Corporations

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**TABLE OF CONTENTS**

I. INTRODUCTION ........................................ 1221
II. JUDICIAL DEVELOPMENTS ........................... 1221
   A. Honoring the Corporate Form ................... 1221
   B. Effects of Failure to Pay Franchise Taxes (In re ABZ Insurance Services, Inc.) .............. 1222
   C. Disregarding the Corporate Form (Texas-Ohio Gas, Inc. v. Meacom III) ......................... 1226
   D. Drafting Corporate Agreements ................. 1230
      1. Taylor-Made Hose, Inc. v. Wilkerson ........ 1231
      2. John Wood Group USA, Inc. v. ICO, Inc ........ 1233
      3. Lockheed Martin Corp. v. Gordon ............. 1238

I. INTRODUCTION

The Texas courts\(^1\) continued to address a number of significant corporate law issues during this Survey period.\(^2\) Like last year's Corporations Survey, Section II of this article presents summaries of the significant judicial developments. Section II groups the significant cases into the categories of (a) honoring the corporate form, (b) effects of the failure to pay franchise taxes, (c) disregarding the corporate form, and (d) drafting corporate agreements. The Texas legislature was not in session during this Survey period.

II. JUDICIAL DEVELOPMENTS

A. Honoring the Corporate Form

During this Survey period, the Texas courts once again stressed the importance of the corporation as an entity separate and apart from its of-
officers, directors, shareholders and subsidiaries. Although there were no remarkable cases, Texas courts reaffirmed that (a) a parent corporation is generally not liable for the torts of its subsidiary;\(^3\) (b) a corporation wholly owned by a sole individual shareholder is still a corporation separate and distinct from its owner and, in the absence of proof of the elements necessary to disregard the corporate veil,\(^4\) the corporation ordinarily shields its owners and shareholders from personal liability;\(^5\) (c) a corporation cannot be liable for actions that took place prior to its incorporation;\(^6\) (d) corporate shareholders cannot sue for the wrongs done to that corporation—rather the corporation itself is the only "person" who may seek to recover for the wrong done to it;\(^7\) and (e) corporations, although distinct from their officers, can act only through them and can be held liable for the tortious acts of their officers only where such acts were made by a "vice principal" or by any other officer acting in the discharge of such officer's corporate duties.\(^8\)

B. Effects of Failure to Pay Franchise Taxes (In re ABZ Insurance Services, Inc.)

Texas corporations and foreign corporations doing business in Texas are required to file reports with the Texas Comptroller and pay franchise

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5. In the Marriage of Morris, 12 S.W.3d 877 (Tex. App.—Texarkana 2000, no pet. h.). The United States Supreme Court also addressed this issue briefly during this Survey period in Nelson v. Adams, 120 S. Ct. 1579, 1586 (2000) ("One-person corporations are authorized by law and should not lightly be labeled sham.").


7. Brock v. Baskin-Robbins USA Co., 113 F. Supp. 2d 1078 (E.D. Tex. 2000). Interestingly, however, the shareholders of a corporation are the equitable owners of the corporation's assets, and as long as the corporation's creditors are not harmed, shareholders collectively may deal with the corporation's property themselves, and can bind the corporation by executing an agreement on the corporation's behalf, even though the corporation itself is not a signatory. Martin v. Martin, Martin & Richards, Inc., 12 S.W.3d 120 (Tex. App.—Fort Worth 1999, no pet. h.).

8. Wal-Mart Stores, Inc. v. Lane, 2000 WL 867594 (Tex. App.—Corpus Christi 2000, no pet. h.). A "vice principal" of a corporation "is a corporate officer, a person with authority to employ, direct, and discharge servants of the master, or a person with whom the master has confided the management of the whole or part of a department or division of the business." Id. at 288. Moreover, in order to recover exemplary damages against a corporation for the acts of one of its agents, "there must be a showing that someone employed in a managerial capacity and acting in the scope of that managerial capacity was grossly negligent." Ianni v. Loram Maint. of Way, Inc., 16 S.W.3d 508, 525 (Tex. App.—El Paso 2000, pet. denied) (citing Dalworth Trucking Co. v. Bulen, 924 S.W.2d 728, 732-33 (Tex. Civ. App.—Texarkana 1996, no writ)). Similarly, an officer, agent or other employee of a corporation "may be personally as responsible as the corporation itself for tortious acts when participating in the wrongdoing." Fairmont Travel, Inc. v. George May Int'l Co., 75 F. Supp. 2d 666, 670 (S.D. Tex. 1999) (citing Mayflower Inv. Co. v. Stephens, 345 S.W.2d 786, 795 (Tex. Civ. App.—Dallas 1960, writ ref'd n.r.e.)).
A corporation that fails to file a franchise tax report or to pay its assessed franchise taxes is subject to having the Comptroller forfeit the corporation’s privileges. Forfeiture of corporate privileges results in the corporation being denied the right to sue or defend in a court of this state and each corporate director or officer being held liable for the debts of the corporation as provided in section 171.255 of the Texas Tax Code. Following the forfeiture of its corporate privileges by the Comptroller, the Secretary of State may then actually forfeit the corporation’s charter. The forfeiture of a corporation’s charter causes such corporation to be a “dissolved corporation” pursuant to the Texas Business Corporation Act.

