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CORPORATIONS

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DURING the current annual Survey period, the Texas legislature and Texas courts refined Texas corporation law with legislative enactments and noteworthy decisions. As a result of the efforts of a number of individuals, the statutes regulating corporations are without question among the most forward-looking, flexible, and modern in the nation. Several court decisions, however, continue to dampen the ability of Texas to foster a climate to attract and retain Texas corporations.

I. LEGISLATIVE DEVELOPMENTS

House Bill 278 was the omnibus act related to several Texas business organizations statutes that became effective on August 26, 1991. During its 1991 regular session, the Texas legislature amended the Texas Business Corporation Act (TBCA) to make several substantive changes. The primary purpose of the legislation, however, was to update, clarify, conform, and simplify existing provisions of the TBCA. The Texas Professional Corporation Act (TPCA) was amended primarily to conform it more closely to the TBCA by eliminating redundant or unnecessary provisions that were contained in the TPCA, while the Texas Miscellaneous Corporation Laws Act (TMCLA) was amended to eliminate the requirement to file an antitrust affidavit and to facilitate filings through the use of facsimiles. In addition, the Texas Limited Liability Company Act (TLLCA) was created to permit an additional type of "tax pass-through" entity.

A. *Texas Business Corporation Act*

1. *Issuance, Redemption, and Classification of Shares*

By amending numerous provisions of the TBCA,¹ the Texas legislature

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1. See TEX. BUS. CORP. ACT ANN. arts. 2.12 (authorization); 2.13 (establishment); 2.14-1 (rights, options, and convertible indebtedness); 2.19B (legends on share certificates); 2.22-1 (preemptive rights); 2.28D (voting); 2.29D (cumulative voting); 2.32 (election of directors); 2.33 (classification of directors); 2.34 (board of directors vacancies); 2.44A (books and records); 4.02 (procedure to amend articles of incorporation); 4.03 (class voting on amend-

recognized that only one substantive distinction should exist between classes and series of shares. While both are created through the articles of incorporation, the latter can be created by resolution of the board of directors, if permitted by the articles of incorporation. The practitioner should find the parallelism that now exists between classes and series of classes a welcome relief when creating, using, or revising preferences, limitations, and relative rights.² To reduce the length of some articles of incorporation, a procedure is now available whereby the board of directors by resolution can eliminate from the articles of incorporation the provisions for a series of shares where no shares of that series have been issued or all issued shares have been canceled. Considering that the preferences, limitations, and relative rights of series of shares can comprise a significant percentage of a corporation's articles of incorporation, this procedure can be useful in eliminating "dead wood." In addition, other changes have been made regarding the procedure for the treatment and status of series of shares.³

To clarify existing law, shares are now explicitly permitted to be redeemable, exchangeable, or convertible not only at the corporation's option but also at the shareholder's or another person's option, or upon the occurrence of a designated event.⁴ The type of consideration for which shares are exchangeable has been clarified from "property or indebtedness of the corporation"⁵ to "shares, obligations, indebtedness, evidence of ownership, right to purchase securities or other securities of the corporation or one or more other domestic or foreign corporations or other entities or for other property or for any combination of the foregoing."⁶ Similar changes have been made with respect to the manner and basis of converting shares in mergers⁷ and share exchanges or acquisitions⁸ to enumerate the types of "other property" that may be received.

2. *Voting*

Each series of a class of shares now has the right to vote as a separate class on enumerated matters that would affect the series.⁹ This right is tempered, however, if the matter that is being voted upon would affect equally all series

ments); 4.04B (articles of amendment); 5.16A (merger of subsidiary into parent); 6.03A (voluntary dissolution by corporation) (Vernon Supp. 1992). The changes to article 2.19B with respect to legends on stock certificates are not intended to require the notation on certificates representing shares of stock to be modified on existing certificates, nor even on future issuances. The prudent course, however, would be to ensure that all future issuances of stock certificates follow the language in article 2.19B.

2. "Preferences, limitations, and relative rights" has supplanted "relative rights and preferences" as the phrase used when describing the matters contained in the articles of incorporation regarding classes and series of shares. See TEX. BUS. CORP. ACT ANN. arts. 2.12A, 2.13A, 3.02A(6) (Vernon Supp. 1992).

3. *Id.* at arts. 2.12, 2.13.

4. *Id.* at art. 2.12B.

5. *Id.* at art. 2.12B(5) (Vernon Supp. 1991).

6. *Id.* at art. 2.12B(5) (Vernon Supp. 1992).

7. *Id.* at arts. 5.01B(3), 5.06A(7).

8. *Id.* at art. 5.02B(3).

9. *Id.* at art. 4.03A.

of the particular class. Under those circumstances, the class of shares, and not the series, votes as a class.¹⁰ Additionally, the board of directors has the authority to modify the designations, preferences, limitations, and relative rights of any series of shares without the approval of any holders of shares other than those holders of shares of the series that will be affected. This authority is available to the board only if the modification falls within the parameters permitted the board in creating any new series of shares.¹¹ To illustrate, consider a resolution by the board to amend the terms of a series of preferred stock. If the amended terms were within the right of the board to establish when creating a series of shares, then the holders of shares of common stock would not be entitled to vote on the amendment. This approach appears to be unique to Texas as no other jurisdiction, including Delaware, has granted such authority.

3. *Directors and Officers*

The amended TBCA now permits the bylaws to provide that directors will be divided not only overall into two or three classes, but also into two or three classes for election solely by the holders of a particular class, series, or group of shares.¹² This provides greater flexibility in corporate governance by permitting, for example, common shareholders to elect their directors for a three year term while preferred shareholders may elect their directors annually.

Additionally, directors that are elected by certain classes, series, or groups may be accorded more or less than one vote on any or all matters if provided for in the articles of incorporation.¹³ The absolute rule of one person one vote may now be varied. No longer will the test for voting control be solely the number of directors that a group of shareholders can elect. The equation will now have to include those directors' effective voting power on matters before the board.

An exception now exists to the requirement that at least a majority of the number of directors constituting the board must be present to constitute a quorum.¹⁴ If the articles and the bylaws are silent as to the number constituting a quorum, then a majority of the board constitutes a quorum.¹⁵ If, however, the articles or the bylaws permit, the minimum required quorum can be decreased to as little as one-third of the number of directors.¹⁶ Quorum requirements at one meeting may vary dramatically depending upon the matter to be considered if certain directors have more or less than one vote. Article 2.35 of the TBCA permits a quorum to be calculated based on direc-

10. *Id.* at art. 4.03B.

11. *Id.* at art. 4.03C.

12. *Id.* at art. 2.33.

13. *Id.* at art. 2.32.

14. *Id.* at art. 2.35 (Vernon Supp. 1991).

15. *Id.* at art. 2.35 (Vernon Supp. 1992).

16. *Id.* Unless a prohibition otherwise exists in the articles of incorporation or the bylaws, the bylaws may be amended by the board of directors with no action required by the shareholders. *Id.* at art. 2.23. The board of directors could therefore increase or decrease its quorum requirements internally.

tors' voting power, provided that in no event may the percentage be less than one-third of the number of directors constituting the board.¹⁷ Articles and bylaws with the foregoing provisions will probably ensure frequent referral to corporate governance documents at meetings as both the absolute number of directors and effective voting power of each will have to be determined.

Finally, the range of persons¹⁸ and type of information¹⁹ upon which directors and officers may rely upon in the discharge of their duties, including authorizing distributions, have been expanded.²⁰ In all cases, directors and officers are still required to exercise good faith and ordinary care when relying upon any information or person.

4. *Written Consents*

The number of places to which written consents of the holders of less than all of the shares entitled to vote on a particular action may be delivered has been increased to include the corporation's registered agent, transfer agent, registrar, and exchange agent.²¹ Simultaneously, the requirement that written consents be dated and delivered to the corporation within sixty days of the earliest dated consent has been narrowed to apply to only those written consents not signed by all of the shareholders entitled to vote.²² The requirement no longer exists for unanimous written consents of shareholders.

5. *Distributions*

Forward looking information is now permitted to be used when determining the financial condition of the corporation under the requirements of the TBCA.²³ The type of financial information contained in article 2.38-3 of the TBCA may be used to determine whether distributions pursuant to the requirements of article 2.38 of the TBCA are permitted.

6. *Articles of Incorporation*

The tally of nineteen specific authorized amendments to articles of incor-

17. *Id.* at art. 2.35.

18. Directors and officers are permitted to rely upon (i) one or more officers or employees of the corporation (including, for officers, members of the board of directors), (ii) legal counsel, public accountants, investment bankers, or other persons as to matters the director or officer reasonably believes are within the person's professional or expert competence, and (iii) for directors, a committee of the board of directors of which the director is not a member. *Id.* at arts. 2.41C, 2.41D, 2.42C.

19. Directors and officers are permitted to rely upon information, opinions, reports, or statements, including financial statements and other financial data, concerning the corporation or another person, that were prepared or presented by the enumerated persons. *Id.*

20. The range of persons and types of information are for purposes of providing a "safe harbor" as opposed to being all inclusive and an affirmative requirement. *Id.*

21. *Id.* at arts. 9.10A(2), 2.26C.

22. *Id.* at art. 9.10A(2).

