely under the control of her principal, she is nevertheless personally liable for any tort in which she personally participates, even if she commits such tort solely in furtherance of her agency on behalf of her principal.¹¹ These basic concepts of

6. See Glenn D. West & Susan Y. Chao, *Corporations*, 56 SMU L. REV. 1395, 1397 n.5 (2003); see also, *Goldstein v. Mortenson*, 113 S.W.3d 769, 781-82 (Tex. App.—Austin 2003, no pet.) (“[a] court may not pierce the corporate veil on a mere showing that an individual served as a director and officer of a corporation and that he held an ownership interest in the corporation.”); *Goetz v. Synthesys Techs., Inc.*, 286 F. Supp. 2d 796, 802 (W.D. Tex. 2003) (“Under Texas law, corporate directors are generally not liable for corporate contractual obligations.”).

7. See *Northwinds Abatement, Inc. v. Employers Ins. of Wausau*, 258 F.3d 345, 351 (5th Cir. 2001); *Royal Mortgage Corp. v. Montague*, 41 S.W.3d 721, 732 (Tex. App.—Fort Worth 2001, no pet.).

8. See *Tractebel Energy Mktg., Inc. v. E.I. Du Pont De Nemours & Co.*, 118 S.W.3d 60, 71-72 (Tex. App.—Houston [14th Dist.] 2003, no pet.) (“[T]he existence of a fiduciary relationship is a result of an agency relationship, not an element of it.”); *Vogt v. Warnock*, 107 S.W.3d 778, 782 (Tex. App.—El Paso 2003, pet. denied) (“[A] power of attorney creates an agency relationship, which is a fiduciary relationship as a matter of law.”).

9. See *Burnside Air Conditioning & Heating, Inc. v. T.S. Young Corp.*, 113 S.W.3d 889, 896 (Tex. App.—Dallas 2003, no pet.) (“One of the elements of an agency relationship is the principal's right to control the agent in carrying out the assigned task.”).

10. See, e.g., *Gonzales County Water Supply Corp. v. Jarzombek*, 918 S.W.2d 57, 60 (Tex. App.—Corpus Christi 1996, no pet.) (“[t]o avoid personal liability, an agent has the duty to disclose not only that he is acting in a representative capacity but also the identity of his principal.”). Even though an agent will be personally liable if she executes an agreement without disclosing her principal, as noted during this Survey period, the undisclosed corporate principal may also be bound on the contract if the agent was acting with authority to bind the principal, due to the general rule that “[t]he acts of a corporate agent on behalf of his or her principal are ordinarily deemed to be the corporation's acts.” *Latch*, 107 S.W.3d at 545.

11. See *Leitch v. Hornsby*, 935 S.W.2d 114, 117 (Tex. 1996). There are two exceptions to this second exception relating to claims of tortious interference and certain negligence claims. See Glenn D. West & Brandy L. Treadway, *Corporations*, 55 SMU L. REV. 803, 813 (2002).

agency law apply in whole cloth to the corporate "person" and the officers who serve as its agents.¹²

A. IMPOSING LIABILITY ON CORPORATE OFFICERS FOR FAILING TO SIGN CORPORATE CONTRACTS IN A REPRESENTATIVE CAPACITY

Although a corporate agent is not liable for any contract she enters into on behalf of a disclosed principal, nothing prevents an agent from agreeing to add her personal liability to that of her principal or from agreeing to substitute her own liability for that of her principal.¹³ Agreeing to become personally liable on a contract entered into on behalf of a corporate principal is certainly a decision any corporate agent should be free to make. All too often, however, Texas cases see corporate agents unintentionally assuming liability for corporate contracts. This results from their failure to clearly identify their capacity as an agent in executing the contract and/or from their failure to clearly identify their corporate principal as the actual party to the contract on whose behalf they are executing the contract as agent. The authors first examined this phenomenon in the 2001 Texas Corporations Survey's review of *Taylor-Made Hose, Inc. v. Wilkerson*.¹⁴ In the 2001 Texas Corporations Survey, we identified *Taylor-Made* as a case in which a corporate agent had become personally liable for the contract of her corporate principal simply by failing to carefully identify her corporate principal as the sole party to the contract and by failing to cross out the personal pronoun "I" in the standard form she signed. Although the persons involved in the cases decided during this Survey period were not as sympathetic as the unwitting corporate officer found personally liable for the corporate contract she signed in *Taylor-Made*, several cases decided during this Survey period highlighted the continuing frequency with which ambiguous drafting gives rise to serious questions regarding whether a corporate agent intended to add her personal guarantee to the obligation of her corporate principal or to substitute her own personal liability for that of her corporate principal.

For example, in *Material Partnerships, Inc. v. Ventura*,¹⁵ a case decided during the Survey period, Jorge Ventura, an officer of Sacos Tubulares del Centro, S.A. de C.V. ("Sacos"), was sued, in his individual capacity, for amounts owing to Material Partnerships for shipments delivered to Sacos on an open account. The assertion of individual liability against Mr. Ventura was based upon a September 25, 1998 letter in which Mr. Ventura wrote: "I . . . want to certify you [sic] that I, personally, guaranty all outstandings [sic] and liabilities of Sacos Tubulares with Material Part-

12. See *Burch v. Hancock*, 56 S.W.3d 257, 261 (Tex. App.—Tyler 2001, no pet.) (noting that the obligations of corporate officers is based on the same law as that for agents for private individuals).

13. See Glenn D. West, *Corporations*, 54 SMU L. REV. 1221, 1231-33 (2001).

14. *Taylor-Made Hose, Inc. v. Wilkerson*, 21 S.W.3d 484 (Tex. App.—San Antonio 2000, pet. denied), as reviewed by West, *supra* note 13, at 1231-33.

15. *Material P'ships, Inc. v. Ventura*, 102 S.W.3d 252 (Tex. App.—Houston [14th Dist.] 2003, pet. denied).

nerships as well as future shipments.”¹⁶ The letter was signed by Mr. Ventura with the designation, “JORGE LOPEZ VENTURA, GENERAL MANAGER.”¹⁷

Mr. Ventura testified that he intended to sign the letter only in his capacity as general manager of Sacos. The trial court found that the letter was ambiguous and that it did not “clearly express an intent to bind Jorge Lopez Ventura in an individual or personal capacity.”¹⁸ On appeal, citing to *Taylor-Made* and to the personal nature of the language in the body of the letter, the Houston Court of Appeals overturned the trial court and held that the letter was an unambiguous assumption of personal liability.¹⁹

Additionally, the court noted that the signature of Mr. Ventura, followed by the designation, “General Manager,” was not sufficient to unambiguously demonstrate that Mr. Ventura was signing only as an agent on behalf of Sacos. Noting that the signature did not take the form of “Sacos by Lopez” or “Lopez for Sacos,” the court held that the Mr. Ventura’s signature was insufficiently representative to create any ambiguity as to the personal nature of the guaranty, given the specific language in the body of the letter using the personal pronoun “I.”²⁰ Unlike the *Taylor-Made* decision we criticized in the 2001 Texas Corporations Survey, we are not persuaded that the court in *Material Partnerships* reached the wrong result in terms of discerning the parties’ intent from the language of the letter. Indeed, the body of the letter clearly states an intention to be personally bound.²¹ Nevertheless, the court’s holding does serve as a reminder to all corporate attorneys of the importance to expressly note the corporate officer signatory’s representative capacity in the signature block of any document signed for the corporation, and also make sure the document itself names the corporation as the contracting party and contains no language indicating an intent to bind the corporate officer signatory in her individual capacity.

Instone Travel Tech Marine & Offshore v. International Shipping Partners, Inc.,²² while not a case involving a corporate officer, is another case decided during the Survey period that highlights the importance of careful drafting in principal/agent situations. In *Instone Travel*, International Shipping Partners (“ISP”), acting as a management services agent for passenger ship owners and charterers, found itself personally liable to a

16. *Id.* at 256.

