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Corporations

Robert F. Gray Jr.

Gregory J. Sergesketter

John M. Welge

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*Robert F. Gray, Jr.**
*Gregory J. Sergesketter***
*John M. Welge****

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

I. CORPORATE DISREGARD

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

The court of appeals affirmed the trial court findings under the Texas Business & Commerce Code that title had passed as to the first three masts since each was found to have been accepted by Champion as conforming goods.[3] As such, Champion and Superior were in breach of contract when

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

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

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

1. 831 S.W.2d 868 (Tex. App.—Houston [14th Dist.] 1992, writ denied).
2. *Id.* at 875. As enunciated in Paramount Petroleum Corp. v. Taylor Rental Center, 712 S.W.2d 534, 536 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.), the "single business enterprise" theory states that "when corporations are not operated as separate entities but rather integrate their resources to achieve a common business purpose, each constituent corporation may be held liable for debts incurred in pursuit of that business purpose."
3. *Superior*, 831 S.W.2d at 872.

the contract as related to the fourth mast was anticipatorily repudiated.[4] The trial court based damages awarded to Anderson for the fourth mast upon a sworn account, which requires title to pass, rather than upon a breach of contract. The fourth mast, however, was never completed, inspected, accepted or shipped and, contrary to the finding of the trial court, had not been wholly identified to the contract.[5] Based on those findings, no title could have passed; therefore, Anderson was denied recovery under sworn account for the fourth mast.[6]

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

Although the court of appeals did not find the evidence sufficient to support some of the trial court's findings, sufficient evidence existed to support the findings that: (1) Champion and Superior had interlocking officers and shareholders; (2) Superior paid Champion's bills, expenses and employee salaries; and (3) Superior purchased inventory used by Champion. The finding of interlocking officers and shareholders was supported only by evidence that one person was a stockholder and an officer of both Superior and Champion.[10] No directors were interlocking and no other contemporaneous officers or shareholders existed between Champion and Superior. The court found that Superior paid Champion's bills based on evidence that Champion had no checking account and that Superior paid Champion's employees salaries and other debts directly.[11] While the two companies considered these transactions to be loans, no documentation of the loans was adduced. The finding that Superior purchased inventory used by Champion was supported by evidence that Champion used Superior's purchase order forms and Superior paid Anderson for the masts.

The court of appeals found these facts sufficient to support the "single business enterprise" theory even though no evidence existed supporting the other trial court findings of: (1) common offices; (2) common employees; (3)

4. *Id.*
5. *Id.* at 874.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.* at 875.

centralized accounting; and (4) services rendered on behalf of the other corporation.[12] The trial court based its finding of common offices on the fact that Champion and Superior had offices in the same building, but the court of appeals rejected such finding since Champion paid rent to Superior and also had its own shop facility.[13] Further, the court of appeals rejected the trial court's finding of centralized accounting based on evidence that the two companies had separate accountants, tax returns and records.[14] Finally, the trial court finding of services rendered on behalf of the other corporation was overturned because the evidence only showed that services were rendered by Superior for Champion, not on behalf of Champion.[15]

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

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

The "single business enterprise" theory appears to have originated in dicta only and not under any fact situation similar to the one presented.[18] Most of the case law on the "single business enterprise" theory refers to relation-

12. *Id.*
13. *Id.* at 874.
14. *Id.* at 875.
15. *Id.*
16. 721 S.W.2d 270 (Tex. 1986). *Castleberry* permits disregarding of the corporate fiction (or "piercing the corporate veil")

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

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

17. TEX. BUS. CORP. ACT ANN. art. 2.21A (Vernon Supp. 1993) (emphasis added).
18. *See* State v. Lone Star Gas Co., 86 S.W.2d 484, 491 (Tex. Civ. App.—Austin 1935), *rev'd on other grounds*, 304 U.S. 224 (1938).

ships between parent corporations and their subsidiaries.[19] In *Paramount*[20] (the case cited by the court for the "single business enterprise" theory), both companies held liable were owned by the same shareholder.[21] Such was not the case in *Superior*. In addition, the court found liability based on the alternative theory of partner by estoppel,[22] rendering the "single business enterprise" theory unnecessary to the disposition of the case.