As has been repeatedly stated by Texas courts, including during the course of this Survey period, neither the forfeiture of corporate privileges by the Comptroller nor the forfeiture of a corporation’s charter by the Secretary of State extinguishes the corporation as an entity. Furthermore, if a corporation files its delinquent reports and pays its delinquent franchise taxes, its corporate privileges and charter are retroactively reinstated.

While the foregoing rules are clear, an interesting issue arose during the Survey period with respect to the interplay between (i) the effect of a forfeiture of the corporation’s charter by the Secretary of State under the Texas Tax Code and (ii) the Texas three-year requirement to pay tax and penalty for not doing so; TEX. TAX CODE ANN. §§ 171.204 (Vernon Supp. 2000) and 171.205 (Vernon 1992) (requirement to file reports with the state comptroller).


TEX. TAX CODE ANN. § 171.252 (Vernon Supp. 2000). Section 171.255 of the Texas Tax Code provides: “(a) 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. (b) The liability of a director or officer is in the same manner and to the same extent as if the director or officer were a partner and the corporation were a partnership. (c) A director or officer is not liable for a debt of the corporation if the director or officer shows that the debt was created or incurred: (1) over the director’s objection; or (2) without the director’s knowledge, and that the exercise of reasonable diligence to become acquainted with the affairs of the corporation would not have revealed the intention to create the debt. (d) If a corporation’s charter or certificate of authority and its corporate privileges are forfeited and revived under this chapter, the liability under this section of a director or officer of the corporation is not affected by the revival of the charter or certificate and the corporate privileges.”


TEX. TAX CODE ANN. § 171.309 (Vernon 1992); TEX. BUS. CORP. ACT ANN., art. 7.01 § B(1) (Vernon Supp. 2000).

TEX. BUS. CORP. ACT ANN., art. 7.12 § F(1)(e) (Vernon Supp. 2000).


Lighthouse Church of Cloverleaf v. Texas Bank, 889 S.W.2d 595 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

Mello, 7 S.W.3d at 331. Note, however, that the liability of officers and directors of the corporation for debts incurred during the period of such forfeiture remains. TEX. TAX CODE ANN. § 171.255(d) (Vernon 1992).
survival statute applicable to "dissolved corporations" pursuant to the Texas Business Corporation Act.

*In Re ABZ Insurance Services, Inc.* involved a motion to dismiss a bankruptcy case and a pending adversary proceeding of a Chapter 7 debtor based on the debtor's forfeiture of its corporate charter for failure to pay franchise taxes.\(^{17}\) The debtor in *ABZ* filed its bankruptcy petition on October 21, 1997, six days after its corporate privileges had been forfeited by the Comptroller pursuant to the Texas Tax Code, but before the Secretary of State forfeited the corporation's charter.\(^{18}\) The Secretary of State did not forfeit the debtor's charter until February 18, 1998.\(^{19}\)

In the motion considered by the court, the movant argued that (1) once the Secretary of State forfeited the debtor's charter, it was no longer an eligible "person" under the Bankruptcy Code, thereby requiring that the bankruptcy case and all adversary proceedings to be dismissed; and (2) in any event, when the Comptroller forfeited the debtor's corporate privileges under the Texas Tax Code, the debtor was barred from bringing any proceeding in any court of the State of Texas, including the bankruptcy court.\(^{20}\)