17. *Id.*

18. *Id.* at 257.

19. *Id.* at 259-60.

20. *Id.* at 261.

21. In a concurring opinion, Justice Kem Thompson Frost noted that construing the letter as being personally binding was the only plausible interpretation of the guaranty language in the letter, as a guaranty is, by definition, the assumption of an obligation by a third party, and to have Sacos “guaranty” its own obligations would render the letter meaningless. *Id.* at 263.

22. *Instone Travel Tech Marine & Offshore v. Int’l Shipping Partners, Inc.*, 334 F.3d 423 (5th Cir. 2003).

third party vendor because of language in the contract indicating it was assuming personal liability.²³

The contract in *Instone Travel* provided that Instone would supply ISP with airline travel tickets and related travel products and services, which ISP would purchase as agent on behalf of passenger ship owners and charterers in order to transport the crews of such passenger ships to and from their vessels. ISP purchased approximately \$52,000 worth of plane tickets on the contract.²⁴

At issue in the contract were two separate provisions. The first provision, Provision VI.A, provided that "Client [ISP] acknowledges that it is unconditionally obligated to pay Contractor [Instone] for each ticket or document issued to Client hereunder."²⁵ The second provision, Provision X, stated that "Contractor acknowledges that Client is acting as agent for an [sic] on behalf of certain vessels, vessel owners and/or Charterers."²⁶

In rejecting the argument that Provision X eliminated personal liability for ISP, the court noted that while the general rule is that an agent is not liable for an obligation undertaken on behalf of a disclosed principal, the general rule can be "overcome when the agent expressly or implicitly accepts liability."²⁷ Here the express language acknowledging an unconditional obligation to pay was a sufficient acknowledgement of individual liability to overcome any import of the agency language found in Provision X.²⁸ The authors would note, however, that the court could have also decided this case on the well-settled rule that in order for an agent to be entitled to rely on the rule that exonerates her from individual liability for a contract entered into for a disclosed principal, the principal must be actually disclosed by name.²⁹ Here, Provision X did not disclose the actual names of any of the putative principals, it simply disclosed a category of persons on whose behalf the agent was purportedly acting.

B. LIABILITY OF CORPORATE AGENTS FOR THEIR PERSONAL PARTICIPATION IN A TORT COMMITTED SOLELY IN THEIR CAPACITY AS A CORPORATE AGENT

The second exception to the general rule of agent non-liability is that an agent will be personally liable for torts individually committed by that agent, even if she commits those torts solely within the scope of her agency. This exception does not exonerate the principal from liability for the torts committed by its agent in the scope of the agency; it simply

23. *Id.* at 431.

24. *Id.* at 425.

25. *Id.* at 427.

26. *Id.* at 427.

27. *Id.* at 430.

28. *Id.* at 431.

29. See *Gonzales County Water Supply Co. v. Jarzombek*, 918 S.W.2d 57, 60 (Tex. App.—Corpus Christi 1996, no pet.); *Latch v. Gratty*, 107 S.W.3d 543, 545 (Tex. 2003); see also *West supra* note 13, at 1233 n.77.

makes the agent liable in addition to the principal.³⁰ As noted in past Texas Corporations Surveys, this exception is easily appreciated in circumstances involving intentional or negligent torts committed by agents outside of the negotiation and execution of binding business arrangements, e.g., physical assault or negligent driving.³¹ It is rarely appreciated by corporate officers, however, in circumstances where the torts are negligent misrepresentation or fraud arising out of the agent's negotiation or execution of contractual obligations on behalf of her corporate principal.³² The Texas Corporations Surveys have been uniformly critical, during each of the past three years, of the Texas courts' continued application of this agency law concept to claims of misrepresentation or fraud by corporate agents arising out of the negotiation or execution of contractual obligations on behalf of their corporations.³³ This criticism derives primarily from the Texas courts' apparent refusal to properly apply Article 2.21 of the Texas Business Corporations Act,³⁴ which the authors believe should preempt the applicability of this general principle of agency law.

Article 2.21 prohibits the imposition of liability on "any holder of shares" or "any affiliate of the corporation," for:

any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, owner, subscriber, 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 holder, owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, subscriber or affiliate.³⁵

The 2003 Texas Corporations Survey set forth in detail, in its criticism of the Corpus Christi Court of Appeals' decision in *Kingston v. Helm*,³⁶ the reasons why the personal liability imposed by agency law for torts

30. See *Leitch v. Hornsby*, 935 S.W.2d 114, 177 (Tex. 1996).

31. See, e.g., West & Treadway, *supra* note 11, at 812.

32. In torts unrelated to the negotiation of freely bargained contracts, the authors acknowledge that there are sound policy reasons for holding agents personally liable for intentional torts in the service of their corporate principals. Certainly the defense of "I was only following orders" should never be countenanced in such circumstances. The authors do believe, however, that torts arising from contractual arrangements are fundamentally different and, as will be seen later, have the benefit of Article 2.21 of the Texas Business Corporations Act. Indeed, the Texas Supreme Court has implicitly recognized this distinction by holding that a corporate officer is not personally liable for tortiously interfering with a contract between the corporation and another party, unless the corporate officer "act[ed] in a fashion so contrary to the corporation's best interests that his actions could only have been motivated by personal interests." *Holloway v. Skinner*, 898 S.W.2d 793, 796 (Tex. 1995).

33. See West, *supra* note 13, at 1226-30; West & Treadway, *supra* note 11, at 811-16; West & Chao, *supra* note 6, at 1403-08.

34. TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon 2003).

35. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003).

36. *Kingston v. Helm*, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2003, pet. denied).

arising from a corporate officer's actions on behalf of her corporation in connection with her negotiation and execution of a corporate contract fall within the statutory parameters of Article 2.21 by its explicit terms.³⁷ First, it is clear that a corporate officer acting within the scope of her authority on behalf of the corporation, as an agent of the corporation, is an "affiliate" of the corporation within the understood meaning of that term.³⁸ By definition, a corporate agent is under the control of her corporate principal; otherwise there is no agency.³⁹ Second, any tort relating to fraud or misrepresentation with respect to a contract is a "matter relating to or arising from" that contractual obligation within the meaning of Article 2.21.⁴⁰ Indeed, as the Fifth Circuit noted during this Survey period in *Benchmark Electronics v. J.M. Huber Corporation*,⁴¹ in Texas it is even possible to base a fraud claim entirely on the specific contractual representations set forth in a contract.

Finally, the other party to a corporate contractual obligation has every opportunity to bargain for a contractual guarantee from any individual, including the corporate agent executing the obligation in the name of her corporate principal. Allowing unbargained-for individual liability on corporate obligations, through claims of fraud and misrepresentation, violates the sanctity of contract that Texas courts repeatedly assert has long been valued in Texas.⁴²

Given these factors, coupled with the explicit statement in Article 2.21 that the remedy set forth therein "is exclusive and preempts any other liability . . . under common law or otherwise,"⁴³ it is difficult to under-

37. See West & Chao, *supra* note 6, at 1403-08.

38. This result is compelled by the general agency principles set forth earlier in this Survey. If one of the central tenets of agency is the principal's right to control the acts of her agent, and if the same rules of agency that apply to individuals apply equally to a corporate principal and its officer agents, one would be hard pressed to argue that a corporate officer is not within the common definition of an affiliate, i.e., "a person controlled by or under common control with the other person." See *Burnside Air Conditioning & Heating, Inc. v. T.S. Young Corp.*, 113 S.W.3d 889, 896 (Tex. App.—Dallas 2003, no pet.); West & Chao, *supra* note 6, at 1406 n.85 (defining "affiliate").

39. See *Northwinds Abatement, Inc. v. Employers Ins. of Wausau*, 258 F.3d 345, 351 (5th Cir. 2001); *Royal Mortgage Corp. v. Montague*, 41 S.W.3d 721, 733 (Tex. App.—Fort Worth 2001, no pet.).

40. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003). In addition, several cases decided during this Survey period reinforce the arguments made in last year's Texas Corporations Survey about the breadth of language used in Article 2.21. See *Von Grafenreid v. Craig*, 246 F. Supp. 2d 553, 560 (N.D. Tex. 2003) (finding that a claim for misrepresentations made in connection with the negotiation of a guaranty contract is clearly a claim that "aris[es] out of and 'relate[s]' to the [contract]."); *Sport Supply Group, Inc. v. Columbia Cas. Co.*, 335 F.3d 453, 465 (5th Cir. 2003) (using a broad construction of the term "arising out of"); *Resendez v. Pace Concerts, Inc.*, No. 07-02-0168-CV, 2003 WL 22207641, at *1 (Tex. App.—Amarillo Sept. 24, 2003, pet. filed) (holding that a fraudulent inducement claim depends on the existence of an otherwise enforceable contract and if the contract is unenforceable because of the application of the Statute of Frauds, fraudulent inducement claim cannot lie.)

41. *Benchmark Elecs. v. J.M. Huber Corp.*, 343 F.3d 719 (5th Cir. 2003); see discussion *infra* at Part IV.B.

42. See *In re Wells Fargo Bank Minn. N.A.*, 115 S.W.3d 600, 607 (Tex. App.—Houston [14th Dist.] 2003, orig. proceeding); see also West *supra* note 13, at 1230.

43. TEX. BUS. CORP. ACT ANN. art. 2.21(B) (Vernon 2003).

stand how Article 2.21 could be interpreted as *not* preempting this general rule of agency law with regard to an agent's liability for fraud or misrepresentation in connection with a contractual obligation entered into by the agent on behalf of her corporate principal. When presented with an opportunity to apply Article 2.21 to claims against corporate officers arising from or related to the negotiation or execution of a corporate contractual obligation (including alleged acts of fraud or misrepresentation in connection with the creation of those contractual obligations), however, Texas courts continued, during this Survey period, to fall back on this second general exception to agent non-liability. Texas courts continue to hold corporate officers individually liable for such torts on the basis that the corporate officer personally participated in the wrongful act (e.g., made the misrepresentation in connection with the contract being entered into), even if done so solely in her capacity as an agent of the corporation.⁴⁴

One case decided during this Survey period that offers a textbook example of this failure to properly apply Article 2.21 is *Gore v. Scotland Golf, Inc.*⁴⁵ In *Gore*, Scotland Golf, Inc. ("SGI") brought suit against Bruce Gore, the president and majority holder of the stock of Ocean Club, Inc. ("Ocean Club"), a golf-related business corporation, for alleged fraud in connection with the sale of the "Gauge," a particular piece of golf equipment, by Ocean Club to SGI. Specifically, SGI alleged that Bruce Gore misrepresented both the business relationship between Ocean Club and Golfsmith, the largest customer for the Gauge, and the existence of exclusive rights for Ocean Club to manufacture and sell the Gauge.⁴⁶

The San Antonio Court of Appeals affirmed the trial court judgment against Gore in his personal capacity, even though (i) the jury failed to find Ocean Club liable as a corporation, (ii) the court specifically disregarded any claims as to piercing the corporate veil, and (iii) there were no allegations that Bruce Gore undertook to personally guarantee the obligations of Ocean Club under the asset sale agreement. Citing *Kingston*⁴⁷ and stating "the law is well-settled that a corporate agent can be held individually liable for fraudulent statements or knowing misrepresentations even when they are made in the capacity of a representative of the

44. See, e.g., *Dominquez v. Payne*, 112 S.W.3d 866, 868 (Tex. App.—Corpus Christi 2003, no pet.) (considering a claim against a corporation, its sales representative, and its majority shareholder for misrepresentation in connection with a sale of land); *Boissiere v. Nova Capital, LLC*, 106 S.W.3d 897, 902 (Tex. App.—Dallas 2003, no pet.) (holding that a corporate agent is individually liable for misrepresentations made on behalf of his or her corporation); *SITQ E.U., Inc. v. Reata Rests., Inc.*, 111 S.W.3d 638, 651 (Tex. App.—Fort Worth 2003, pet. denied) (restating general rule that "corporate agents are individually liable for fraudulent or tortious acts committed while in the service of their corporation").

45. *Gore v. Scotland Golf, Inc.*, No. 04-01-00548-CV, 2003 WL 553271, at *1 (Tex. App.—San Antonio Feb. 28, 2003, pet. denied).

46. *Id.* at *1-2.

47. *Kingston v. Helm*, 82 S.W.3d 758, 759 (Tex. App.—Corpus Christi 2002, pet. denied).

corporation,”⁴⁸ the court had little trouble reaching its decision.

Any tortious act taken by Bruce Gore was taken in his capacity as agent for Ocean Club, the corporate entity actually entering into the contract to sell the Gauge and the entity that was to directly benefit from the sale agreement entered into with SGI and the only party to the purchase agreement other than SGI. Similarly, any fraud or misrepresentation by Bruce Gore arose out of or related to that purchase agreement, as the alleged fraud was clearly designed to induce SGI to buy the Gauge pursuant to the terms of the negotiated purchase agreement. As a result, Bruce Gore, as a corporate officer acting on behalf of Ocean Club and therefore as an affiliate of Ocean Club,⁴⁹ should have been entitled to rely upon Article 2.21. Under Article 2.21, any individual claim of fraud against Bruce Gore should have been rejected unless the plaintiff could demonstrate that Bruce Gore committed “actual fraud . . . primarily for the direct personal benefit of [Bruce Gore].”⁵⁰ Perhaps that may have been demonstrated in this case, but by failing to even consider the appropriate test, Bruce Gore was deprived of the statutory benefits of Article 2.21 to which these authors believe he was entitled.⁵¹

It is important to note that the rule of agency cited by the *Gore* court—that an agent remains responsible for her own torts—has no applicability to a corporate shareholder; any personal liability for Bruce Gore in this capacity would need to be premised on a veil-piercing theory, a theory specifically disregarded by the court.⁵² Bruce Gore, the corporate officer, as opposed to Bruce Gore the majority stockholder, was simply the corporate agent (i.e., an “affiliate”) through which Ocean Club executed its corporate policy. Despite these factors, the Corpus Christi Court of Appeals imposed personal liability on Bruce Gore, in his capacity as a corporate agent, without even a passing reference to Article 2.21.

Although it remains remarkable that decisions such as *Gore* are being handed down without even a discussion of the potential applicability of Article 2.21, the authors do note with approval the recent decision of the Texas Supreme Court in *Southern Union Co. v. City of Edinburg*,⁵³ In *Southern Union*, the Texas Supreme Court correctly applied Article 2.21 in the context of a claim against the affiliates of a corporation based on the theory of “single business enterprise”⁵⁴ and overturned the decision

48. *Gore*, 2003 WL 553271, at *4.

49. See West & Chao, *supra* note 6, at 1406 n.84.

50. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003).

51. Because Bruce Gore was the majority shareholder of Ocean Club he was clearly an indirect beneficiary of the fraud, but that would be true any time a corporate officer was also an owner of shares in his corporation. By requiring a showing of “direct personal benefit,” the authors believe that something more than the indirect benefit derived from owning shares is contemplated by Article 2.21.

52. Of course, had a veil-piercing theory been considered by the court, Article 2.21 should have applied to that theory as well.

53. *S. Union Co. v. City of Edinburg*, No. 01-0785, 2003 WL 22495756, at *1 (Tex. Oct. 31, 2003).