23. *Id.* at art. 2.38-3. Specifically, "projection, forecast, or other forward looking information relating to the future economic performance, financial condition, or liquidity of the corporation that is reasonable in the circumstances" may, but is not required to, be used in "determinations whether a corporation is insolvent and of the value of the net assets, and determination of stated capital, and surplus of the corporation." *Id.*

poration has been eliminated to preclude any negative inference from the failure of any item to be included.²⁴ This change conforms the TBCA to the latest version of the Revised Model Business Corporation Act (RMBCA). To further conform to the RMBCA and to remove any argument by a shareholder who votes against an amendment to the articles of incorporation that he is entitled to compensation for any reduction in the shareholder's rights that results from the amendment, this tally was replaced with the provision to make clear that a shareholder does not have any vested property right resulting from any provision in the articles of incorporation.²⁵

7. *Elimination of "Trust Fund" Theory*

The amendment to the TBCA that may have the most significant effect is the elimination of the "trust fund" theory, which was an equitable doctrine that allowed holders of pre-dissolution claims against a dissolved corporation to trace the assets that were distributed by the corporation to its shareholders and to recover those assets to the extent of the claims. 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.²⁶

8. *Consideration for Issuance of Shares*

Although a proposed constitutional amendment was introduced during the 1991 regular session that would repeal the constitutional provision restricting the consideration for which stock and bonds of a Texas corporation may be issued,²⁷ the Texas legislature did not pass the legislation. However, the TBCA has been amended to ensure that its restrictions are no more restrictive than the prohibition in the Texas Constitution.²⁸ Prior to its repeal,

24. *Id.* at art. 4.01B.

25. *Id.*

26. *Id.* at art. 2.41G.

The liability provided in Subsection (1) of Section A of this Article [2.41] shall be the only liability of directors to a corporation or its creditors for authorizing a distribution by the corporation that is not permitted by Article 2.38 of [the TBCA]. The liability provided in Section E of this Article [2.41] shall be the only liability of shareholders to a corporation or its creditors for accepting or receiving a distribution by the corporation that is not permitted by Article 2.38 of [the TBCA]; provided, however, that this Section [2.41G] does not limit any liability under the Uniform Fraudulent Transfer Act or the United States Bankruptcy Code. *Id.*

27. "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void." TEX. CONST. art. XII, § 6.

28. TEX. BUS. CORP. ACT ANN. art. 2.16A (Vernon Supp. 1992).

Subject to any provision of the Constitution of the State of Texas to the contrary, the board of directors may authorize shares to be issued for consideration consisting of any tangible or intangible benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities of the corporation. *Id.*

the TBCA contained the same restrictions as the Texas Constitution.²⁹ In addition, the TBCA went further by explicitly stating what courts have held to be implicit in the constitution that "neither promissory notes nor the promise of future services shall constitute payment or part payment for the issuance of shares of a corporation."³⁰ The major change made by the amendment is to create the foundation for greater flexibility in the consideration for issuance of shares if the prohibition of the Texas Constitution is later repealed. Until then, the general rule as to consideration for shares remains unchanged, and practitioners should use the same standards as before when assessing the type of consideration to be given for shares.

9. Mergers

While the TBCA's merger provisions were substantially revised in 1989, conforming changes were not made for corporations being reorganized under a federal statute. This omission has been corrected. The TBCA now specifically permits the sale, lease, exchange, or other disposition of all, or substantially all, of the corporation's property and assets without board or shareholder notice or approval when carrying out a plan of reorganization.³¹

Prior to the 1991 amendments to the TBCA, once articles of merger were filed with the Secretary of State, the merger or share exchange could not be revoked.³² Now articles of merger can be filed but canceled prior to the effectiveness of the merger or share exchange.³³ If all parties to the merger or share exchange execute a statement that the plan of merger or share exchange has been abandoned in accordance with the plan and the TBCA, and if this statement is filed with the Secretary of State, then the Secretary of State will issue a certificate of abandonment. This procedure should provide additional flexibility in permitting the filing of articles of merger at any time without the concern that once filed, the merger or share exchange may not be revoked.

The effect of a merger or share exchange has also been clarified by amendment to the TBCA.³⁴ All encumbrances, not just existing liens, are to remain with the asset to which they relate in a merger.³⁵ The entity to which

29. "The consideration paid for the issuance of shares shall consist of money paid, labor done, or property actually received." *Id.* at art. 2.16A (Vernon Supp. 1991).

30. *Id.* at art. 2.16B. See *Emco, Inc. v. Healy*, 602 S.W.2d 309, 313 (Tex. Civ. App. - Texarkana 1980, no writ) ("A promissory note, although considered property in the general sense, is not 'money paid' or 'property actually received' for stock as contemplated by the constitution and statutes."); *Champion v. Commissioner*, 303 F.2d 887, 891 (5th Cir. 1962) ("[W]e are met with the same constitutional provisions. Where it is provided that stock can be issued only for labor done, as in Texas and Delaware, the requirement is not met where the consideration for the stock is work or services to be performed in the future.")

31. TEX. BUS. CORP. ACT ANN. art. 4.14 (Vernon Supp. 1992).

32. *Id.* at art. 5.03I (Vernon Supp. 1991). While the prior statute did provide that the effective date could be later than the date on which the articles of merger were filed, no authority existed to revoke filed articles. *Id.* at art. 5.05. The delay of effectiveness is still contained in the TBCA, but is now made applicable to other documents filed under the TBCA as well. *Id.* at art. 10.03 (Vernon Supp. 1992).

33. *Id.* at art. 5.03I.

34. *Id.* at art. 5.06.

35. *Id.* at art. 5.06A(2).

an asset is transferred pursuant to a plan of merger therefore takes the asset subject to all encumbrances associated with that asset. In addition, a liability allocated pursuant to a plan of merger is the obligation of the entity to which the liability was allocated; absent a novation, however, the entity that was liable for the obligation immediately before the time of the merger also remains as a primary obligor.³⁶ Prior to amendment, proceedings against, but not by, a party to a merger could be continued as if the merger had not occurred or another party to the merger who was allocated the associated liability could become a substituted party.³⁷ As amended, a proceeding by a party to a merger may be continued to the same extent as a proceeding against that party to a merger.³⁸

The TBCA was amended to prevent the triggering of dissenters' rights when two publicly-held corporations merge pursuant to a stock for stock exchange with cash paid in lieu of fractional shares.³⁹ Prior to this amendment, the payment of any cash in a merger triggered dissenters' rights. The protections otherwise afforded shareholders are still in place.

Another conforming change to the TBCA was to make the authorization requirements for a sale, lease, exchange, or other disposition of substantially all of the assets of a corporation that is not in the usual and regular course of business similar to those of a merger or a share exchange. Two notable changes were effected by the amendment. First, not all shares have the right to vote on the disposition, but only those shares that are specifically entitled to vote on the matter.⁴⁰ Second, the board of directors is no longer required to adopt a resolution recommending the disposition, provided the board submits the proposal for disposition to the shareholders with a statement of the basis for determining not to make a recommendation.⁴¹

10. Dissolution

Prior to the most recent amendments to the TBCA, an insolvent corporation could not file articles of dissolution unless the corporation had applied its assets, so far as they would go, to the just and equitable payment of the corporation's liabilities. This effectively prohibited an insolvent corporation from dissolving if the corporation had contingent or unliquidated liabilities.⁴² As amended, articles 6.04 and 6.06 of the TBCA now permit an insolvent corporation to voluntarily dissolve if "adequate provision" is made to apply the corporation's assets, "so far as they will go", *after* the date of dissolution.⁴³ In the case of an insolvent corporation, "adequate provision" is made if the corporation simply holds all of its assets at the date of dissolu-

36. *Id.* at art. 5.06A(3).

37. *Id.* at art. 5.06A(4) (Vernon Supp. 1991).

38. *Id.* at art. 5.06A(4) (Vernon Supp. 1992).

39. *Id.* at art. 5.11B.

40. *Id.* at art. 5.10A(4). Now, only voluntary dissolutions require the affirmative vote of two-thirds of all shares, whether or not they are otherwise entitled to vote on the matter. *Id.* at art. 6.03A(3).

41. *Id.* at arts. 5.10A(1), 5.10A(2).

42. *Id.* at arts. 6.04A, 6.06A (Vernon Supp. 1991).

43. *Id.* at arts. 6.04A, 6.06A (Vernon Supp. 1992).

tion and thereafter applies them to pay the corporation's liabilities as each liability accrues and becomes liquidated.

As a result of an amendment to the TBCA, a corporation now has the opportunity to be resuscitated. For a period of 120 days after a certificate of dissolution is issued by the Secretary of State, a corporation may revoke its voluntary dissolution.⁴⁴ The authority to revoke a voluntary dissolution is obtained either through the written consent of all shareholders or at a special meeting of the shareholders called for such purpose by the board of directors.⁴⁵ To effect the revocation, articles of revocation of dissolution must be delivered for filing to the Secretary of State within the 120 day period.⁴⁶ One caveat is that if between the issuance of a certificate of dissolution and the delivery for filing of articles of revocation of dissolution, another entity files or reserves the corporation's name, then the corporation's articles of incorporation must "contemporaneously" be amended to change its name.⁴⁷ Except for that caveat, after revocation of the dissolution, the corporation may again carry on its business as though no revocation occurred.⁴⁸

The article providing for limited survival of a corporation after dissolution

44. *Id.* at art. 6.05A.