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

The elements of the "single business enterprise" theory were not met in *Superior*. The "single business enterprise" theory is a subset of the "alter ego" theory.[30] One element of the "alter ego" theory requires that one of the entities own stock in the other.[31] No indication exists that either Supe-

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

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

21. *Id.* at 536.

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

23. *Id.* at 536.

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

25. *Id.* at 149.

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

27. *Id.* at 275.

28. *Id.* at 276.

29. *Id.* at 275.

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

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

rior or Champion owned stock of the other. Only two theories should have been available to hold Superior liable. The first theory would require a finding that the contractual loss was the result of actual fraud by Superior upon Anderson.[32] To satisfy this requirement, the court would have to elicit evidence that Anderson detrimentally relied upon a Superior representation that (1) Superior and Champion were one and the same or (2) Superior's financial wherewithal would be available if Champion did not pay. The second theory is "partner by estoppel."[33] Similarly, the fact basis for this theory would have been that: (1) Superior represented that Superior and Champion were partners in purchasing the masts; and (2) relying upon such representation, Anderson provided credit to the apparent partnership.

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

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

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

33. When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:

(a) When a partnership liability results, he is liable as though he were an actual member of the partnership;

(b) When no partnership liability results, he is liable jointly with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.

TEX. REV. CIV. STAT. ANN. art. 6132b, § 16(1) (Vernon 1970).

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

35. *Id.* at 845.

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

the corporate veil would promote injustice since the corporation had sufficient assets to pay the claim.[37] The court of appeals therefore remanded the matter to the trial court.[38]

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

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

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

37. *Mancorp*, 836 S.W.2d at 845-46.
38. *Id.* at 848.
39. *Id.* at 846.
40. *Id.* at 847.
41. *Id.* at 846.
42. *Id.*
43. *Id.*
44. *Id.* at 848.
45. *See* Gray & Sergesketter, *supra* note 36, at 233.

stroy an important fiction under which so much of the business of the country is conducted."[46]

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

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

While the result of the case and the court's recognition that Art. 2.21A of the TBCA[50] has superseded *Castleberry*[51] are proper, the court's analysis as to corporate disregard strays in melding sham to perpetrate a fraud with specific reliance on a shareholder's financial backing. A shareholder of a Texas corporation is not liable for any contractual obligation of such corporation unless the shareholder (1) has expressly agreed by means of a guaran-

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

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

48. *Id.* at 274.

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

50. TEX. BUS. CORP. ACT ANN. art. 2.21A (Vernon Supp. 1993).

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

tee or similar contractual arrangement to be liable for the obligation, (2) has perpetrated an actual fraud[52] upon the obligee primarily for the shareholder's direct personal benefit,[53] or (3) is expressly liable for the obligation under another statute.[54] To pierce the corporate veil through the basis of "sham to perpetrate a fraud," a shareholder has to commit, primarily for the shareholder's direct personal benefit, an actual fraud against the person seeking to disregard the corporate entity. While the evidence produced by Fidelity did not support a finding that the shareholders perpetrated an actual fraud upon Fidelity primarily for the shareholders' direct personal benefit, the evidence does suggest that Fidelity might have been able to reach the shareholders pursuant to the fraudulent transfer provisions of the Texas Business & Commerce Code.

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

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

The court sets a dangerous precedent by using the tax code to hold directors and officers personally liable for the debts of the corporation incurred

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

53. TEX. BUS. CORP. ACT ANN. art. 2.21A(2) (Vernon Supp. 1993).

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

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

56. *Id.* at 743.

57. TEX. TAX CODE ANN. § 171.255(a) (Vernon 1992).

58. If the corporate privileges of a corporation are forfeited for the failure to file a report or pay a tax or penalty, each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived. The liability includes liability for any tax or penalty imposed by this chapter on the corporation that becomes due and payable after the date of the forfeiture.