54. *Id.* at *10-14.

of the Corpus Christi Court of Appeals in *Rio Grande Valley Gas Co. v. City of Edinburg*,⁵⁵ a decision discussed, and criticized, in the 2002 Texas Corporations Survey.⁵⁶ The decision in *Rio Grande* saw the court impose a four percent franchise fee contained in a contract between the City of Edinburg and Rio Grand Valley Gas Co. (“RGVG”), a subsidiary of Valero Energy Corporation (“Valero”), on Valero and other corporate affiliates of RGVG. The court based its holding on the theory that the affiliate corporations at issue were a “single business enterprise” and that Valero had used its corporate affiliates as a sham to perpetrate a fraud, which the court interpreted as requiring only proof of *constructive* fraud. The 2002 Texas Corporations Survey criticized this analysis for its failure to even mention Article 2.21 and its failure to apply the correct standard for liability as required by Article 2.21, which is a showing of *actual* fraud for the direct personal benefit of the affiliate.⁵⁷

In *Southern Union*, the supreme court applied the same analysis as that set forth in the 2002 Texas Corporations Survey and found that the affiliates were not liable for the four percent franchise fee contained in the contract entered into solely by RGVG. The supreme court emphatically endorsed the notion that Article 2.21 is the exclusive means for imposing liability on shareholders and affiliates of a corporation with respect to contractual matters. Specifically the supreme court stated that, “whatever label might be given to the City’s attempt to treat the Valero entities as a single entity, [A]rticle 2.21 of the Texas Business Corporation Act controls.”⁵⁸ and that “[A]rticle 2.21 is the exclusive means for imposing liability on a corporation for the obligations of another corporation in which it holds shares.”⁵⁹ Additionally, the Court held that actual fraud, as required by Article 2.21, was the correct burden and that the facts of the case did not support such a finding, thus relieving the Valero affiliates from any obligations under the four percent franchise fee. The analysis by the Texas Supreme Court in *Southern Union* gives the authors some continued hope that this thoughtful application of Article 2.21 will see continued expansion to protect officers (who are also “affiliates”) of the corporation in cases like *Gore*.

III. FIDUCIARY DUTIES

This Survey period saw Texas courts hand down several decisions regarding the fiduciary duties owed by the directors and officers of a Texas corporation. It is one of the most basic tenets of corporate law that the directors and officers of a corporation owe fiduciary duties to their corpo-

55. *Rio Grande Valley Gas Co. v. City of Edinburg*, 59 S.W.3d 199 (Tex. App.—Corpus Christi 2000), *aff’d in part and rev’d in part*, 2003 WL 22495756 (Tex. Oct. 31, 2003).

56. *See West & Treadway, supra* note 11, at 809-11.

57. *See id.*

58. *Rio Grande Valley*, 2003 WL 22495756 at *11.

59. *Id.* at *12.

ration, including the duties of care and loyalty.⁶⁰ However, several jurisdictions are beginning to recognize expansions to the scope of these duties in certain contexts. During this Survey period, Texas courts considered whether fiduciary duties are owed to the creditors of a corporation as it approaches insolvency.

Historically, fiduciary duties ran solely to the corporation, and the corporation's creditors were protected only to the extent they could negotiate contractual protection.⁶¹ A growing number of jurisdictions, however, are finding the existence of such a fiduciary duty to the corporation's creditors when the corporation approaches insolvency.⁶²

Consistent with this growing trend is the holding of the United States District Court for the Northern District of Texas in *In re Brentwood Lexford Partners*.⁶³ In *Brentwood*, the officers of BLP, a limited liability company, distributed excess cash flow to its members at the same time that the company failed to make a payment on a promissory note. After the holders of the note accelerated payment following the default, the officers resigned and formed a competing company.

In discussing whether a claim for breach of fiduciary duty could be maintained by the holders of the note against the officers of BLP, the court, applying Texas law, stated that while generally the officers of a

60. See *Lewis v. Knutson*, 699 F.2d 230, 235 (5th Cir. 1983); *Resolution Trust Corp. v. Acton*, 844 F. Supp. 307, 313 (N.D. Tex. 1994), *aff'd*, 49 F.3d 1086 (5th Cir. 1995). It is interesting to note, in light of the discussion in Part II above, that these fiduciary duties have their origin in the fiduciary duties owed by all agents to their principals. See *Tractebel Energy Mktg., Inc. v. E.I. DuPont De Nemours & Co.*, 118 S.W.3d 60, 71-72 (Tex. App.—Houston [14th Dist.] 2003, no pet.); *Vogt v. Warnock*, 107 S.W.3d 778, 782 (Tex. App.—El Paso 2003, pet. denied). In *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503, 510 (Tex. App.—Houston [1st Dist.] 2003, no pet.), the court noted that a corporate employee as agent of his corporate principal is a fiduciary who “has a duty to act primarily for the benefit of the employer in matters connected with his agency.” Further, the corporate employee has the “duty not to compete with the principal on his own account in matters relating to the subject matter of the agency and the duty to deal fairly with the principal in all transactions between them.” *Id.* Notwithstanding the foregoing, that fiduciary duty, in the absence of an enforceable agreement to the contrary, does not prevent the employee from competing with his principal after the agency ends. In fact, a corporate employee's fiduciary duty does *not* prevent an employee “from making preparations for a future competing business venture . . . [and he] has no general duty to disclose [those] plans and [he] may secretly join with other employees in the endeavor without violating any duty to the employer.” *Id.*

61. See *Dollar v. Lockney Supply Co.*, 164 S.W. 1076, 1079 (Tex. App.—Amarillo 1914, no writ) (“The relation of a director to stockholders or to the corporation, we think, is one of trustee, as held by the wright of authorities . . . but as to creditors or strangers they are agents of the corporation.”); see also *Geyer v. Ingersoll Publications Co.*, 621 A.2d 784, 787 (Del.Ch. June 18, 1992) (“the general rule is that directors do not owe creditors duties beyond the relevant contractual terms”); cf. *Myer v. Cuevas*, 119 S.W.3d 830, 836 (Tex. App.—San Antonio 2003, no pet.) (“[c]orporate officers owe fiduciary duties to the corporations they serve . . . [but] corporate officers do not owe fiduciary duties to individual shareholders unless a contract or special relationship exists between them in addition to the corporate relationship.”).

62. See, e.g., *In re Hechinger Inv. Co.*, 280 B.R. 90, 92 (Bankr. D. Del. 2002).

63. See *In re Brentwood Lexford Partners, LLC*, 292 B.R. 255 (Bankr. N.D. Tex. 2003); *In re Subpoena Issued to Dennis Friedman*, 286 B.R. 505, 508 (S.D.N.Y. 2002); *In re Joy Recovery Technology Corp.*, 286 B.R. 54 (Bankr. N.D. Ill. 2002).

corporation owe a fiduciary duty to the corporation and its shareholders, "when a corporation enters the zone of insolvency, the fiduciary duty shifts from the shareholders to the creditors of the corporation."⁶⁴ Although in the instant case the court held that the fiduciary claims failed,⁶⁵ the implicit adoption by the bankruptcy court of this rule under Texas law is certainly worth noting, although most Texas corporate attorneys have long advised their clients of the existence of this shifting or expanding duty concept in the "zone of insolvency."

In contrast, in *Prostok v. Browning*⁶⁶ the Dallas Court of Appeals questioned whether any fiduciary duties were owed to Browning by a Texas corporation outside of its dissolution. In *Prostok*, the junior bondholders of National Gypsum Company ("National Gypsum") brought a series of claims, including claims for breach of fiduciary duty, against the officers and directors of National Gypsum for actions taken in connection with its bankruptcy. The junior bondholders alleged that the officers and directors of National Gypsum, along with the senior bondholders and other parties in interest, intentionally manipulated the financial data of the company so as to undervalue the amounts that the junior bondholders received in its reorganization.⁶⁷

With respect to whether fiduciary duties were owed under Texas law by the officers and directors to the creditors of National Gypsum by virtue of it being an insolvent corporation, the court held that the junior bondholders had waived any claim by not asserting it in their appeal. However, the court did suggest in dicta that it doubted that any fiduciary duties to the bankrupt corporation's creditors existed. It stated that any fiduciary claim would exist under the so called "trust fund doctrine," and that such doctrine (i) only existed during the dissolution of a corporation, not in a reorganization and (ii) that Texas Business Corporations Act Article 7.12,⁶⁸ the statutory source of the doctrine, does not create any fiduciary duties owed to the creditors of a corporation.⁶⁹

The court did hold that the officers and directors of National Gypsum had a fiduciary duty to the junior bondholders as a result of their status as officers of a debtor-in-possession under the federal bankruptcy laws, but as this claim was premised on federal law, it is outside the scope of this Survey.⁷⁰ Taken together, *Prostok* and *Brentwood* suggest some uncer-

64. *Id.* at 272.