Interestingly, the court agreed with the proposition that a corporation whose corporate privileges have been forfeited by the Comptroller is barred from participating in court proceedings, including obtaining relief in federal bankruptcy courts situated in Texas, noting that the term "court of this state" as used in the Texas Tax Code had previously been interpreted by a federal court to apply to both Texas state and federal courts.\(^{21}\) The court further found that the debtor corporation in this case had in fact forfeited its privileges of suing and defending in a "court of this state" on October 15, 1997, which as previously stated, occurred six days prior to the date the corporation filed for protection under the Bankruptcy Code.\(^{22}\) Nevertheless, the court determined that when the Secretary of State forfeited the debtor's charter on February 18, 1998, the forfeiture "revived" the debtor's right to sue and defend in Texas courts for the purpose of liquidating and distributing its assets as a "dissolved corporation," pursuant to the three year limited survival statute under the Texas Business Corporation Act.\(^{23}\)

A bankruptcy filing made within the three-year period following a corporation's dissolution due to charter forfeiture for failing to pay franchise taxes, and any attendant adversary proceedings necessary to (i) collect its assets, (ii) pay or satisfy its debts and (iii) liquidate its business, does indeed appear to be within the purview of the actions permitted and is

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18. *Id.* at 257
19. *Id.*
20. *Id.*
22. *Id.*
clearly necessary for a dissolved corporation to undertake during its three year survival period, as provided by the Texas Business Corporation Act. It is unclear from the decision, however, what result would have ensued if the motion had instead been filed immediately after the bankruptcy petition was filed, which would have occurred 6 days after the Comptroller forfeited the debtor’s corporate privileges, including its right to sue and defend in the courts of the state, but before the Secretary of State formally forfeited the corporation’s charter. According to the reasoning of the court, the corporate debtor could not have properly filed the petition or adversary actions during that period. This is because a corporation whose corporate privileges have been forfeited is not in fact a “dissolved corporation” with revived rights to sue and defend under the Texas Business Corporation Act. Rather, the corporation is denied such privileges under the Texas Tax Code. By happenstance of timing of the Secretary of State’s forfeiture of the charter and the ensuing revival of the debtor’s ability to undertake dissolution, this debtor got lucky. Had the creditor raised this issue earlier (within the four-month period before the Secretary of State forfeited the debtor’s charter), it may well have prevailed. Similarly, had the Secretary of State not forfeited the debtor’s charter following the Comptroller’s forfeiture of the debtor’s corporate privileges, the creditor likewise would have prevailed. 

24. See Tex. Bus. Corp. Act Ann., art. 6.04 (Vernon Supp. 2000); Tex. Bus. Corp. Act Ann., art. 7.12. Indeed, the corporation, at any time during the liquidation of its business and affairs, may make application to any district court of this State in the county in which the registered office of the corporation is situated to have the liquidation continued under the supervision of such court as provided by the Act.

25. See ABZ, 245 B.R. at 257. The court intimates that the corporation would not have been left without redress during this period between forfeiture of privileges and forfeiture of charter because its shareholders could act in a representative capacity. The Bankruptcy Code does not provide, however, for a “representative” filing on behalf of a corporation.


27. A bankruptcy court addressing this issue could be faced with some interesting choices. For example, if the court dismisses the case, can the former debtor simply pay the overdue franchise taxes and then become eligible to file a bankruptcy petition? Can the new eligible debtor then sue to recover the tax payment as a preferential payment? What if the motion to dismiss is brought by a creditor who received a substantial preferential payment and, if the case is dismissed, the creditor will be beyond the preference reach-back period if the case is later recommenced? Should the bankruptcy court rely on technicalities and cause the debtor’s estate to lose a potential source of recovery; or might the court find a way to keep the debtor in bankruptcy, by allowing, for example, the debtor to pay its prepetition franchise tax above and ahead of the debtor’s prepetition creditors? Thus, under particular facts and circumstances this issue can have ramifications far beyond intellectual curiosity.

28. The text of section 171.309 seems to not require the Secretary of State to forfeit a charter after 120 days. The Secretary of State “may forfeit” the charter if the conditions in the statute are met. Tex. Tax Code Ann. § 171.309 (Vernon 1992). This language contrasts with the language of section 171.302, which requires (“the comptroller shall certify”) the Comptroller to certify the name of the corporation to the Attorney General and Secretary of State after the 120th day that the corporate privileges are forfeited. Tex. Tax Code Ann. § 171.302 (Vernon 1992). Thus, a corporation would theoretically be kept in the “purgatory” of forfeited privileges, but not be dissolved and thereby not be in a position to be bankrupt.
C. DISREGARDING THE CORPORATE FORM (TEXAS-OHIO GAS, INC. v. MEACOM III)

During the last Survey period, this Corporations Survey noted the general reluctance by most Texas courts to disregard the corporate form, or to otherwise impose personal liability on officers, directors, and shareholders of corporations, without significant justification for doing so, pursuant to the factors set forth in the cornerstone case of Castleberry v. Branscum. Each of the cases discussed in last year's Corporations Survey, however, involved efforts by a plaintiff to impose personal liability on the shareholders of a corporation for personal injuries sustained by the plaintiff as a result of the actions of such corporation.