TEX. TAX CODE ANN. § 17.255(a) (Vernon 1992); *see Dae Won Choe*, 823 S.W.2d at 743.

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

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

II. DISSOLUTION

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

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

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60. *Id.*
61. Rogers v. Adler, 696 S.W.2d 674, 677 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).
62. TEX. BUS. CORP. ACT ANN. art. 2.41 (Vernon Supp. 1993).
63. 771 F. Supp. 823 (S.D. Tex. 1991).
64. *Id.* at 828-29.
65. *Id.* at 826.
66. *Id.* This theory has been abolished pursuant to amendments to the TBCA shortly after this case was decided. To impose liability on directors for paying, or on shareholders for receiving, illegal distributions from Texas corporations, the remedies now are exclusively contained in Article 2.41 of the TBCA, the Uniform Fraudulent Transfer Act, and the United States Bankruptcy Code. *See* Robert F. Gray, Jr. et al., *Corporations, Annual Survey of Texas Law*, 45 SW. L.J. 1525, 1529 (1992).

shareholders upon dissolution of Lowery was a conversion of money owed to it as a creditor.

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

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

III. SHAREHOLDER AGREEMENTS

In *Dixie Pipe Sales, Inc. v. Perry*,[74] a Texas court of appeals properly interpreted Article 2.22 of the TBCA to apply to transfers of stock made from an executor to a beneficiary under a will.[75] Perry and Thompson each received a certificate representing stock in Dixie Pipe Sales, Inc. (Dixie) from the executor of the estate of an original owner of the stock. They delivered the stock certificates to Dixie and requested that the stock be transferred into

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67. TEX. CIV. PRAC. & REM. CODE ANN. § 16.003 (Vernon 1986).
68. TEX. BUS. CORP. ACT ANN. art. 7.12 (Vernon Supp. 1993).
69. "An action may not be brought against a director for liability imposed by this section after two years after the date on which the act alleged to give rise to the liability occurred." TEX. BUS. CORP. ACT ANN. art. 2.41A(3) (Vernon Supp. 1993).
70. *Motorola*, 771 F. Supp. at 828-29.
71. *Id.* at 829.
72. *Id.* (quoting Hunter v. Forth Worth Capital Corp., 620 S.W.2d 547, 551 (Tex. 1981)); *see* Robert F. Gray, Jr. et al., *Corporations, Annual Survey of Texas Law*, 45 Sw. L.J. 1525, 1533 (1992).
73. *Motorola*, 771 F. Supp. at 829.
74. 834 S.W.2d 491 (Tex. App.—Houston [14th Dist.] 1992, writ denied).
75. *Id.* at 494.

their names. Dixie refused to transfer the stock, citing provisions of its bylaws, and tendered checks for the stock's book value. The bylaws of Dixie contained provisions granting Dixie the right of first refusal to buy the stock upon any transfer of the stock, but did not expressly make the restrictions applicable to testamentary transfers.

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

IV. CORPORATE OPPORTUNITY AND SHAREHOLDER DERIVATIVE ACTIONS

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

76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. 824 S.W.2d 274 (Tex. App.—Amarillo 1992, writ denied).
81. *Id.* at 278.

and expenses to Gillman and Windle.[82]

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

The jury found that the disclosure Waters made to Johnson failed to be reasonably calculated to give full disclosure to Accent of an investment opportunity.[87] In reversing the district court, the court of appeals was not persuaded that as minority shareholders Gillman and Windle had a right to be informed of the investment opportunity, stating that although officers and directors are fiduciaries of the corporation, they are not duty-bound to disclose a corporate investment opportunity to the minority shareholders.[88] The court noted that an ordinary private corporation formed under the TBCA that is not a close corporation operates under the direction of the board of directors and not the shareholders. Reiterating the well-settled precept of Texas corporate law that shareholders are not entitled to participate in, either individually or collectively, or to control, the business and affairs or management of the ordinary private corporation, the court of appeals correctly found that a corporation's officers and directors have no duty to disclose corporate investment opportunities to minority shareholders.[89]