65. With respect to the claim that the transfer of the excess cash flow to the owners of the company when the officers knew that the company would not be able to make its payment on the promissory note violated a fiduciary duty owed to the creditors of the corporation, the court held that the acquiescence of the noteholder to the distribution plan barred its claim on the doctrine of equitable estoppel. With respect to the claim that the officers of BLP breached a fiduciary duty by leaving the company to form a competing company, the court held that the officers did not breach any duty as they were not bound by a non-competition agreement. *See id.* at 272-273.

66. *Prostok v. Browning*, 112 S.W.3d 876 (Tex. App.—Dallas 2003, pet. filed).

67. *Id.* at 886.

68. *See* TEX. BUS. CORP. ACT ANN. art 7.12 (Vernon 2003).

69. *Prostok*, 112 S.W.3d at 907-08.

70. *See id.* at 910-11.

tainty as to whether Texas has adopted or will formally adopt the rule of other jurisdictions regarding the scope of fiduciary duties owed as a corporation approaches insolvency.

IV. CONTRACT CONSTRUCTION AND DRAFTING

A. SANCTITY OF CONTRACT V. FRAUDULENT INDUCEMENT

Texas courts have a longstanding respect for the freedom of contract and for the terms of a freely bargained agreement.⁷¹ Several cases decided during this Survey period highlighted the commitment of the Texas courts to enforcement of the agreed upon terms of a contract as written.⁷² Additionally, this principle served as the underpinning of an en banc rehearing and reversal of a decision discussed in last year's Texas Corporations Survey that had demonstrated a less stalwart commitment to this ideal.

Last year's Texas Corporations Survey criticized the willingness of at least one divided Texas appellate court, in *DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*,⁷³ to allow a fraudulent inducement claim to undermine the sanctity of an otherwise unambiguous written contract.⁷⁴ During this Survey period, a divided en banc panel of that same court granted the appellant's motion for rehearing and substituted a new opinion in place of the one issued during last year's Survey period.⁷⁵ In its new opinion, the majority basically adopted the position of the dissent in the prior opinion—the position with which the 2003 Texas Corporations Survey agreed—and the dissent in the new opinion basically adopted the position of the majority in the prior opinion. Recognizing that a fundamental element of a claim of fraudulent inducement is not only that there was a misrepresentation made in connection with a contract being entered into, but also that “the plaintiff actually *and justifiably* relied on the misrepresentation” in entering into that contract,⁷⁶ a majority of the en banc panel held that “reliance upon an oral representation that is directly contradicted by the express, unambiguous terms of a written agreement

71. See *In re Wells Fargo Bank Minnesota N.A.*, 115 S.W.3d 600, 607 (Tex. App.—Houston [14th Dist.] 2003) (orig. proceeding) (stating, in upholding contractual jury waivers in a case of first impression in Texas, that Texas has a “strong commitment to the principle of contractual freedom” quoting *Churchill Forge, Inc. v. Brown*, 61 S.W.3d 368, 371 (Tex. 2001)).

72. See *Wells Fargo Bank*, 115 S.W.3d at 611-12 (enforcing contractual jury waiver); *Dorsett v. Cross*, 106 S.W.3d 213, 219-20 (Tex. App.—Houston [1st Dist.] 2003, pet. denied) (interpreting contractual terms to determine that failure to satisfy condition precedent did not excuse other parties duty to perform on theory that “the rules of contractual interpretation require us to give the language in an agreement its plain grammatical meaning unless to do so would defeat the intent of the parties”).

73. *DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*, No. 14-01-00507, 2002 WL 31318550 (Tex. App.—Houston [14th Dist.] Oct. 17, 2002) (opinion withdrawn).

74. See West & Chao, *supra* note 6, at 1415-21.

75. *DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*, 112 S.W.3d 854 (Tex. App.—Houston [14th Dist.] 2003, pet. filed).

76. *Id.* at 858 (emphasis in original).

between the parties is not justified as a matter of law.”⁷⁷

The “bright line” rule established by *DRC Parts* favoring the sanctity of the written agreement over claims of fraudulent inducement is welcomed by these authors as consistent with the law’s requirement that a person in an arm’s length transaction read an agreement to which it is a party⁷⁸ and “exercise ordinary care and reasonable diligence for the protection of his own interests.”⁷⁹ This ruling is also consistent with the purposes for which written agreements (as opposed to oral agreements) exist “to provide greater certainty regarding what the terms of the transaction are and that those terms will be binding, thereby lessening the potential for error, misfortune and dispute.”⁸⁰ Simply stated, the parties to a written agreement “should be able to rely on the finality of freely bargained agreements.”⁸¹

77. *Id.* While not as “bright line” as the court’s decision in *DRC Parts*, the Fifth Circuit also denied a fraudulent inducement claim during the Survey period for failure to show justifiable reliance where a plaintiff “blindly relied on . . . [an] oral assurance . . . without requesting written confirmation or consulting with a tax or investment professional.” *Lewis v. Bank of Am., N.A.*, 343 F.3d 540, 547 (5th Cir. 2003). *But see*, *Young v. Neatherlin*, 102 S.W.3d 415, 418 (Tex. App.—Houston [14th Dist.] 2003, no pet.) (stating that parol evidence is “admissible to show whether a party was fraudulently induced to enter into the contract.”). This Survey period also brought forth a case reminding us that carefully drafting “entire agreement” clauses in the context of the particular agreement can be helpful in defeating fraudulent inducement claims. *Armstrong v. American Home Shield Corp.*, 333 F.3d 566, 570-71 (5th Cir. 2003). When multiple agreements are entered into, entire agreement clauses can be particularly tricky to draft. *See* *Perlstein v. D. Steller 3, Ltd.*, 109 S.W.3d 36 (Tex. App.—Corpus Christi 2003, pet. denied).

78. *See In re Media Arts Group, Inc.*, 116 S.W.3d 900, 908 (Tex. App.—Houston [14th Dist.] 2003, pet. denied) (stating that “under Texas law, a person is obligated to protect himself by reading what he signs and, absent fraud, may not excuse himself from the consequences of failing to meet that obligation”). *See also*, *Ross v. Citifinancial, Inc.*, 344 F.3d 458, 464 (5th Cir. 2003) (upholding the district court’s ruling that “under Mississippi law, a plaintiff has a duty to read a contract before signing it and cannot reasonably rely on oral misrepresentations regarding its terms.”).

79. *DRC Parts & Accessories, L.L.C.*, 112 S.W.3d at 858 (citing *Thigpen v. Locke*, 363 S.W.2d 247, 251 (Tex. 1962)). *See also* *Lewis v. Bank of Am. N.A.*, 343 F.3d 540, 546 (5th Cir. 2003) (quoting *Field v. Mans*, 516 U.S. 59, 71 (1995) (citing RESTATEMENT (SECOND) OF TORTS § 541 cmt. a (2003))) (stating that “a plaintiff cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory inspection.”).