Among the various decisions handed down by the Texas courts during this Survey period, Texas-Ohio Gas, Inc. v. Mecom is significant because it provides an opportunity to distinguish between the judicial treatment of cases in which personal shareholder liability is sought as a result of a tort committed by a corporation unrelated to a contractual obligation, and cases where personal liability is sought as a result of a contractual obligation of the corporation, regardless of whether liability is based on the contract or some alleged tort related to such contract. In the latter situation, the Castleberry common law alter ego theories have been superseded by Texas' Shareholder Protection Act, Article 2.21(A)(2) of the Texas Business Corporation Act.

Article 2.21(A) of the Texas Business Corporation Act provides in pertinent part:

A. A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate thereof or of the corporation, shall be under no obligation to the corporation or its obligees with respect to:

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, owner, subscriber, or affiliate is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory, unless the obligee dem-

30. See Castleberry, 721 S.W.2d at 272. Under Castleberry, the “alter ego” factors are: “(1) when the [corporate] fiction is used as a means of perpetrating fraud; (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation; (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation; (4) where the corporate fiction is employed to achieve or perpetrate a 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 a crime or to justify a wrong.”
31. West & Fairman, supra note 29, at 775-78.
32. 28 S.W.3d 129 (Tex. App.—Texarkana 2000, no pet. h.).
34. TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon Supp. 2000) [hereinafter in text Article 2.27].
onstrates that the holder, owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, subscriber, or affiliate; or

(3) any 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 this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.  

Furthermore, Article 2.21(B) of the Texas Business Corporation Act provides that the limitation of liability of shareholders, owners, subscribers and affiliates set forth in Section A is “exclusive and preempts any other liability imposed on a holder, owner, or subscriber of shares of a corporation or any affiliate thereof or of the corporation for that obligation under common law or otherwise,” except where there is an express guarantee or assumption of liability by such person or some other statute imposes such liability.

The effect of Article 2.21 on tort cases involving alter ego allegations has been to simply remove, by virtue of Clause (3) of Article 2.21(A), the failure to observe corporate formalities as a factor in finding an alter ego to exist.  

Clause (2) of Article 2.21(A), however, appears to have been clearly intended, in cases involving the contractual obligations of a corporation, to eliminate the ability of parties to such contract to make claims of alter ego, even for fraud or other tort claims arising out of a contractual dispute, unless the claimant can demonstrate that the contracting corporation was used to perpetrate an actual fraud on the claimant “primarily” for the “direct personal” benefit of the shareholder or other individual upon whom personal liability is sought to be imposed.

*Texas-Ohio Gas* involved a plaintiff who sought to recover from shareholders and employees of a corporation for the contractual debts of the corporation. The plaintiff’s claims included negligent misrepresentation, fraud, fraudulent inducement, and tortious interference with a contract, based on alleged contractual misrepresentations in which the

35. *Id.*


37. *See, e.g.*, Hall v. Timmons, 987 S.W.2d 248, 250 n.2 (Tex. App.—Beaumont 1999, no pet.); *see also* Aluminum Chems. (Bol.), Inc. v. Bechtel Corp., 28 S.W.3d 64, 67 n.3 (Tex. App.—Texarkana 1999, no pet.). However, it has also been stated during this Survey period regarding Article 2.21, perhaps incorrectly, that “[a]lthough there is some collegial disagreement about its intent, the cited amendments to the Texas Business Corporation Act removed the traditional distinction between the application of alter ego in a contract and a tort context. The result is that fraud must now be shown before a plaintiff may recover in either situation.” *Aluminum Chems.*, 28 S.W.3d at 68 n.4.


plaintiff agreed to sell natural gas to the corporation on credit.\textsuperscript{40} At the center of the plaintiff's claims was the defendants' alleged misrepresentation to the plaintiff that the corporate entity entering into the contract with the plaintiff had "merged" with a "stronger" corporation when, in fact, the defendants' corporation had become a lower-tier subsidiary of that stronger parent entity.\textsuperscript{41}