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

82. *Id.* at 276.
83. *Id.* at 278.
84. TEX. CIV. PRAC. & REM. CODE ANN. § 15.036 (Vernon Supp. 1993).
85. *Accent*, 824 S.W.2d at 277-78.
86. *Id.* at 277.
87. *Id.* at 276.
88. *Id.* at 278.
89. *Id.*
90. 829 S.W.2d 352 (Tex. App.—Fort Worth 1992, no writ).
91. *Id.* at 356.
92. Bush v. Brunswick Corp., 783 S.W.2d 724 (Tex. App.—Fort Worth 1989, writ denied).
93. *See* Gray & Sergesketter, *supra* note 36, at 234-35.
94. *Bush*, 783 S.W.2d at 731.

cluding all shareholders, regardless of whether or not they signed the shareholder agreement.

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

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

95. *Id.* at 354.
96. *Id.*
97. *Id.* at 355.
98. *Id.* at 356.
99. *See* Gray & Sergesketter, *supra* note 36, at 234-35.
100. Massachusetts v. Davis, 140 Tex. 398, 407, 168 S.W.2d 216, 221 (Tex. 1942), *cert. denied*, 320 U.S. 210 (1943).
101. Faour v. Faour, 789 S.W.2d 620, 621 (Tex. App.—Texarkana 1990, writ denied). While most courts have viewed this as an exception to the general rule, it is an otherwise separate cause of action that is not dependent upon the relationship of the parties to the corporation. *See* Gray & Sergesketter, *supra* note 36, at 233.
102. *Brunswick*, 829 S.W.2d at 356.

held that the injuries suffered by them as shareholders were separate from the injuries suffered by the corporation and all other shareholders.[103]

V. SECURITIES REGULATION

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

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

Kidder argued that the bonds were sold by AABC and not by Kidder; therefore, Kidder asserted that it had no privity with plaintiffs and was not a "Seller" within the meaning of the Texas Securities Act (TSA).[108] The court followed the reasoning of the United States Supreme Court in *Pinter v. Dahl*,[109] noting that "one who 'offers or sells' a security is not limited to

103. *Id.*

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

105. *Id.* at 303.

106. *Id.* at 305.

107. *Id.* at 306.

108. TEX. REV. CIV. STAT. ANN. art. 581-1 - 581-41 (Vernon 1964 & Supp. 1993); *Lutheran*, 829 S.W.2d at 306.

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

those who pass title."[110] The court further stated that Article 581-33(A)(2) of the TSA applies to "any link in the chain of the selling process."[111] The court went on to take the expansive view that Kidder was a "Seller" within the meaning of the TSA since Kidder acted as an agent for AABC in preparation of the private placement memorandum.[112]

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

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

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

The private placement that is the subject of the instant decision was made only to sophisticated and accredited investors who warranted in the purchase agreement that they performed an independent investigation. Im-

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110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.* at 307. The TSA states that the buyer "may sue either at law or in equity for rescission or for damages if the buyer no longer owns the security." TEX. REV. CIV. STAT. ANN. art. 581-33(A)(2) (Vernon Supp. 1993).

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

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

116. *Id.*

117. *Id.*

118. *Id.*

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

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

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

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

121. *Id.* at 308.
122. *Id.*
123. *Id.*
124. *Id.* at 309.
125. *Id.*
126. *Id.* at 310.
127. Robert F. Gray, Jr., et al., *Corporations, Annual Survey of Texas Law*, 45 Sw. L.J. 1525, 1551 (1992).
128. 111 S. Ct. 2773 (1991).
129. 111 S. Ct. 2439, 2447-48 (1991).
130. In addition, two federal circuit courts have found Section 27A to be constitutional. Anixter v. Home-Stake Production Co., 1992 Fed. Sec. L. Rep. (CCH) ¶ 96,968 (10th Cir. Aug. 24, 1992); Henderson v. Scientific-Atlanta, Inc., 971 F.2d 1567 (11th Cir. 1992).
131. Pacific Mut. Life Ins. Co. v. First Republicbank Corp., 806 F. Supp. 108 (N.D. Tex. 1992).