80. *DRC Parts*, 112 S.W.3d at 858; *see also* *Natural Gas Clearinghouse v. Midgard Energy Co.*, 113 S.W.3d 400, 407-09 (Tex. App.—Amarillo 1999, pet. filed) (holding that parties to a contract choose the terms they agree to be bound by in a written contract and failure to provide for a specific contingency is their own fault). This rule also means that even outside claims of fraudulent inducement, extrinsic evidence of the meanings of terms used in an otherwise unambiguous contract may not be admitted. *Standard Constructors, Inc. v. Chevron Chem. Co., Inc.*, 101 S.W.3d 619, 624 (Tex. App.—Houston [1st Dist.] 2003, pet. denied). *But see*, *Carrico v. Kondos*, 111 S.W.3d 582, 587 (Tex. App.—Fort Worth 2003, pet. denied) (“A recital of acknowledgement of consideration is no more than a statement of fact that may be contradicted by parol evidence.”).

81. *Barker v. Roelke*, 105 S.W.3d 75, 84 (Tex. App.—Eastland 2003, pet. denied). It is important to note, however, that this bright line rule only applies in “freely bargained” arm’s length transactions and if there has been mutual mistake, unconscionability, duress or the breach of fiduciary duty in connection with the execution of the contract, this bright line rule would not apply. *See, e.g.*, *Sabre, Inc. v. Lyn-Lea Travel Corp.*, No. CIV.A.3:96-CV-2068-R, 2003 WL 22203707, at *7 (N.D. Tex. Sept. 23, 2003) (finding a breach of fiduciary duty claimed but not proved); *Bolle, Inc. v. Am. Greetings Corp.*, 109 S.W.3d 827, 837 (Tex. App.—Dallas 2003, pet. denied) (finding a mutual mistake claimed and proved); *Jureczki v. Banc One Texas, N.A.*, 252 F. Supp. 2d 368, 378-79 (S.D. Tex. 2003) (finding

The Houston Court of Appeals, following the decision in *DRC Parts*, has indicated that evidence of fraudulent inducement in relation to the inclusion of an arbitration clause in a contract is similarly inadmissible under Texas law.⁸² This ruling is in conflict with several decisions of other Texas appellate courts, including two decided during this Survey period,⁸³ suggesting that fraud, as it specifically relates to the adoption of forum selection or arbitration clauses, may be used to override the inclusion of such provisions. We hope that more Texas appellate courts in the future will adopt the reasoning of the Houston Court of Appeals in *DRC Parts* and that the Texas Supreme Court, having had the opportunity to settle this split in the circuits, will likewise adopt the well reasoned opinion of the Houston Court of Appeals in *DRC Parts*.

B. DRAFTING EFFECTIVE CHOICE OF LAW AND DISCLAIMER OF EXTRA-CONTRACTUAL REPRESENTATIONS CLAUSES

Consistent with the bright line rule in *DRC Parts*, parties to a transaction should be able to “define the transaction in a writing so as to preclude a claim of fraud based on representations not made, and explicitly disclaimed, in that writing.”⁸⁴ Indeed, Texas has recognized that a contractual provision disclaiming reliance on extra-contractual assurances or representations will be upheld to the extent that the “clause is an important part of the basis of the bargain, not an incidental or ‘boiler-plate’ provision, and is entered into by parties of equal bargaining position.”⁸⁵

unconscionability alleged but not proved), *aff'd*, 2003 WL 22121027 (5th Cir. 2003); *HRN, Inc. v. Shell Oil Co.*, 102 S.W.3d 205, 216 (Tex. App.—Houston [14th Dist.] 2003, pet. granted) (finding duress claimed, but not proved). *See also*, *Cerberus Int’l, Inc. v. Apollo Mgmt., L.P.*, 794 A.2d 1141 (Del. 2002) (important recent Delaware Supreme Court decision regarding reformation of a merger agreement based on mutual or unilateral mistake), as discussed in *Survey—Mergers and Acquisitions*,” 58 *BUS. LAW.* 1521, 1522-23 (Aug. 2003). Impossibility of performance also remains a viable means of effectively altering the terms of an otherwise unambiguous contract where the tough requirements for this defense can be met. *See, e.g.*, *Tractebel Energy Mktg., Inc. v. E.I. DuPont De Nemours & Co.*, 118 S.W.3d 60, 66 (Tex. App.—Houston [14th Dist.] 2003, no pet.) (“[I]mpracticability excuses a party’s breach of contract when the contract itself does not provide an escape clause and the doctrine’s other requirements are satisfied.”).

82. *See In re Media Arts Group, Inc.*, 116 S.W.3d at 909-10.

83. *See In re Whitfield*, 115 S.W.3d 753, 757 (Tex. App.—Beaumont 2003, no pet.) (stating that fraud must specifically relate to the arbitration agreement to defeat an arbitration clause); *My Café CCC, Ltd. v. Lunchstop, Inc.*, 107 S.W.3d 860, 866 (Tex. App.—Dallas 2003, no pet.) (stating that “[a] forum selection clause may be set aside if it is induced by fraud.”). *See also* *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n.14 (1974); *In re First Merit Bank*, 52 S.W.3d 749, 756 (Tex. 2001).

84. *Harsco Corp. v. Segui*, 91 F.3d 337, 339 (2d Cir. 1996).

85. *Prudential Ins. Co. of Am. v. Jefferson Assocs., Ltd.*, 896 S.W.2d 156, 162 (Tex. 1995); *see also*, *Bynum v. Prudential Residential Servs., Ltd. P’ship*, No. 01-02-00747-CV, 2003 WL 22456111, *9 (Tex. App.—Houston [1st Dist.] Oct. 30, 2003, no pet. h.) (superceded by No. 01-02-00747-CV, 2004 WL 440412 (Tex. App.—Houston [1st Dist.] Mar. 11, 2004)); *Proctor v. RMC Capital Corp.*, 47 S.W.3d 828, 833 (Tex. App.—Beaumont 2001, no pet.); *Yzaguirre v. KCS Res., Inc.*, 47 S.W.3d 532, 542-43 (Tex. App.—Dallas 2001), *aff’d*, 53 S.W.3d 368, 375 (Tex. 2001). If the provision is boiler-plate, not subject to negotiation, or set forth in a contract with an unsophisticated party, however, the provision will not be upheld. *See, e.g.*, *Oakwood Mobile Homes, Inc. v. Cabler*, 73 S.W.3d 363, 369-

Because an essential element of either fraud, fraudulent inducement, or negligent misrepresentation is “justifiable reliance” by the aggrieved party on a specific representation or assurance given by the other party,⁸⁶ “where a party specifically disclaims reliance upon a particular representation in a contract, that party cannot, in a subsequent action for common-law fraud, claim it was fraudulently induced to enter into the contract by the very representation it has disclaimed reliance upon.”⁸⁷

Recognizing that it is possible to defeat a fraud claim based on a clearly expressed and freely bargained for disclaimer of reliance on extra-contractual representations⁸⁸ does not mean that a fraud claim cannot still be brought based on the representations that are set forth in the written agreement. While a breach of contract, even a negligent, grossly negligent or intentional breach, is not a tort and cannot give rise to exemplary damages,⁸⁹ Texas recognizes that under the right facts “a party’s acts may breach duties in tort or contract alone or simultaneously in both.”⁹⁰ Determining whether a party’s actions constitute a breach of contract, a tort, or a combination of the two, depends on whether the complained-of conduct violates “an independent legal duty, separate from the existence of the contract itself.”⁹¹ If, in order to maintain its cause of action, “a party must prove the contents of its contract and must rely on the duties created therein” then the action is one in contract only.⁹² If, on the other hand, a party’s complained of conduct would be legally actionable regardless of whether the parties had entered into a contractual relationship (i.e., the conduct breached a duty arising by law outside of the contractual duties set forth in the contract, even if the complaining party is relying on representations explicitly set forth in the contract) then the action may be maintained as one arising in tort.⁹³ Texas courts have long “recognized that a fraud claim can be based on a promise made with no intention of performing, irrespective of whether the promise is later subsumed within

73 (Tex. App.—El Paso 2002, pet. denied); *Burleson State Bank v. Plunkett*, 27 S.W.3d 605, 615-16 (Tex. App.—Waco 2000, pet. denied).