Apparently, the plaintiff had previously sold natural gas to another company owned and operated by the defendants, GM Hydrocarbons.\textsuperscript{42} The defendants sold GM Hydrocarbons to Olympic Energy Corporation ("OEC") in a transaction pursuant to which OEC assumed the contractual obligations of GM Hydrocarbons, but GM Hydrocarbons operated as a wholly owned division or subsidiary of OEC and continued to do business in its own name.\textsuperscript{43} OEC also controlled another indirect and wholly-owned subsidiary, Olympic Gas Marketing ("OGM").\textsuperscript{44} OGM was a corporation with $1,000 in capital and all of its other assets were encumbered.\textsuperscript{45} The false representation complained of by Texas-Ohio was that the defendants, in order to induce Texas-Ohio to sell gas to OGM and other OEC related entities on the same credit terms previously enjoyed by GM Hydrocarbons, misrepresented to Texas-Ohio that GM Hydrocarbons had been merged with OGM. Thus, Texas-Ohio was led to believe that in doing business directly with OGM, they were actually doing business with a "newer and larger corporation."\textsuperscript{46} OGM and its related entities subsequently purchased over $1 million in natural gas, failed to pay for it, and were placed in bankruptcy.\textsuperscript{47}

Based on the pleadings, the trial court dismissed all of the plaintiff's claims without specifying the nature of, or grounds for, the dismissal.\textsuperscript{48} On appeal, the issue was whether there were any grounds to support the dismissal.\textsuperscript{49} The defendants argued that the dismissal was proper either as (a) a Rule 13 sanction for filing groundless claims in bad faith or for the purpose of harassment, (b) a failure to state a claim, or (c) a no evidence summary judgment.\textsuperscript{50} Thus, at the heart of the appellate court's review was whether a claim against the individual defendants for the con-

\textsuperscript{40} Id. at 133-34. Texas-Ohio's claims were generally based on its allegation that the defendants participated individually and as co-conspirators in a fraudulent scheme that induced Texas-Ohio to sell natural gas to insolvent entities.

\textsuperscript{41} Id.

\textsuperscript{42} Id.

\textsuperscript{43} Id. 28 S.W.3d at 133-34.

\textsuperscript{44} Id. at 134 n.1. Apparently OGM was also the name under which all of the related Olympic entities did business at the time the alleged misrepresentation was made. Because OGM was not actually formed as a corporate entity until after the alleged misrepresentation was made.

\textsuperscript{45} Texas-Ohio Gas, 28 S.W.3d at 134 n.2.

\textsuperscript{46} Id. at 133.

\textsuperscript{47} Id. at 134.

\textsuperscript{48} Id.

\textsuperscript{49} Id.

\textsuperscript{50} Id. Unfortunately, the court of appeals determined that the defendant's motion could not be construed as a no evidence summary judgment. Id. at 142.
tractual debts of OGM to Texas-Ohio was legally supportable under Texas law.

The appellate court reviewed the plaintiff’s allegations and the defendants’ contention that the plaintiff’s “entire action [was] a groundless attempt to extend corporate debt liabilities to individuals” in violation of Article 2.21 of the Texas Business Corporation Act.\(^5\) The appellate court found that “all of Texas-Ohio’s claims [were] attempting to hold shareholders personally liable for a matter relating to or arising from a contractual obligation of the corporation.”\(^5\) Consequently, the court correctly invoked the exclusivity of Article 2.21 as the only means of imposing shareholder liability with respect to the claims alleged by the plaintiff.\(^5\) In applying Article 2.21, the court held that the plaintiff’s claim alleging negligent misrepresentation was “groundless,” because it lacked the element of actual fraud required by Article 2.21.\(^5\)

With respect to the remaining claims for fraud, fraudulent inducement, and tortious interference with a contract, however, the court reached a different conclusion, determining that such claims were not groundless under the shareholder liability provisions of Article 2.21.\(^5\) Specifically, the court noted that while the plaintiff did not allege personal fraud by the defendants, the plaintiff’s claims were nevertheless based upon the defendants’ alleged participation in a fraudulent conspiracy to induce Texas-Ohio to sell natural gas to a company that the defendants knew to be insolvent.\(^5\) Thus, despite the court’s acknowledgment that the defendants’ actions were on behalf of the corporate entities that employed them, and notwithstanding the further acknowledgment of the general rule that corporate agents or employees acting within the scope of their employment or agency relationship cannot, as a matter of law, form a conspiracy, the court held that “corporate agents can conspire with one another even if they are purportedly acting as employees of the corporation, if they are in fact acting primarily for their own personal benefit.”\(^5\) According to the court, it was irrelevant that the plaintiff’s petition did not allege that the fraud committed by the defendants through this conspiracy was for the personal benefit of the defendants, as required by Article 2.21.\(^5\) Such failure simply amounted to a defect in the petition, which should have been remedied through special exceptions.\(^5\) As such, the court noted that Article 2.21 does not bar shareholder liability in cases of actual fraud for personal gain. The court therefore concluded that all of the plaintiff’s claims, with the exception of negligent misrepresentation, were not groundless, and there was no proper basis for the trial