45. *Id.*

46. The original and a copy of the articles of revocation of dissolution must be executed on behalf of the corporation by an officer and set forth:

- (1) the name of the corporation;
- (2) the date that the revocation of dissolution was authorized and, if the dissolution has become effective, the effective date of the dissolution that was revoked; and

(3) if the corporation elected to revoke voluntary dissolution proceedings by the written consent of all of its shareholders, a copy of the consent, together with a statement that the consent was signed by all shareholders of the corporation or was signed in their names by their attorneys thereunto duly authorized; or

(4) if the corporation elected to revoke voluntary dissolution proceedings by act of the corporation:

(a) a copy of the resolution to revoke, together with a statement that such resolution was adopted by the shareholders of the corporation and of the date of the adoption thereof;

(b) the number of shares outstanding and, if the shares of any class were entitled to vote as a class, the designation and number of outstanding shares of each such class; and

(c) the number of shares voted for and against such resolution, respectively, and if the shares of any class or series were entitled to vote as a class, the number of shares of each such class or series voted for and against such resolution, respectively.

Id. at art. 6.05B.

It would appear that through inadvertence, the designation and number of outstanding shares of each series entitled to vote as a class is not required to be stated in the articles of revocation of dissolution, although the number of shares of the series that voted for and against the resolution is. *Id.* at arts. 6.05B(4)(b), (c). Conversely, articles of dissolution require that the designation and number of outstanding shares of each series entitled to vote as a class be stated in the articles of dissolution, but no requirement exists to set forth the number of shares of the series that voted for and against the resolution. *Id.* at arts. 6.06A(7)(b), (c). In preparing articles of dissolution or articles of revocation of dissolution, prudent practice would be to include in both the designation and number of outstanding shares of such series and the number of shares of such series that voted for and against the resolution.

47. *Id.* at art. 6.05C.

48. *Id.* at art. 6.05D.

has been substantially revised.⁴⁹ First, a new section has been added to define "dissolved corporation", "claim", and "existing claim".⁵⁰ Second, reference to claims by or against officers, directors, or shareholders has been eliminated because article 7.12 deals with claims by and against a dissolved corporation. Officers, directors, and shareholders can never be liable to third parties for claims against the corporation unless the corporation itself is liable for those claims. The directors who continue to manage the affairs of the dissolved corporation have the same duties with respect to, and liabilities for actions taken on behalf of, a dissolved corporation as a corporation that has not dissolved.⁵¹

Dissolved corporations are only liable for "existing claims", which include pre-dissolution claims and post-dissolution contracts.⁵² Post-dissolution claims (other than those on account of contracts entered into after dissolution) are excluded. Previously, if no action or proceeding had been taken on a pre-dissolution claim, a dissolved corporation could not make a final distribution to its shareholders until the three-year period had expired. Now if a dissolved corporation prefers to dispose of existing claims earlier, it may send a notice requiring a claimant to present its claim within 120 days after the date the notice is sent.⁵³ If not presented within the 120-day period, the claim is extinguished. If timely presented, the corporation may reject the claim and require the claimant to bring an action or proceeding on the claim within 180 days after the date of the rejection notice and before expiration of

49. *Id.* at art. 7.12.

50. *Id.* at art. 7.12F.

Dissolved corporation means

a corporation (a) that was voluntarily dissolved by the issuance of a certificate of dissolution by the Secretary of State and was not issued a certificate of revocation [of dissolution] pursuant to Section C of Article 6.05 of this Act, (b) that was involuntarily dissolved by the Secretary of State and was not reinstated pursuant to Section E of Article 7.01 of this Act, (c) that was dissolved by decree of a court when the court has not liquidated all the assets and business of the corporation as provided in this Act, or (d) that was dissolved by the expiration of its period of duration and has not revived its existence as provided in this Act.

Id.

Claim means "a right to payment, damages, or property, whether liquidated or unliquidated, accrued or contingent, matured or unmatured." *Id.* This definition is based on the Uniform Fraudulent Transfer Act term.

Existing claim means "a claim that existed before dissolution and is not otherwise barred by limitations or a contractual obligation incurred after dissolution." This definition adds the concept that an existing claim includes a contractual obligation incurred after dissolution. Only existing claims survive dissolution. *Id.* at art. 7.12C.

51. *Id.* at art. 7.12B. A corporation may not prosecute in its name any action or proceeding after three years from the date of the corporation's dissolution. *Id.* at art. 7.12A. For many dissolved corporations, their remaining assets are distributed just prior to the termination of the three-year period, and it is at that point that directors face their most critical responsibilities to the dissolved corporation (i.e., determining to whom and to what extent the remaining assets will be distributed). If those assets are neither distributed to shareholders nor reserved to pay "existing claims" that are the subject of actions brought before or during the three-year period, the directors will presumably be liable to the corporation notwithstanding the expiration of the three-year period.

52. *Id.* at art. 7.12C.

53. *Id.* at art. 7.12D.

the three-year post-dissolution period.⁵⁴ If the claimant does not then bring an action or proceeding timely, the claim is extinguished.

By effectively employing the statute, a corporation can, in effect, reduce the limitations periods under certain circumstances. For example, a corporation may take an action that might result in a claim that would otherwise have a five-year limitations period. If the corporation dissolves, which may be in its best interests if the claim would make the corporation insolvent, any claim must become the subject of an action or proceeding within three years or else the claim is extinguished. The limitations period is thereby effectively reduced by two years and can be reduced further if the corporation timely sends a notice requiring the claimant to present its claim within 120 days.

11. *Delayed Effectiveness*

Delayed effectiveness of up to 90 days after filing of certain documents with the Secretary of State is now permitted with the addition of a new article to the TBCA.⁵⁵ In addition, effectiveness may be delayed until the occurrence of future events or facts. In such case, a further filing stating that such events or facts occurred must be filed with the Secretary of State within 90 days after the initial filing.⁵⁶ If not timely filed, then the proposed action to be taken by such documents does not become effective.⁵⁷

B. *Texas Professional Corporation Act*

Amendments to the TPCA were made primarily to conform to the provisions of the TBCA. Articles of Incorporation now must follow the requirements of the TBCA and additionally state that the entity is a professional corporation and the specific kind of professional corporation.⁵⁸ To facilitate incorporation, incorporators of a professional corporation no longer are required to be licensed or otherwise authorized to render professional serv-

54. *Id.*

55. The effectiveness of the following documents may be delayed:

- (1) the incorporation of a corporation under the TBCA;
- (2) an amendment to a corporation's articles of incorporation, including an amendment effected pursuant to a statement of resolution establishing a series of shares;
- (3) the restatement of a corporation's articles of incorporation;
- (4) a merger or a share exchange;
- (5) a cancellation of redeemable or reacquired shares or a reduction in stated capital;
- (6) a voluntary dissolution;
- (7) the authorization or withdrawal of a foreign corporation to transact business in the State of Texas;
- (8) an amendment to the certificate of authority of a foreign corporation;
- (9) a bylaw or agreement restricting the transfer of shares or securities of a corporation pursuant to the TBCA;
- (10) a change in registered office or registered agent; and
- (11) a change of address of a registered agent.

Id. at art. 10.03A.

56. *Id.* at art. 10.03D.

57. *Id.* at art. 10.03E.

58. TEX. REV. CIV. STAT. ANN. art. 1528e, § 4 (Vernon Supp. 1992).

ices;⁵⁹ however the requirement still exists for directors and officers of a professional corporation.⁶⁰

An important addition to the TPCA is the specific limitations with respect to the duties and liabilities of the shareholders of a professional corporation.⁶¹ By including in the TPCA the provisions that a shareholder of a professional corporation, in his capacity as a shareholder, has no duty to supervise the officers and employees of the corporation and has no greater liability than a shareholder of any other Texas business corporation, the Texas legislature has correctly narrowed the focus of statutory duties and liabilities to officers and directors and not placed additional burdens on shareholders of professional corporations. To the extent that a professional corporation is not a close corporation,⁶² shareholders of a professional corporation should be regarded the same as shareholders of any other corporation. These amendments ensure that this principle will apply.

The TPCA sections addressing corporate powers and bylaws of professional corporations have been deleted in their entirety, which makes the corresponding provisions of the TBCA now applicable.⁶³ Similarly, the provisions governing directors and officers of professional corporations have been eliminated, except for the requirement that directors and officers be licensed or otherwise authorized to render professional services.⁶⁴

As amended, the TPCA provides greater flexibility for professional legal corporations. A professional legal corporation is now permitted to have as shareholders other professional legal corporations and foreign professional legal corporations and is no longer required to have as a majority of its shareholders, in number and ownership percentage, individuals licensed to practice law in the State of Texas.⁶⁵ Foreign professional legal corporations are, in essence, professional legal corporations organized under the laws of a jurisdiction other than Texas and may apply for a certificate of authority to do business in Texas in accordance with the TBCA.⁶⁶ Legal services, however, must be rendered on behalf of the corporation ultimately by an individual licensed to practice law in Texas.⁶⁷

C. *Texas Miscellaneous Corporation Laws Act*

Two changes were enacted in the TMCLA by deleting one article and

59. *Id.*

60. *Id.* at §§ 9, 10.

61. *Id.* at § 5.

62. TEX. BUS. CORP. ACT ANN. Part Twelve (Vernon Supp. 1992).

63. TEX. REV. CIV. STAT. ANN. art. 1528e, §§ 7, 11 (Vernon Supp. 1992). The corresponding TBCA provisions are TEX. BUS. CORP. ACT ANN. arts. 2.02, 2.23 (Vernon Supp. 1992), respectively.

64. TEX. REV. CIV. STAT. ANN. art. 1528e, §§ 9, 10 (Vernon Supp. 1992). The corresponding TBCA provisions are TEX. BUS. CORP. ACT ANN. arts. 2.31, 2.42 (Vernon Supp. 1992), respectively.