86. See *Bynum*, 2003 WL 22456111 at *11.

87. *Harsco Corp.*, 91 F.3d at 345; see also, *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex. 1997).

88. See *Proctor*, 47 S.W.3d at 831-32 (considering a particularly expansive and clear disclaimer clause). It is important to note that this rule was not always so clear in Texas. See, e.g., *Roy Klossner Co. v. McIntire*, 301 S.W.2d 197, 201 (Tex. Civ. App.—San Antonio 1957, writ refused n.r.e.) (stating that Texas law is settled that “fraud, either in the inducement or in the execution, may be proved despite clauses in the contract that state otherwise.”).

89. *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986).

90. *Shell Oil Prods. Co. v. Main Street Ventures, L.L.C.*, 90 S.W.3d 375, 381 (Tex. App.—Dallas 2002, pet. dismissed by agr.) (citing *Jim Walters Homes*, 711 S.W.2d at 618); see also, *Cont’l Dredging, Inc. v. De-Kaizerred, Inc.*, 120 S.W.3d 380, 389 (Tex. App.—Texarkana 2003, pet. filed) (“A mere breach of contract alone is not sufficient to be a false, misleading, or deceptive act under the DTPA.”).

91. *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998).

92. *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 496 (Tex. 1991) (Gonzalez, J., concurring).

93. *Formosa Plastics Corp. USA*, 960 S.W.2d at 47.

a contract"⁹⁴ because "it is well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself."⁹⁵

Against this backdrop is *Benchmark Electronics, Inc. v. J.M. Huber Corp.*,⁹⁶ a Fifth Circuit decision decided during this Survey period construing a stock purchase agreement governed by New York law. Benchmark Electronics, a Texas corporation with its principal operations in Texas, brought suit against J.M. Huber Corporation, a New Jersey corporation based in New Jersey alleging "the breach of various contract provisions, fraud and negligent misrepresentation" in connection with the purchase by Benchmark of the stock of J.M. Huber Corporation's Alabama based subsidiary, AVEX.⁹⁷ The district court, applying New York law to both the contract and tort claims, granted summary judgment to J.M. Huber Corporation. On appeal, the Fifth Circuit vacated the district court's summary judgment. In doing so, the court noted that while "New York law governs Benchmark's contract claims, Texas law applies to its fraud, statutory fraud and negligent misrepresentation claims."⁹⁸

The court based this distinction upon the fact that the AVEX purchase agreement only provided that the "Agreement shall be governed by, and construed in accordance with, the internal laws of the State of New York."⁹⁹ Noting that "Texas law requires an issue-by-issue choice of law analysis" and that the quoted contractual provision "is narrow because it deals only with the construction and interpretation of the contract," the court held that "Benchmark's claims of fraud and negligent misrepresentation are not governed by the parties' narrow choice of law provision."¹⁰⁰ While the court upheld the parties' choice of New York law to govern the contract and any claims based on a breach of the contract, the court found that Texas had "the dominant contacts with the parties and the transaction, . . . [and therefore] the 'most significant relationship' to Benchmark's fraud and misrepresentation claims."¹⁰¹

The AVEX stock purchase agreement contained a provision whereby Benchmark specifically disclaimed reliance on "precontractual represen-

94. *Id.* at 46.

95. *Id.*

96. *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719 (5th Cir. 2003).

97. *Id.* at 722.

98. *Id.* at 731.

99. *Id.* at 726-27.

100. *Id.* (citing *Stier v. Reading & Bates Corp.*, 992 S.W.2d 423, 433 (Tex. 1999)); *Busse v. Pacific Cattle Feeding Fund No. 1, Ltd.*, 896 S.W.2d 807, 812-13 (Tex. App.—Texarkana 1995, writ denied).

101. *Benchmark Elecs., Inc.*, 343 F.3d at 728. In the absence of an effective contractual choice of law clause, "Texas courts use the Restatement's 'most significant relationship' test to decide choice of law issues." *Id.* at 727 (citing *Hughes Wood Prods., Inc. v. Wagner*, 18 S.W.3d 202, 205 (Tex. 2000)). While the due diligence data room was in New York, the transaction was negotiated in part in New York, the original stock purchase agreement was executed in New York, and the closing occurred in New York, Benchmark was "a Texas company with its principal place of business in Angleton, Texas. The alleged injury occurred to Benchmark in Texas, and it arose from misrepresentations made in or directed to this state." *Id.* at 728.

tations" not expressly set forth in the agreement. The stock purchase agreement also set forth a number of express contractual representations "dealing with the same subject matter as Huber's precontractual representations."¹⁰² Applying New York law to determine the effectiveness of the disclaimer provision, the court held that the disclaimer was enforceable, noting that "the specificity of what is warranted by Huber precludes Benchmark, a sophisticated business entity, from claiming reliance upon other precontractual representations covering the same subjects."¹⁰³ As noted previously, it is likely the disclaimer clause would have also been upheld under Texas law.¹⁰⁴

At this point, however, the limited nature of the parties' choice of law provision becomes critical. According to the court, unlike Texas, "New York substantive law affords Benchmark no claim for extracontractual fraud and misrepresentation claims."¹⁰⁵ Accordingly, based on the Fifth Circuit's analysis, had the parties' choice of law clause governed the entire relationship between the parties (including tort claims arising from or related to the subject matter of the contract) and not just the contractual relationship between the parties, the decision of the court to uphold the disclaimer clause would have defeated any tort claim under New York law. As noted previously, however, Texas law permits claims based on fraud and negligent misrepresentation even if the representations on which those claims are based are otherwise set forth in a contract.¹⁰⁶ As a result, Benchmark is able to pursue tort damages, including exemplary damages, rather than being limited to only contractual damages, for any contractual representation that Huber is found to have breached.

The lesson from *Benchmark Electronics* is clear. When choosing a law to govern the parties' contractual relationship, determine whether the choice of law clause should cover any tort or statutory claims that might "arise out of or relate to" the subject matter of the contract and understand the effect of having chosen that law on any resulting extra-contractual claims.¹⁰⁷

102. *Id.* at 729.

103. *Id.* (emphasis added).

104. *See Harsco Corp. v. Sequi*, 91 F.3d 337, 345 (2d Cir. 1996).

105. *Benchmark Elecs., Inc.*, 343 F.3d at 726; *see also Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex. 1997). *See Animal Protective Found. of Schenectady, Inc. v. Bast Hatfield, Inc.*, 306 A.D.2d 683, 684 (N.Y. App. Div. 2003) ("A cause of action alleging fraud cannot be maintained when the fraud charged relates to a breach of contract.") (quoting *Middle Country Cent. School Dist. v. J.F. O'Healy Constr. Corp.*, 230 A.D.2d 777, 778 (N.Y. App. Div. 1996)); *Todd v. Grandoe Corp.*, 302 A.D.2d 789, 791 (N.Y. App. Div. 2003) ("Where, as here, the alleged fraud is indistinguishable from the breach of contract, no fraud cause of action arises."); *Salvador v. Uncle Sam's Auction & Realty, Inc.*, 307 A.D.2d 609, 611 (N.Y. App. Div. 2003) ("[I]t is well settled that a cause of action for fraud does not arise when, as here, the fraud alleged relates to a breach of contract.") (quoting *Fourth Brach Assoc. Mechanicville v. Niagra Mohawk Power Corp.*, 235 A.D.2d 962, 963 (N.Y. App. Div. 1997)).

106. *See Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998).