\(^{51}\) Texas-Ohio Gas, 28 S.W.3d at 136.
\(^{52}\) Id. at 137.
\(^{53}\) Id. at 137-38.
\(^{54}\) Id.
\(^{55}\) Id. at 138.
\(^{56}\) Id. at 134.
\(^{57}\) Texas-Ohio Gas, 28 S.W.3d at 138 n.10.
\(^{58}\) Id. at 138.
\(^{59}\) Id.
Texas-Ohio Gas is a disturbing decision. Despite the apparent clarity of Article 2.21 and the fundamental notion that parties to a contract have an opportunity to bargain for guarantees from parent companies, affiliates, or shareholders, should such assurances be desired, the court has effectively allowed a party to a contract that expressly names a specific corporation as the obligor, to obtain an unbargained-for guarantee from the corporation's shareholders to the extent that a jury finds that a "representation" was made on behalf of the corporation that the contracting corporation had "merged" with another corporation. This decision does a serious disservice to the sanctity of the corporate entity and to the principles enunciated in Part of A of Section II. If the Texas-Ohio Gas decision correctly states Texas law, piercing the corporate veil has effectively become a simple exercise in pleading fraudulent inducement, even if the plaintiff contracted solely with a corporate entity acting through its authorized officer, and the corporation's shareholders did not contractually assume the obligation. This result is directly contrary to the Texas courts' repeated condemnation of concocted tort claims arising from a clearly contractual arrangement. Furthermore, the court's decision diverges from Article 2.21 and the Texas legislature's clear mandate that piercing the corporate veil in contract cases (including tort claims arising out of such contracts) requires the corporation to have been used to perpetuate an "actual fraud primarily" for the "direct personal benefit" of the persons upon whom personal liability is sought to be imposed. Apparently there were no allegations in Texas-Ohio Gas that the defendants "primarily" and "directly" benefited from the purchase of the gas by OGM. If the primary beneficiary is the corporation, indirect benefits to a shareholder (such as those obtained by being an employee or shareholder of the benefited corporation) or even direct benefits to a shareholder, are not sufficient under Article 2.21 to impose liability. Therefore, this author does not believe Texas-Ohio Gas was decided correctly.

D. Drafting Corporate Agreements

As discussed in last year's Corporations Survey, drafting agreements with corporate entities presents unique issues not present in dealing with individuals or other entities. As noted in the discussion of Texas-Ohio in
Part C of this Section, even clear drafting specifically naming the corporation as the only party to an agreement is not a guarantee that a plaintiff will not attempt to rewrite the agreement to add parties thereto. Careful drafting can, however, eliminate most of those attempts. During the Survey period, Texas courts confronted (1) a case involving the failure to clearly draft a document with a corporate entity in mind, as opposed to an individual, and the effect of such lack of clarity on the individual involved; (2) a case involving the binding nature of a letter of intent containing a provision requiring the parties to negotiate "in good faith" and specifically stating that the provision was intended to be binding; and (3) a case addressing whether a successor corporation assumed certain tort liabilities when its predecessor purchased a corporation's assets.

1. Taylor-Made Hose, Inc. v. Wilkerson

While it is true that, "an officer of a corporation may assume personal responsibility for a corporate transaction either by adding his responsibility to that of his corporate principal, or by tendering his own responsibility for that of his principal," except in situations where a corporate officer (who is usually also a significant owner of the corporation) executes a specific separate personal guaranty, it is rare that a corporate officer executing a document on behalf of a corporation intends to become personally liable therefor. Too often, however, despite the presumed literacy of most corporate officers, the body of the document or signature block does not clearly specify the officer's representative capacity.