65. TEX. REV. CIV. STAT. ANN. art. 1528e, §§ 3(d), 12 (Vernon Supp. 1992).

66. *Id.* at §§ 3(a), 19A(a).

67. *Id.* at §§ 15, 19A(a).

adding another. Article 2.08 of the TMCLA,⁶⁸ which has been repealed, required foreign corporations applying for a certificate of authority to furnish an antitrust affidavit.⁶⁹ To think that a corporation would, but for this deleted article, violate antitrust laws is not very tenable. This deletion will reduce the required paperwork to qualify a foreign corporation in Texas. Article 7.07 was added to the TMCLA to permit any instrument filed with the Secretary of State pursuant to any statute pertaining to a particular type of corporation or entity to which the general corporate laws are applicable to be a copy, including a facsimile, of the original executed instrument.⁷⁰ This new article is intended to authorize, but not require, the Secretary of State to accept filings through its facsimile machines, which theoretically could permit filings to be made from any facsimile location, thus reducing the time currently required for filing. The Secretary of State currently will accept facsimiles, provided that the filing fee is hand delivered the same day or payment by credit card is prearranged.⁷¹

D. Texas Limited Liability Company Act

The TLLCA⁷² creates a new type of business entity known as a limited liability company (an LLC) that may closely resemble either a corporation or a limited partnership, depending on which provisions of the statute are selected. Many TLLCA provisions are similar to other Texas statutes providing owners of entities with limited liability, such as the TBCA and the Texas Revised Limited Partnership Act (TRLPA). An LLC can be organ-

68. TEX. REV. CIV. STAT. ANN. art. 1302-2.08 (Vernon Supp. 1991).

69. The affidavit had to state:

that such corporation is not a trust or organization in restraint of trade in violation of the laws of this State, has not within twelve (12) months next preceding the making of such affidavit, become or been a part to any trust agreement of any kind which would constitute a violation of any antitrust law of Texas existing at the date of such affidavit, and has not within that time, entered into or been in any wise a party to, any combination in restraint of trade within the United States, and that no officer of such corporation has, within the knowledge of affiant, within such time and on behalf of such corporation or for its benefit, made any such contract, or entered into or become a party to any such combination in restraint of trade.

Id.

70. *Id.* at art. 1302-7.07 (Vernon Supp. 1992).

Any original instrument required or authorized to be filed with the Secretary of State under any provision of the Texas Business Corporation Act, the Texas Non-Profit Corporation Act, the Texas Limited Liability Company Act or any special Statute of this State pertaining to a particular type of corporation or entity to which the general corporate laws are applicable, may be a photographic, photostatic, facsimile, or similar reproduction of a signed instrument. Any signature or any instrument required or authorized to be filed with the Secretary of State may be a facsimile.

Id.

71. The facsimile number for filings is (512) 463-5709. According to the Office of the Secretary of State, payment by credit card (VISA or MasterCard) is accepted provided a completed Secretary of State credit card form or a letter with the credit card holder's signature that lists the credit card, account number, and expiration date is on file with the Office of the Secretary of State.

72. *Id.* at art. 1528n.

ized so that it is classified as a partnership for federal income tax purposes and thus taxed as a "pass-through" entity. An LLC, however, provides more flexibility than traditional "pass-through" entities such as limited partnerships or corporations that elect to be taxed under Subchapter S of the Internal Revenue Code of 1986, as amended (S Corporations). The principal advantage of an LLC compared to a limited partnership is that no requirement exists for at least one owner to retain unlimited liability.⁷³ The principal advantage of an LLC compared to an S Corporation is that no restrictions on the nature or number of owners exist.⁷⁴ The Texas franchise tax, however, is imposed on LLCs while not on limited partnerships. This disadvantage will diminish the suitability of organizing an entity under the TLLCA. If the Texas franchise tax on an LLC will be prohibitively high, the benefits of the TLLCA will not be fully realized and use of a Texas limited partnership may be more suitable.

The TLLCA can be described as both a flexible and a "knowing" type statute. This characterization is based on features of the TLLCA that can affect three of the four primary corporate characteristics forming the basis for determining whether the entity is classified for federal income tax purposes as either a partnership or an association taxable as a corporation.⁷⁵ As a flexible statute, the TLLCA provides choices for structuring an LLC. As a "knowing" statute, the TLLCA provides pitfalls to be aware of in making those choices; otherwise an LLC may not be treated as a partnership for federal income tax purposes. Other states, such as Colorado, Virginia and Wyoming, have enacted statutes that have been described as bare-bones or bullet proof.⁷⁶ These statutes offer little or no chance for deviations in structure and any entity organized thereunder should be classified as a partnership for federal income tax purposes. In a third category, other states, such as Florida and Kansas, have statutes that are bullet proof with respect to free transferability of interests,⁷⁷ but are flexible regarding continuity of life.⁷⁸

If at least three of the four corporate characteristics are found, the entity will be classified as a corporation. An LLC will usually have the corporate characteristics of limited liability and centralized management,⁷⁹ so the remaining characteristics of continuity of life and free transferability of interests must be avoided to ensure federal income tax classification as a

73. *Id.* at art. 1528n-4.03.

74. *Id.* at art. 1528n-1.02A(4), 4.01.

75. The four characteristics of a corporation are (i) limited liability, (ii) centralization of management, (iii) continuity of life, and (iv) free transferability of interests. *Larson v. Commissioner*, 66 T.C. 159 (1976); see *Rev. Proc.* 89-12, 1989-1 C.B.

76. COLO. REV. STAT. §§ 7-80-101 to 7-80-913 (1990); VA. CODE ANN. §§ 13.1-1001 to 13.1-1069 (Michie 1991); WYO. STAT. § 17-15 (1989). The TLLCA is based on the Colorado statute; however, the TLLCA provides flexibility and thus is not bullet proof.

77. FLA. STAT. ANN. § 608.432 (West Supp. 1991); KAN. STAT. ANN. § 17-7618 (1990).

78. FLA. STAT. ANN. § 608.441 (West Supp. 1991); KAN. STAT. ANN. § 17-7622 (1990).

79. Centralized management can be avoided if the right to manage is vested with the members, with voting proportional to unreturned capital. To be classified as a partnership for federal income tax purposes, avoidance of centralized management would be necessary if either continuity of life or free transferability of interests is found.

partnership. As such, a lawyer should be aware of the consequences of adding provisions that, although allowed by the flexibility of the TLLCA, may preclude an LLC's federal income tax classification as a partnership.

The TLLCA's flexibility permits an LLC to be structured so that it has continuity of life. The maximum duration of an LLC is 30 years,⁸⁰ unless dissolved earlier by the occurrence of one of the events specified in article 6.01(A)(4).⁸¹ Use of the foregoing provision should result in the LLC not having continuity of life. If that provision is altered by the LLC's regulations providing that dissolution of the LLC will not occur upon the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member, the LLC will have continuity of life and the classification of the LLC as a partnership for federal income tax purposes may be jeopardized. Similarly, the TLLCA permits an LLC to have free transferability of interests. By providing in its regulations for transfer of a membership interest by other than unanimous consent of its members,⁸² an LLC will probably be saddled with the unwanted corporate characteristic of free transferability of interests, which jeopardizes the LLC's partnership classification for federal income tax purposes.

The Texas franchise tax is imposed on Texas LLCs and other LLCs doing business or authorized to do business in the State of Texas.⁸³ The computation of the tax is set forth for corporations, which includes Texas LLCs.⁸⁴ It is unclear, however, how that computation is applied to foreign LLCs since the definition of corporation does not specifically include a foreign LLC.⁸⁵

The TLLCA provides limited liability for the owners of an LLC who are called "members."⁸⁶ The limited liability provided members is similar to that provided shareholders of a corporation or limited partners in a limited partnership. Managers, who are analogous to a corporation's board of directors, are vested with the power to direct the management of the business and affairs of an LLC, unless that power is reserved to the members.⁸⁷ Managers

80. TEX. REV. CIV. STAT. ANN. art. 1528n-3.02A(2) (Vernon Supp. 1992).

81. *Id.* at art. 1528n-6.01A(4).

82. *Id.* at art. 1528n-4.07.

83. TEX. TAX CODE ANN. § 171.001(a)(2) (Vernon 1992).

84. *Id.* at § 171.002(b).

85. *Id.* at § 171.001(b)(2). Most franchise tax provisions contained in the Texas Tax Code address only "corporations". The Texas Tax Code includes within the definition of "corporation" an LLC as defined in the TLLCA. The TLLCA defines "Limited Liability Company" as a "limited liability company organized and existing under this chapter." TEX. REV. CIV. STAT. ANN. art. 1528n-1.02A(3) (Vernon Supp. 1992). There is, however, a separate definition for foreign limited liability companies. *Id.* at art. 1528n-1.02A(9). Since the TLLCA has two separate definitions, one for LLC and one for foreign LLC, only an LLC is specifically included in the Texas Tax Code definition of "corporation" and those provisions that address only "corporations" are therefore not specifically applicable to a foreign LLC.

86. As long as a person does not otherwise lack capacity, any individual, partnership, limited partnership, limited liability company, foreign limited liability company, trust, estate, corporation, custodian, trustee, executor, administrator, nominee or entity in a representative capacity can be a member of an LLC. TEX. REV. CIV. STAT. ANN. art. 1528n-1.02A(4) (Vernon Supp. 1992).