107. The authors can find no case that clearly holds that a contractual choice of law provision purporting to govern a future tort claim will be enforced. However, the case law

C. CONTRACT FORMATION—LETTERS OF INTENT

The letter of intent continued to be a subject of Texas case law during this Survey period. Letters of intent are a much used tool in corporate practice in Texas, as elsewhere, to indicate the general terms of an agreement prior to the negotiation and execution of more formal and definitive documentation.¹⁰⁸ Texas courts recognize that a purported letter of intent can be either a true letter of intent, i.e., one that is “non-binding,” or a preliminary agreement, i.e., one that is binding notwithstanding that further more formal documentation is expressly contemplated by the letter.¹⁰⁹ Given the propensity of Texas courts (and the courts of other states) to find binding agreements from purported letters of intent, the Texas Corporations Survey in each of the last three years has repeatedly urged Texas corporate attorneys to be vigilant about including unequivocal statements in their letters of intent that the letters are “non-binding.”¹¹⁰

The seminal Texas case considering letters of intent during the last three Survey periods was *John Wood Group USA, Inc. v. ICO, Inc.*¹¹¹ The *John Wood* court, while noting that a letter of intent that agreed upon the material terms of an agreement, even if other provisions are left open for further negotiations, could in certain situations be binding, held that a contract which expressly stated it was “not binding” would be unenforceable.¹¹² This seemingly straightforward result focused attention on the apparent bullet-proof manner of insuring that a letter of intent is not binding—simply say so in exactly those terms explicitly.

During this Survey period, one Texas court has introduced a new element of uncertainty in the law of letters of intent. In *Opus South Corp. v. Limestone Construction, Inc.*,¹¹³ the United States District Court for the Northern District of Texas held that even when a letter of intent expressly states that it is not binding, as required by *John Wood*, it may still be possible to create a binding agreement from the actions of the parties following the execution of that otherwise non-binding letter of intent.

Opus South Corporation (“Opus”) and Limestone Construction, Inc. (“Limestone”) entered into a letter of intent to form a new entity to develop, construct, lease, and sell apartment communities. The letter of in-

does indicate that contractual choice of law claims are often found not to govern a tort claim because they are drafted too narrowly, not because such a provision, if drafted broadly enough, would not be enforceable. See *Stier v. Reading & Bates Corp.*, 992 S.W.2d 423, 433 (Tex. 1999).

108. West & Treadway, *supra* note 11, at 818.

109. See West & Chao, *supra* note 6, at 1411-15; West & Treadway, *supra* note 11, at 818-23; West *supra* note 13, at 1233-38.

110. See West & Chao, *supra* note 6, at 1411-15; West & Treadway, *supra* note 11, at 818-23; West *supra* note 13, at 1233-38.

111. *John Wood Group USA, Inc. v. ICO, Inc.*, 26 S.W.3d 12 (Tex. App.—Houston [1st Dist.] 2000, pet. denied).

112. *John Wood Group USA, Inc.*, 26 S.W.3d at 15, 20. See generally West, *supra* note 13, at 1233-38.

113. *Opus S. Corp. v. Limestone Constr., Inc.*, No. CIV.A.03-CV-0711-G, 2003 WL 22329033 (N.D. Tex. Oct. 6, 2003).

tent expressly stated “This Letter of Intent is not binding on either Limestone or Opus. . . .”¹¹⁴ Following the execution of the letter of intent, however, the parties took certain actions contemplated by the letter of intent, including the borrowing of funds. Notwithstanding that the letter of intent at issue was expressly non-binding, the *Opus* court stated that, “where the intent of the parties is not clear in the agreement, or when subsequent actions by the parties suggest that they did intend to be bound by an agreement that was expressly non-binding, Texas courts have held that the intent of the parties to be bound becomes a question of fact.”¹¹⁵ As such, even though the letter of intent was stated to be expressly non-binding, the actions of the parties in furtherance of the letter of intent were held by the court to create a question of fact, sufficient to withstand summary judgment, as to whether a valid contract between Limestone and Opus existed.¹¹⁶

Additional cases, including one cited by the *Opus* court¹¹⁷ and one decided during this Survey period,¹¹⁸ support the idea that a binding contract can be created by the subsequent partial performance of a party to an agreement that was otherwise non-binding. Thus, in addition to the admonition repeated in past Texas Corporation Surveys that to make a proposed non-binding letter of intent truly non-binding you must say so in explicit terms, the authors must now add another warning. Parties to an otherwise non-binding letter of intent should not perform under that letter of intent as if it were a binding agreement, other than to complete due diligence and prepare formal documentation, so as to avoid creating a question as to whether they are manifesting a subsequent intent to be bound to that otherwise “non-binding” letter of intent.

V. CONCLUSION

Texas courts have again demonstrated that officers of Texas corporations face potential personal liability to third parties even when acting solely on behalf of and within the express scope of authority granted to them by the corporations for which they act. This potential personal liability is based on the application of common-law agency principles that generally exonerate an agent (i.e., an officer) from any personal liability for actions taken on behalf of a disclosed principal (i.e., the corporation), but which nevertheless hold the agent liable for (i) any torts committed by the agent during her agency,¹¹⁹ and (ii) any contractual obligations entered into by the agent where she fails to clearly evidence the represen-

114. *Id.* at *1.

115. *Id.* at *5 (emphasis added).

116. *Id.*

117. *Murphy v. Seabarge*, 868 S.W.2d 929, 933 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

118. *See Live Oak Ins. Agency v. Shoemaker*, 115 S.W.3d 215, 219 (Tex. App.—Corpus Christi 2003, no pet.) (stating that “Texas has long recognized that a contract can be formed by conduct”).

119. Subject to certain specified exceptions. *See West & Treadway supra* note 11, at 813.

tative nature of her signature or fails to clearly identify her principal as the true party to the contract.¹²⁰ Finally, the personal liability to which a corporate officer is subject for any torts she commits on behalf of her corporation extends to claims of misrepresentation and fraud in connection with the execution of contracts that otherwise clearly and unequivocally state that they are the obligations of the corporation alone and for which the officer's signature is likewise clearly and unequivocally representative.

Except for the Texas Supreme Court's application of Article 2.21 to defeat the effort of one party to a contract to cause affiliates of the other sole corporate party to become liable on that contract under a piercing the corporate veil theory, this Survey period again saw no application of Article 2.21 to relieve Texas corporate officers from the sometimes harsh application of these general agency rules in the context of contractual obligations and the tort claims that frequently arise therefrom. Our protests in past Texas Corporations Surveys concerning the Texas courts' failure to properly apply Article 2.21 in this context have again gone unheeded.

On the other hand, Texas courts demonstrated a refreshingly clear commitment to the sanctity of the written agreement. Reading *DRC Parts* and *Benchmark* together suggests that one may be able to achieve, through carefully drafted disclaimer provisions, what the Texas Legislature has apparently been unable to accomplish with Article 2.21. Texas clearly recognizes the enforceability of disclaimer provisions to the extent they are contained in contracts entered into with sophisticated parties negotiating at arm's length. *Benchmark* suggests, moreover, that a contractual provision (in that case a choice of law clause) may address and thereby make the contract govern any extra-contractual tort claims that may arise out of or relate to the subject matter of the contract or the circumstances surrounding the negotiation and execution of that contract.¹²¹ Consequently, while the authors continue to believe Article 2.21 applied properly should provided sufficient protection, Texas attorneys should at least consider whether corporate officers may benefit from the insertion of an express contractual provision, in any contract executed by an officer on behalf of a corporation, exonerating the corporate officer from any liability, in contract or tort, for any representation made by or on behalf of the corporation in that contract or otherwise.¹²²

120. In addition, as demonstrated by at least one Texas court during the Survey period, the common-law fiduciary duties officers owe their corporations, which also derive from agency principles, may expose corporate officers, under certain circumstances, to personal liability to third party creditors of the corporation. See *In re Brentwood Lexford Partners LLC*, 292 B.R. 255 (Bankr. N.D. Tex. 2003).

121. See also, *In re J.D. Edwards World Solutions Co.*, 87 S.W.3d 546, 550 (Tex. 2002) (finding that a claim that a contract was fraudulently induced remains subject to the arbitration provision set forth in that contract).

122. In light of the *Opus* decision, consideration may also be given to including in letters of intent a provision disclaiming any intention to be subsequently bound to a non-binding letter of intent as a result of actions taken in furtherance thereof.