Lynne Wilkerson, a corporate vice-president, found herself a victim of this common mistake when Taylor-Made Hose, Inc. sought to impose personal liability on her in connection with a credit application she signed on behalf of her employer, North American Transit, Inc. The one-page application, which clearly sought credit information concerning the corporate entity and not that of Wilkerson, contained the following clause in the terms and conditions: "I, personally agree to pay all invoices and costs of collection . . . on any amount remaining unpaid after 90 days." The form was then signed as follows:

OFFICER'S NAME: Lynne Wilkerson  TITLE: Vice-President

SIGNATURE OF OFFICER: /s/ Lynne Wilkerson

DATE: 7-21-94

63. 21 S.W.3d 484 (Tex.App.—San Antonio 2000, pet. denied).
65. One Texas court pointed out during the last Survey period, that even an illiterate person is held to have known and understood the legal effect of a contract he signed. See Reyes v. Storage and Processors, Inc., 995 S.W.2d 722 (Tex. App.—San Antonio 1999, pet. denied).
66. See Mort Keshin & Co. v. Houston Chronicle Publ'g Co., 992 S.W.2d 642, 647 (Tex. App.—Austin 1998, no. pet.).
67. Taylor-Made, 21 S.W.3d at 489.
Based on the clause quoted above, Taylor-Made sued Wilkerson personally as the guarantor of North American Transit's debts to Taylor-Made following North American Transit's discharge in bankruptcy.68 The trial court rendered a take nothing summary judgment against Taylor-Made, concluding that Wilkerson had signed the application only in her representative, and not individual, capacity.69

On appeal, Taylor-Made argued that the credit application “unambiguously establishes Wilkerson to be a personal guarantor of” the obligations of the corporate applicant.70 The San Antonio Court of Appeals agreed that the credit application was unambiguous, noting that “[b]y agreeing to ‘personally . . . pay’ North America Transit’s delinquent account, Wilkerson made herself personally liable for the corporation’s debt.”71

In holding that the credit application was unambiguous, the court ignored the content of the application that clearly requested information solely for the corporation and instead found an individual obligation in the phrase “I, personally agree.”72 According to this court, apparently a corporation cannot be an “I” nor can it “personally agree.”73 As a result, the court of appeals reversed the trial court’s judgment and remanded the case for further proceedings consistent with the court of appeals’ opinion.74

A dissenting opinion by Justice Lopez, joined by Chief Justice Hardberger, disagreed that the application unambiguously made Wilkerson the guarantor of her employer’s debts and warned that the “majority’s opinion puts at risk the personal estates of corporate officers and employees across the State of Texas. . . .[who] can now be lured into personally guaranteeing the debts of their employer no matter how weakly-worded and despite the fact that they are signing the document solely in their official capacity.”75

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68. Id. at 487.
69. Id.
70. Id. at 488.
71. Id.
72. For a discussion of the rules governing the admissibility of parol evidence to demonstrate whether a person signed in a representative or individual capacity see Gary D. Spivey, Annotation, Admissibility of Parol Evidence to Show Whether Guaranty of Corporation’s Obligations was Signed in Officer’s Representative or Individual Capacity, 70 A.L.R.3d 1276 (1976); L.S. Tellier, Annotation, Admissibility of Oral or Extrinsic Evidence on Question of Liability on Bill of Exchange, Promissory Note, or Other Contract Where Signature is Followed by Word or Abbreviation Which May be Either Descriptive or Indicative of Contracting Character, 113 A.L.R. 1364 (1938).
73. But see TMG Truck Serv., Inc. v. Petty, 313 S.W.2d 142 (Tex. Civ. App.—Dallas 1958, writ ref’d n.r.e.). (Use of the pronoun “I” in the body of the contract with the words “I, [name of the president] president of [name and address of corporation] agrees to pay”, where the signature block named the corporation and the title of the officer, did not render the corporation’s president who signed the contract personally liable as a matter of law).
74. The decision that the majority appears to have principally relied upon in reaching its decision, Austin Hardwoods, Inc. v. Vanden Berghe, 917 S.W.2d 320 (Tex. App.—El Paso 1995, writ denied), is clearly distinguishable. In Austin Hardwoods, the credit application read: “If a corporation, the undersigned personally guarantees the payment of this account in his individual capacity.” Id. at 323.
75. Taylor-Made, 21 S.W.3d at 495.
Taylor-Made should be a reminder of the need to caution clients about signing "standard forms." In addition to insisting that the representative capacity of an officer is clearly stated, clients should also make certain that the only obligor in the body of the agreement is the corporate entity\textsuperscript{76} and remove any "form" language reflecting the personal pronoun "I" and other similar words such as "personally."\textsuperscript{77}

2. \textit{John Wood Group USA, Inc. v. ICO, Inc.}\textsuperscript{78}

In \textit{John Wood}, the court addressed the common practice among corporate practitioners of using preliminary letters of intent to outline the basic terms of a corporate acquisition prior to negotiating the definitive purchase agreement. Ever since the much criticized decision in \textit{Texaco, Inc. v. Pennzoil Co.},\textsuperscript{79} Texas corporate practitioners have been particularly sensitive to ensuring that their letters of intent cannot possibly be mistaken for binding agreements.