87. *Id.* at art. 1528n-2.12.

of an LLC also have the same powers as officers of a corporation organized under the TBCA.⁸⁸ These powers can be delegated to other persons designated by the managers as officers.⁸⁹

Part Two of the TLLCA closely follows Part Two of the TBCA, but the TLLCA also contains some provisions not found in the TBCA. The name of an LLC must contain the word "Limited" or the abbreviation "Ltd." or "L.C."⁹⁰ An LLC is governed by regulations as opposed to bylaws with the initial regulations being adopted by the managers named in the articles of organization.⁹¹ While the regulations in many respects are similar to bylaws, the regulations will differ because they will include many provisions normally contained in partnership agreements such as income and loss allocation provisions for book and federal income tax purposes. The TLLCA allows debts to be incurred and contracts to be formed on behalf of the LLC by managers, members, officers, or agents.⁹² These persons can also dispose of an LLC's property.⁹³ Officers and other agents of an LLC are granted the foregoing powers by statute; the regulations of the LLC must expressly provide otherwise if only managers (if management is vested in the managers) or members (if management is retained by the members) are empowered with these rights.⁹⁴ The records required to be kept by the LLC are similar to the type of record keeping required of a limited partnership under Section 1.07 of the TRLPA.⁹⁵

The formation of the LLC is governed by Part Three of the TLLCA and is modeled after Parts Three and Four of the TBCA. The procedures for forming an LLC are very similar to the procedures for forming a corporation under the TBCA although an LLC is formed through articles of organization as opposed to articles of incorporation under the TBCA. Even though an LLC's registered office is not specifically enumerated in article 1528n-3.02 as being required to be in the articles of organization, the Secretary of State requires inclusion of the registered office's address prior to accepting articles of organization for filing. This requirement exists even though the address of the registered agent is specifically required by the TLLCA to be included in the articles of organization,⁹⁶ and that address must be identical to the registered office's address.⁹⁷ Part Four of the TLLCA, which is derived from certain sections contained in Articles 3, 4, and 7 of the TRLPA, governs admission of members and the rights of members. In this respect an LLC takes on the attributes of a limited partnership. The interest in the LLC is

88. *Id.* at art. 1528n-2.21.

89. *Id.*

90. *Id.* at art. 1528n-2.03A(1).

91. *Id.* at art. 1528n-2.09(A).

92. *Id.* at art. 1528n-2.10.

93. *Id.* at art. 1528n-2.11.

94. If management is vested in the managers, every manager and officer of an LLC can bind the LLC unless the manager or officer lacks both actual and apparent authority. *Id.* at art. 1528n-2.10A(3), 2.21.

95. *Id.* at art. 1528n-2.22.

96. *Id.* at art. 1528n-3.02A(4).

97. *Id.* at art. 1528n-2.05.

assignable, but admission to membership requires the consent of all the other members unless the regulations specify otherwise.⁹⁸ This part also expresses the intention of the Texas legislature that neither members nor managers are liable for the debts of the LLC either in Texas or in other jurisdictions.⁹⁹ The nature of the membership interest in an LLC is personal property with the member having no interest in any specific property of the LLC.¹⁰⁰

Part Five of the TLLCA, which is designed after Articles 5 and 6 of the TRLPA, governs contributions to and distributions by an LLC while Part Six of the TLLCA, which contains provisions based on Part Six of the TBCA and Article 8 of the TRLPA, addresses the dissolution of an LLC. Dissolution can occur at the expiration of a fixed duration, at the occurrence of specified events, by written consent of all of the members, the termination of the continued membership of a member (unless the remaining members consent to continuation of the LLC) or by entry of a decree of judicial dissolution.¹⁰¹ An LLC's regulations may provide that events causing termination of the continued membership of a member, such as death, retirement, resignation, expulsion, bankruptcy, or dissolution, will not cause an LLC's dissolution.¹⁰² As previously noted, if the regulations do provide that the foregoing events will not cause a dissolution, continuity of life will exist and could subject the LLC to forfeiture of its favored federal income tax treatment as a partnership. If the regulations provide that the LLC can be continued after a dissolution event occurs with the unanimous consent of the members, the LLC should not have continuity of life. The winding up and transfer of assets to the members of an LLC is similar to that of a limited partnership.¹⁰³ The procedures required prior to filing articles of dissolution, and the preparation and filing of the articles of dissolution, closely follow articles 6.04 to 6.07 of the TBCA.¹⁰⁴ If an LLC is a partnership for federal income tax purposes, the rules regarding partnership liquidations, and not the rules regarding corporate liquidations, will apply.

Part Seven of the TLLCA, which governs the admission of foreign LLCs, was fashioned from Part Eight of the TBCA.¹⁰⁵ A foreign LLC is broadly defined to include all limited liability entities formed under the laws of a jurisdiction other than Texas and not authorized to qualify to do business in Texas under any other statute.¹⁰⁶ After receiving a certificate of authority to do business in Texas, a foreign LLC has all of the rights and privileges of a Texas LLC.¹⁰⁷ The definition of a foreign LLC and the delineation of a foreign LLC's rights and privileges eliminate concerns about whether Texas would respect the limited liability accorded to owners of limited liability en-

98. *Id.* at art. 1528n-4.07.

99. *Id.* at art. 1528n-4.03.

100. *Id.* at art. 1528n-4.04.

101. *Id.* at art. 1528n-6.01.

102. *Id.* at art. 1528n-6.01A(4).

103. *Id.* at art. 1528n-6.03, 6.04.

104. *Id.* at art. 1528n-6.05 to 6.08.

105. *Id.* at art. 1528n-7.01 to 7.13.

106. *Id.* at art. 1528n-1.02A(9).

107. *Id.* at art. 1528n-7.02.

tities formed under laws of other jurisdictions.¹⁰⁸ Part Eight of the TLLCA, which primarily relates to powers of the Secretary of State, is based on Part Nine of the TBCA. In addition, Part Eight states that the TBCA and the TMCLA supplement provisions of the TLLCA to the extent the TLLCA does not provide for a matter contained in either the TBCA or the TMCLA, including the merger provisions of Part Five of the TBCA and the limitation of liability contained in article 7.06 of the TMCLA.¹⁰⁹ Lastly, Part Nine of the TLLCA, which relates to filings and fees, follows articles 10.01 and 10.02 of the TBCA.¹¹⁰

II. CASE LAW DEVELOPMENTS

A. Corporate Disregard

During the current Survey period, the Texas courts decided several corporate disregard cases that construe *Castleberry v. Branscum*¹¹¹ and its veil piercing techniques in light of the 1989 amendments to the TBCA. Although the 1989 amendments eliminated most of the previously used bases for shareholder liability for the contractual obligations of the corporation, these cases demonstrate that many times courts still mistakenly fail to apply these legislative amendments when piercing the corporate veil.

In *Coastal Shutters & Insulation, Inc. v. Derr*¹¹² a Texas court of appeals held that the corporation's president and shareholder was liable based on an alter ego theory, even though the trial court found that the corporate entity was not used as a sham to perpetrate a fraud.¹¹³ On August 7, 1979, Feinman, who became the president and majority shareholder of Coastal Shutters, signed a promissory note obligating Coastal Shutters to pay \$25,000 to Ireland. Coastal Shutters ratified this pre-incorporation note when Feinman signed two separate extensions of the note. Derr, as executrix of Ireland's estate, sued on the note and obtained a judgment against Coastal and Feinman individually.

On appeal, Feinman argued that he should not be personally liable as a result of the trial court finding that the corporation was not used as a means to perpetuate a fraud. Feinman's argument failed to account for his potential liability based on an alter ego theory. The court noted the distinction between these two bases for disregarding the corporate fiction¹¹⁴ citing *Castleberry*,¹¹⁵ the leading pre-1989 TBCA amendments case on corporate disregard, and, relying upon *Castleberry*, outlined the situations where a court may disregard the corporate fiction. Alter ego and "sham to perpetuate a fraud" are two separate theories on which a shareholder may be liable but

108. See *Means v. Limpia Royalties*, 115 S.W.2d 468 (Tex. Civ. App. — Fort Worth 1938, writ dismissed).

109. TEX. REV. CIV. STAT. ANN. art. 1528n-8.12 (Vernon Supp. 1992).

110. TEX. BUS. CORP. ACT ANN. arts. 10.01, 10.02 (Vernon Supp. 1992).

111. 721 S.W.2d 270 (Tex. 1986).

112. 809 S.W.2d 916 (Tex. App.—Houston [14th Dist.] 1991, no writ).

113. *Id.* at 918.

114. *Id.* at 921.

115. 721 S.W.2d 270.

the court noted that several Texas cases have blurred the distinction between the two.¹¹⁶ Alter ego, which was pled by the appellee, "applies when there is such unity or a blurring of identity between two corporations or a corporation and an individual that the separateness of the single corporation has ceased and holding only the corporation liable would cause injustice."¹¹⁷ The court found enough evidence in the record to uphold the trial court finding of liability based on an alter ego theory.¹¹⁸ The evidence showed that corporate formalities were not followed, funds and assets were commingled, and physical facilities shared with those of other entities controlled by Feinman. The evidence further showed that the corporation was undercapitalized and was operated as a mere tool of Feinman. The court stated that since these facts supported an alter ego finding, the "sham to perpetrate a fraud" basis of corporate disregard was not necessary to hold Feinman liable. Therefore, the failure to find a "sham to perpetrate a fraud" does not preclude the alter ego finding.

Ignoring the clear legislative intent of the 1989 amendments to the TBCA,¹¹⁹ the court found the shareholder liable as the alter ego of the corporation based on such factors as failure to observe corporate formalities, commingling, and undercapitalization — even where the trial court specifically found that there was no fraud. This case underscores the fact that many courts in the State of Texas have mistakenly failed to consider article 2.21 of the TBCA when reviewing cases dealing with the disregard of the corporate entity to hold shareholders of Texas corporations liable for the contractual obligations of the corporation.

In a refreshingly scholarly Texas court of appeals case, *Farr v. Sun World Savings Association*,¹²⁰ the corporate entity was disregarded based on the actual fraud theory provided by article 2.21 of the TBCA.¹²¹ Farr was chief executive officer and owned 44% of Farr Mortgage Company, which obtained a loan from Sun World Savings Association using a third-party note as collateral. Although Farr Mortgage Company agreed not to sell the note

116. *Coastal*, 809 S.W.2d at 921.

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

118. *Coastal*, 809 S.W.2d at 921.

119. TEX. BUS. CORP. ACT ANN. art. 2.21A (Vernon Supp. 1992). The amendment states in relevant part:

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, including without limitation: (a) the failure to comply with any requirement of [the Texas Business Corporation] Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by [the Texas Business Corporation] Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.

Id. Therefore, these factors should not be considered by the courts when asked to disregard the corporate entity and hold its shareholders liable for the contractual obligations of the corporation.

120. 810 S.W.2d 294 (Tex. App.—El Paso 1991, no writ).

121. TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon Supp. 1992).

without first obtaining Sun World's written consent, Farr subsequently reacquired possession of the note from Sun World, fraudulently canceled the endorsement to Sun World without obtaining Sun World's permission, sold the note and used the proceeds to pay other debts of Farr Mortgage Company and his personal bank loans. The judgment against Farr individually was based on actual fraud for actual damages of over \$130,000 and \$35,000 for exemplary damages.¹²²

On appeal Farr argued that the recent amendments to article 2.21 of the TBCA should apply instead of *Castleberry*, which was in effect at the time of the events. The court noted that *Castleberry* allowed the imposition of liability for constructive fraud and failure to observe corporate formalities, but the amendments to article 2.21A of the TBCA have eliminated these methods of establishing shareholder liability. Farr asserted that the law to be applied should be the law at the time of trial, which is article 2.21A of the TBCA, and not *Castleberry*. The court correctly agreed with Farr that the TBCA amendments apply retroactively since the amendments provide a remedy and not a right.¹²³ While the amendments to article 2.21A of the TBCA eliminate constructive fraud and failure to observe corporate formalities as bases for shareholder liability for contract claims, they do not affect the liability of a shareholder for tort claims or for actual fraud.¹²⁴ Applying the requirements of article 2.21A(2) of the TBCA to the factual findings of the trial court,¹²⁵ the court found that the holding against Farr was based on actual fraud and was therefore properly upheld on appeal.

The United States Court of Appeals for the Fifth Circuit stubbed its toe during the Survey period by failing to correctly apply the current Texas law of corporate disregard in *Permian Petroleum Co. v. Petroleos Mexicanos*.¹²⁶ Permian sued Petroleos Mexicanos (Pemex) for breaching a contract to pay for gas delivered. Pemex claimed a credit that permitted it to withhold payment pursuant to an agreement between Pemex and IDEC, which the court found was doing business as Permian. The agreement arose when IDEC and Pemex disputed the amount of gas delivered by one of IDEC's distributors. In settling the dispute, the agreement provided Pemex with a double credit to be applied against its future obligations to IDEC. IDEC, however, had sold its LPG assets, from which the double credit could be applied, to Permian before entering into the agreement with Pemex. Only after execution of the agreement was Pemex informed by IDEC that Permian might be a separate but identically named company. IDEC used the name Permian in its business dealings with Pemex and Ray Horton, the President of Permian, in continuing to do business with Pemex led Pemex to believe that it was dealing with the same company with which it had previously dealt. On these bases, the district court found that Permian and IDEC were used inter-

122. *Farr*, 810 S.W.2d at 295.

123. *Id.* at 297; see Robert F. Gray, Jr. & Gregory J. Sergesketter, *Corporations, Annual Survey of Texas Law*, 44 Sw. L.J. 225, 227 (1990).

124. *Farr*, 810 S.W.2d at 296.

125. *Id.* at 297.

126. 934 F.2d 635 (5th Cir. 1991).

changeably to transact business with Pemex and created confusion as to which corporation Pemex had dealt with in the past. The district court held that IDEC and Permian were alter egos of each other and pierced the corporate veil.¹²⁷

The Fifth Circuit, however, followed *Zahra Spiritual Trust v. United States*,¹²⁸ which held in a reverse piercing case that the alter ego doctrine does not apply unless one of the alter egos owns stock in the other.¹²⁹ Since neither Permian nor IDEC owned stock in the other at any relevant time, the alter ego doctrine was not applicable. The Fifth Circuit stated, however, that both alter ego and sham to perpetrate a fraud theories were before the district court so Pemex could argue both theories on appeal.¹³⁰ In a complete failure to observe Texas law, the Fifth Circuit applied the pre-article 2.21A amendment Texas law of *Castleberry* in finding the sham to perpetrate a fraud doctrine applicable.¹³¹ The court then mistakenly held Permian liable under the sham to perpetrate a fraud doctrine as a result of the confusion created by using the names IDEC and Permian interchangeably. This doctrine has been abolished and, in this case, the corporate veil should not have been pierced without a finding of actual fraud.¹³²

B. *Survival of Actions Upon Dissolution*

In *Solomon v. Greenblatt*¹³³ the Dallas court of appeals held that the dissolution of a corporation did not end the corporation's liability on a personal consulting contract and the corporation's sole director and shareholder was personally liable for the dissolved corporation's debt to the extent of distributions received after dissolution.¹³⁴ The case involved two consulting contracts between Solomon, a business consultant, and Greenblatt, an insurance agent, and his insurance corporation, Greenblatt & Associates, Inc. Solomon had lifetime contracts to provide business consulting services for Greenblatt and for Greenblatt & Associates, Inc. Subsequently, the corporation was dissolved but still received residual commissions for policies previously sold. When Greenblatt dissolved the insurance corporation on November 30, 1986, it owed Solomon \$1,500. This amount was based on a \$1,000 per month contract, which was partially paid for October of 1986 and unpaid for November of 1986.

127. *Id.* at 642.

128. 910 F.2d 240 (5th Cir. 1990); see Robert F. Gray, Jr. & Gregory J. Sergesketter, *Corporations, Annual Survey of Texas Law*, 45 Sw. L.J. 227, 229-230 (1991).

129. *Permian*, 934 F.2d at 643 (citing *Zahra*, 910 F.2d at 246).

130. *Permian*, 934 F.2d at 644-45.

131. *Id.* at 645.

132. The elements of common law fraud in Texas are: (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).

133. 812 S.W.2d 7 (Tex. App.—Dallas 1991, writ requested).

134. *Id.* at 19-20.

The trial court held that the corporation's liability could not exceed the \$1,500 owed at the time of dissolution.¹³⁵ The court of appeals disagreed and held that the corporation was liable to the extent of the pre-dissolution claim, which may be more than \$1,500 if, upon remand, the trial court found that Solomon remained available and able to render satisfactory performance under the contract once she had left Texas.¹³⁶ The parties agreed that article 7.12 of the TBCA¹³⁷ determines the survival of claims against the dissolved corporation. Under this article, the amount of the disputed claim is based on whether the claim is enforceable after dissolution. If the claim is rendered unenforceable by dissolution, then the corporation's liability would be limited to \$1,500, which was the amount owed prior to dissolution. Noting that the enforceability of a partially executory contract for personal services against a dissolved corporation was a question of first impression in Texas,¹³⁸ the court analogized to Texas cases involving similar situations such as the death of a natural person terminating a contract for personal services.¹³⁹ The court found the natural death analogy inadequate since voluntary dissolutions of corporations occur only because "their directors or shareholders decide to kill them."¹⁴⁰ Considering cases from other jurisdictions, the court held that the voluntary dissolution of a Texas corporation does not relieve it of liability for its executory contracts, including executory contracts to pay for personal services.¹⁴¹ The court noted a possible exception based on dicta contained in *Thrasher v. Thrasher*¹⁴² for "the rare circumstance where a corporation exists, and is understood to exist, for the purpose of performing a function that the contracting parties know to be of finite duration, and the anticipated terminal event occurs."¹⁴³ The exception did not apply to this case since there was no indication that the contracting parties expected dissolution of the corporation while Greenblatt was still working.¹⁴⁴ Dissolution did not render the contract for personal services unenforceable so the case was remanded to determine the amount of the claim against the corporation.

Since the dissolved corporation was already liquidated, Solomon asserted claims against Greenblatt personally based on the alter ego theory and article 6.04 of the TBCA.¹⁴⁵ The court found no evidence of alter ego¹⁴⁶ but did hold Greenblatt liable for the claims against the dissolved corporation to the extent that he received distributions in liquidation.¹⁴⁷

135. *Id.* at 16.

136. *Id.* at 20.

137. TEX. BUS. CORP. ACT ANN. art. 7.12(A)(1)-(2) (Vernon Supp. 1991).

138. *Solomon*, 812 S.W.2d at 16.

139. *Salter v. Jones*, 348 S.W.2d 381 (Tex. Civ. App.—El Paso 1961, no writ).

140. *Solomon*, 812 S.W.2d at 17.

141. *Id.* at 18.

142. 232 S.E.2d 734 (Va. 1977).

143. *Solomon*, 812 S.W.2d at 18.

144. *Id.*

145. TEX. BUS. CORP. ACT ANN. art. 6.04 (Vernon Supp. 1991).

146. *Solomon*, 812 S.W.2d at 19.

147. *Id.* at 19-20. The court used an equitable remedy, the trust fund theory, enunciated in *Henry I. Siegel Co. v. Holliday*, 663 S.W.2d 824, 827 (Tex. 1984). Under the trust fund the-

The Fort Worth court of appeals looked at post-dissolution claims in *Weibel v. Martin Industries, Inc.*¹⁴⁸ In this wrongful death case, Weibel's husband was struck and killed by a truck manufactured by the defendant, Martin Industries, Inc. The accident occurred, however, ten months after dissolution of the defendant. The widow based her claim on article 7.12 of the TBCA¹⁴⁹ and the open courts doctrine. Citing *Hunter v. Fort Worth Capital Corp.*¹⁵⁰ the court held that article 7.12 of the TBCA does not provide for post-dissolution claims. Weibel further argued that interpreting article 7.12 of the TBCA to exclude any remedy for post-dissolution claims would violate the open courts doctrine.¹⁵¹ The court denied any relief to the widow stating that the "claim against a dissolved corporation did not involve an established right to redress of any injury"¹⁵² so no violation of the open courts doctrine occurred.

The same result was reached by the Beaumont court of appeals in *Anderson v. Hodge Boats & Motors, Inc.*¹⁵³ Anderson sued Hodge for negligence, products liability, and gross negligence with regard to a boat sold by Hodge to Anderson. Hodge was dissolved prior to the incident and suit was brought more than three years after dissolution. The court held that article 7.12 of the TBCA is the exclusive means for an injured party to sue a dissolved corporation and the statute did not apply to these facts.¹⁵⁴ Following *Weibel*,¹⁵⁵ the court found no violation of the open courts doctrine.¹⁵⁶

ory, "when the assets of a dissolved corporation are distributed to the shareholders, a creditor of the dissolved corporation may pursue the assets on the theory that in equity they are burdened with a lien in his favor." *Id.* If the assets can no longer be traced, the directors of the dissolved corporation become personally liable for their value. *Id.* at 828. The trust fund theory has been eliminated. See *supra* note 26 and accompanying text. As such under article 2.41 of the TBCA, a director who votes for an unauthorized distribution is liable to the corporation and a shareholder who receives the distribution is liable only to provide contribution to the director if the shareholder knew that such distribution was not permitted. In this case, it is not clear as to whether Greenblatt's personal liability was based on his position as a director or as a shareholder of the dissolved corporation, or both.

148. 806 S.W.2d 345 (Tex. App.—Fort Worth 1991, writ denied).

149. TEX. BUS. CORP. ACT ANN. art. 7.12 (Vernon Supp. 1991).

150. 620 S.W.2d 547 (Tex. 1981); with respect to post-dissolution claims, *Hunter* has been codified; see *supra* note 52 and accompanying text.

151. The open courts doctrine states that, "[A]ll courts shall be open, and every person for an injury done him, in his lands, goods, person or reputation, shall have remedy by due course of law." TEX. CONST. art. I, § 13.

152. *Weibel*, 806 S.W.2d at 346.

153. 814 S.W.2d 894 (Tex. App.—Beaumont 1991, writ denied).

154. *Id.* at 896.

155. 806 S.W.2d 345.

156. Although not a Texas case, *Penasquitos, Inc. v. Superior Court*, 812 P.2d 154 (Cal. 1991), is noteworthy due to its substantial expansion of corporate survival actions in California. The Supreme Court of California allowed suit against a dissolved corporation based on pre-dissolution activities that gave rise to post-dissolution claims. This follows a trend by the drafters of the RMBCA and three federal districts. The decision does not address post-dissolution claims against the shareholder, but only against the corporation. The court's reasoning for allowing this type of suit is that it will not affect distribution of assets since in California, as in Texas, only known liabilities must be provided for. *Id.* at 160. In addition, the court rationalized its decision by pointing out that the only time a dissolved corporation will be sued is when there are assets or insurance to pay the judgment. *Id.* at 161. As a result of this decision and based on the California Corporation Code, the duration of potential liability for a dissolved California corporation may be eternal even though the RMBCA and other states pro-

C. Derivative Actions and Appraisal Rights

Generally, an individual shareholder of a Texas corporation does not have a separate and independent cause of action for injuries suffered by the corporation that result in the depreciation of the value of the shareholder's shares.¹⁵⁷ The courts have found an exception to this rule, however, where the shareholder has a cause of action 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.¹⁵⁸ While most courts have viewed this as an exception to the general rule, it is in reality an otherwise separate cause of action that is not dependent upon the relationship of the parties to the corporation.¹⁵⁹ Whether the wrong is against the corporation solely or against the shareholder personally determines the party that may bring the cause of action.¹⁶⁰ When Texas courts permit shareholders to bring actions in their individual capacity for what are in essence wrongs against the corporation, the concept of the corporation as a separate legal entity is unwisely eroded.

In *Wingate v. Hajdik*¹⁶¹ the Texas supreme court correctly held that an individual shareholder cannot recover damages for injury to the corporation. Wingate and Hajdik were business partners, each owning half of Glenmeadow Townhomes, Inc. In a suit by Wingate against Hajdik, the trial court found that Hajdik had misappropriated corporate assets, made fraudulent misrepresentations to Wingate, and breached his fiduciary duty to Wingate. Without segregating the bases for the judgment, the trial court awarded Wingate actual and exemplary damages in addition to interest and attorneys' fees. In a continuation of the approach by Texas courts discussed in last year's Survey,¹⁶² the Texas supreme court noted that a shareholder can recover for wrongs against him individually, but cannot recover in his individual capacity for a wrong against the corporation, even though he may be injured by the wrong.¹⁶³ Wingate asserted both personal claims and claims that belonged to Glenmeadow. Since the trial court did not segregate the personal and corporate causes of action, the Texas supreme court properly reversed and remanded the case for a new trial at which Wingate would not be permitted to recover individually for any misappropriation of corporate assets by Hajdik.¹⁶⁴

vide a five-year or similar limitations period after dissolution in which to bring suit. While this decision is not the law of Texas, it may represent a trend in corporate law survival actions that wisely has not been followed by the Texas legislature. See *supra* notes 52-54 and accompanying text.

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

158. *Id.* at 408, 168 S.W.2d at 222.

159. See *Faour v. Faour*, 789 S.W.2d 620, 621 (Tex. App.—Texarkana 1990, writ denied).

160. *Id.* at 622.

161. 795 S.W.2d 717 (Tex. 1990).

162. Robert F. Gray, Jr. & Gregory J. Sergesketter, *Corporations, Annual Survey of Texas Law*, 45 Sw. L.J. 227, 233-241 (1991).

163. *Wingate*, 795 S.W.2d at 719.

164. *Id.* at 720.

In *Gannon v. Baker*¹⁶⁵ a Texas court of appeals held that the claim by a dissenting shareholder that there was fraud or irregularity in the sale of assets that affected the fair value of the minority stock was not barred by the dissenting shareholder invoking his appraisal remedy.¹⁶⁶ Gannon owned 20% and Baker the remaining 80% of J&B Sign Company at the time when substantially all of the corporation's assets were sold for \$8,000,000. Gannon dissented from the sale because he considered the corporation's value to be \$11,000,000 and also believed that he owned 50% of the corporation under an oral leveling agreement. The trial court found that the oral leveling agreement violated the statute of frauds and the parol evidence rule, and Gannon was awarded the appraised value of his 20% share, which the court found to be \$479,464.¹⁶⁷ The trial court further held that appraisal was Gannon's exclusive remedy.¹⁶⁸

Gannon alleged that Baker had usurped corporate opportunities, diverted and converted corporate assets and profits, entered into transactions unfavorable to the corporation but favorable to Baker, maliciously suppressed dividends, and engaged in fraud during liquidation.¹⁶⁹ These alleged acts did not occur in connection with the sale of the corporation's assets and only had the incidental effect of lowering the value of Gannon's stock in the corporation. As such, the court followed *Wingate v. Hajdik*¹⁷⁰ and properly held that these causes of action belonged to the corporation and not to Gannon personally.¹⁷¹

Gannon also alleged that Baker committed fraud in the asset sale transaction by failing to disclose material information and engaging in self-dealing. The court remanded the case for determining only whether Gannon could prove that this fraud occurred and the extent to which the fraud affected the fair value of his stock. If proven, then Gannon would be entitled to recover special damages from the corporation.¹⁷²

Specifically, the court held that in the absence of fraud in the transaction, article 5.12 of the TBCA¹⁷³ is a dissenting shareholder's exclusive remedy. As such, the dissenting shareholder may recover from the corporation the appraised value of his shares plus special damages occasioned by fraud in the sale of substantially all of the assets — but not occasioned by acts of fraud occurring prior to, or not connected with, the sale.¹⁷⁴ To recover any further damages, Gannon had to proceed against Baker individually and either

165. 807 S.W.2d 793 (Tex. App.—Houston [1st Dist.] 1991, writ granted), *rev'd in part and remanded*, Gannon v. Baker, 818 S.W.2d 754 (Tex. 1991).

166. *Id.* at 797.

167. The court of appeals affirmed the trial court's granting of summary judgment on the oral leveling agreement, however, the Texas supreme court reversed and remanded this issue. Gannon v. Baker, 818 S.W.2d 754 (Tex. 1991).

168. *Gannon*, 807 S.W.2d at 796.

169. *Id.* at 796.

170. 795 S.W.2d 717 (Tex. 1990).

171. *Gannon*, 807 S.W.2d at 798-99.

172. *Id.* at 797.

173. TEX. BUS. CORP. ACT ANN. art. 5.12 (Vernon Supp. 1992).

174. *Gannon*, 807 S.W.2d at 799.

show that Baker violated a contractual duty owed to Gannon individually or bring a derivative action on behalf of the corporation against Baker.

D. Securities Law

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*¹⁷⁵ the United States Supreme Court set a uniform statute of limitations for actions brought under Section 10(b) (Section 10(b) of the Securities Exchange Act of 1934 (1934 Act)¹⁷⁶ and Securities and Exchange Commission Rule 10b-5 promulgated thereunder (Rule 10b-5)¹⁷⁷ and, without analysis, applied the new limitations period to the case. Pursuant to this decision, an action under Section 10(b) or Rule 10b-5 must be brought within one year after discovery of the facts constituting the violation and within three years after the violation.¹⁷⁸ This decision sets a uniform federal statute of limitations for a cause of action where courts had previously borrowed limitations periods from analogous state statutes. Writing for the majority, Justice Blackmun reasoned that the one and three year limits for Section 10(b) targets the same types of problems as Section 9 and Section 18 of the 1934 Act.¹⁷⁹ Thus, it was appropriate to give each of the sections the same statute of limitations.

The issue of limitations arose in this five to four decision, in which five separate opinions were delivered, when a New Jersey law firm was sued under Section 10(b) and Rule 10b-5 for misrepresentations made in connection with memoranda prepared by the law firm for a sale of partnership interests. The district court granted the law firm summary judgment based on an analogous state statute of limitations. The Ninth Circuit reversed and remanded because of unresolved factual issues about when the plaintiffs discovered or should have discovered the fraud.

In reversing the Ninth Circuit, the Supreme Court articulated a two-part test to determine which limitations period was appropriate. The first part of the test is to determine whether a uniform statute of limitations is to be selected. If the tendency of a federal cause of action is to encompass a number of diverse areas such that a single state limitations period may not be consistently applied within a jurisdiction, then a uniform limitations period should be adopted. If the first part of the test is answered affirmatively, then the second part of the test is to determine whether the limitations period should be derived from a federal or state source. The geographic character of the claim must be examined to determine if it has a multistate nature that would lead to forum shopping, and expensive and complex litigation. If so, then a federal source is more appropriate. Even if the geographic nature favors using a federal source, a presumption for state borrowing exists. To rebut that presumption, an analogous federal source must afford a "closer fit" with the cause of action than does any available state-law source. To

175. 111 S. Ct. 2773 (1991).

176. 48 Stat. 891, 15 U.S.C.A. § 78j(b) (1981).

177. 17 C.F.R. § 240.10b-5 (1991).

178. *Lampf*, 111 S. Ct. at 2782.

179. *Id.*

determine "closer fit", factors such as commonality of purpose and similarity of elements are examined.¹⁸⁰ The Supreme Court applied the test to the case, found that a uniform limitations period should apply, and rejected the state-borrowing doctrine to federal securities claims.¹⁸¹ The Court found consideration of state-law alternatives unnecessary since Congress provided an express limitations period for correlative remedies within the 1934 Act.¹⁸²

After determining that federal law was the proper source of limitations for Section 10(b) and Rule 10b-5 actions, the Court considered which federal statute of limitations to employ. The Court noted that most limitations periods contained in the 1934 Act were based on some variation of the one year and three year limitation periods. The one and three year periods found in Section 9 and Section 18 of the 1934 Act were chosen because those sections, like Section 10(b), also target the protection of investors from manipulation of stock prices.¹⁸³ The five year limitations period of Section 20A of the 1934 Act was rejected because that section was adopted by Congress to alter the remedies available for only a specific problem, namely insider trading.¹⁸⁴ The Court further found that the principle of equitable tolling would not apply as it was fundamentally inconsistent with the three year cut-off for claims found in the 1934 Act.¹⁸⁵ The result of the majority opinion is to enact a uniform one and three year limitations period for Section 10(b) and Rule 10b-5 claims and to deny the use of the equitable tolling principle.

Justice Scalia concurred in the judgment, but only because a private cause of action created by the courts, such as actions pursuant to Section 10(b) and Rule 10b-5, should have the same limitations period that has been legislatively created for analogous causes of action contained in the enactment that formed the basis for the creation of the cause of action (i.e. the 1934 Act). Absent a congressionally created limitations period, Justice Scalia generally considers state limitations periods as governing unless inconsistent with the purposes of the federal act, in which case no limitations period exists. With "implied" causes of action, however, examination of the federal statutes from which these causes of action are derived and use of their respective limitations periods is required.¹⁸⁶

Justice Stevens' dissent, in which Justice Souter joined, noted that Congress and not the judiciary should determine the appropriate limitations period for causes of action, and, failing Congress taking action, courts should follow the Rules of Decision Act¹⁸⁷ of looking to analogous state limitations periods and not undertake a lawmaking task of creating limitations periods.¹⁸⁸ Justice Kennedy, with whom Justice O'Connor joined, dissented

180. *Id.* at 2779.

181. *Id.* at 2780.

182. *Id.* at 2781-82.

183. *Id.* at 2781. Specifically, Section 9(e) of the 1934 Act was selected as the governing limitations period standard for Section 10(b) and Rule 10b-5 actions. *Id.* at 2782 n.9.

184. *Id.* at 2781.

185. *Id.* at 2782.

186. *Id.* at 2783 (Scalia, J., concurring in part and concurring in the judgment).

187. 28 U.S.C. § 1652 (1966).

188. *Lampf*, 111 S. Ct. at 2783-84 (Stevens, J., dissenting).

from the adoption of the three year period of repose, although agreeing with the one year from discovery rule.¹⁸⁹ In a separate dissent joined by Justice Kennedy, Justice O'Connor disagreed with the Court's decision in applying the new limitations period retroactively to the case at hand and not reserving the new rule for application only in new cases.¹⁹⁰

On December 19, 1991, President Bush signed a federal banking bill reversing the retroactive application of the decision by adding a new section 27A to the 1934 Act that applies to "any private civil action implied under section 10(b) of the Act that was commenced on or before June 19, 1991."¹⁹¹ For those cases, the applicable limitations period is that "provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991."¹⁹²

The Court eliminated forum-shopping and confusion by setting a uniform limitations period as opposed to permitting the continued borrowing of limitations periods from state law for judicially created causes of action, but prudently restrained itself from judicially legislating a limitations period not specifically contained in the 1934 Act. Although some, including Justices O'Connor and Kennedy, believe that the limitations period now is too short, action to correct that perception rests with Congress and the President, not the judiciary. If action is undertaken, legislative reforms, such as comparative liability and discovery limitations, should be considered to specifically deter meritless securities litigation that continues to grow. Congress, however, appears to be in a legislative gridlock in its attempts to reform general securities litigation.

In a Texas securities law case, *Gant v. State*,¹⁹³ Gant's conviction for securities fraud under the Texas Securities Act¹⁹⁴ was affirmed. The conviction was based on the failure by Gant to disclose to prospective investors that money invested by previous investors in the securities offering had been used by Gant for purposes other than those disclosed.¹⁹⁵

Gant sold working interests in an oil and gas lease known as Lenoree No. 1 through the use of a confidential memorandum that outlined the terms of the offering. The memorandum disclosed that funds invested in the venture would be used to drill, test, and complete a well on the Lenoree No. 1 and further stated that all invested funds would be held in escrow until the earlier of receipt of subscriptions for \$100,000 and July 15, 1985. Needless to say, the well was never drilled and the investors' money was not returned. Despite the memorandum's disclosures, Gant disbursed funds received from other investors for personal expenses and other purposes unrelated to the Lenoree No. 1. The complainants testified that their investment decision in

189. *Id.* at 2788 (Kennedy, J., dissenting).

190. *Id.* at 2785 (O'Connor, J., dissenting).

191. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 476, 105 Stat. 2236, 2387 (1991).

192. *Id.*

193. 814 S.W.2d 444 (Tex. App.—Austin 1991, no writ).

194. TEX. REV. CIV. STAT. ANN. art. 581 (Vernon 1964).

195. *Gant*, 814 S.W.2d at 448.

the venture would have been affected if they had been informed of Gant's use of prior invested funds in the venture.

Gant challenged the sufficiency of the evidence asserting that failure to disclose the use of previous investors' money was not fraud under the Texas Securities Act. Based on *Bridwell v. State*¹⁹⁶ the Court found (i) the undisclosed facts material since a "reasonable investor" would want to know about those facts, (ii) the existence of a criminal investigation, indictment, or complaint not a prerequisite to the duty to disclose a material fact, and (iii) failure to disclose those facts fraud under the Texas Securities Act.¹⁹⁷ Based on the foregoing, Gant's conviction and punishment of three concurrent two-year imprisonment terms and an aggregate fine of over \$18,000 were upheld.

196. 761 S.W.2d 401(Tex. App.—Dallas 1988), *aff'd*, 804 S.W.2d 900 (Tex. Crim. App. 1991).

197. *Gant*, 814 S.W.2d at 449-50.