In \textit{John Wood}, ICO, Inc. ("ICO") sought to purchase the assets of NDT, a manufacturer of pipe inspection equipment, from NDT's parent companies, Wood Group Drilling & Production Services, Ltd. and John Wood Group USA, Inc. (the "Wood Group").\textsuperscript{80} ICO and the Wood Group negotiated and entered into a letter agreement outlining the essential terms of the proposed sale.\textsuperscript{81} The letter agreement contained the following clause:

15. Binding Effect. This Letter Agreement constitutes a summary of the principal terms and conditions of the understanding which has been reached regarding the sale of certain assets to Purchaser (ICO). \textit{It does not address all of the terms and conditions which the parties must agree upon to become binding and consummated.} The Purchaser, however, does intend to move forward with its due diligence and expects to expend considerable sums to review the Sellers' Business. In consideration therefor, the parties have agreed to make cer-

\textsuperscript{76} If the body of the contract makes clear that the obligation is intended to be that of the corporation, the form of the signature appears to be less significant. \textit{See} Robertson v. Bland, 517 S.W.2d 676 (Tex. Civ. App.—Houston [1st Dist.] 1974), writ dism'd; FDIC v. K-D Leasing Co., 743 S.W.2d 774 (Tex. App.—El Paso 1988, no writ); \textit{See also}, D.C. Barrett, Annotation, \textit{Person Who Signs Contract But is Not Named in Body Thereof as Party to Contract and Liable Thereunder}, 94 A.L.R.2d 691 (1964).

\textsuperscript{77} For additional examples of what not to do, see the cases discussed in W.A.E., Annotation, \textit{Personal Liability of Directors as Affected by Terms of Contract or Form of Signature}, 33 A.L.R. 1353 (1924), supplemented 51 A.L.R. 319 (1927). Particular caution should be used when signing in any name other than the actual name of the corporation. Using an assumed or trade name may impose personal liability on the officer, even if he clearly signed in a representative capacity, because his principal (the corporation whose actual true name was not used) may be undisclosed. \textit{See} Lachmann v. Houston Chronicle Pub'g Co., 375 S.W.2d 783 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.); Wolf v. Little John Corp. of Liberia, 585 S.W.2d 774 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.); Lassiter v. Rotogravure Comm. Inc., 727 S.W.2d 8 (Tex. App.—Dallas 1986, writ ref'd n.r.e.).

\textsuperscript{78} 26 S.W.3d 12 (Tex. App.—Houston [1st Dist.] 2000, no pet.).

\textsuperscript{79} 729 S.W.2d 768 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

\textsuperscript{80} \textit{John Wood}, 26 S.W.3d at 14.

\textsuperscript{81} \textit{Id.} at 15.
tain covenants of this letter binding upon the parties notwithstanding the fact that not all details of the transactions have been agreed upon. Accordingly, it is understood and agreed that this letter is an expression of the parties' mutual intent and is not binding upon them except for the provisions of paragraphs (4), (7), (9), (10), (11), (12), (13), and (14) hereof.82

The binding provisions included an agreement to negotiate in good faith, a prohibition on third-party negotiations ("no shop") and a confidentiality agreement, as well as some other less important provisions.83 The provisions dealing with the purchase price, conditions for closing, assets to be acquired and terms of issuance of ICO shares were nonbinding.84

Following the execution of the letter agreement, the negotiations for the sale of NDT eventually broke down and subsequently (after the end of the no shop period set forth in the letter agreement), the Wood Group closed a deal for the sale of NDT with Tuboscope Vetco International, a competitor of ICO.85 ICO then purchased another manufacturer of pipe inspection units and sued the Wood Group for breach of the letter agreement to sell NDT.86 After trial, the jury awarded ICO $8.5 million in actual damages for breach of contract, $2,761,917 in prejudgment interest and $4,504,766 (40% of ICO's recovery) in attorney's fees, plus post judgment interests and costs.87

On appeal, the Wood Group argued that the letter agreement was non-binding as a matter of law and that the trial court erred by submitting a question to the jury concerning the breach of that letter agreement.88 ICO argued that the letter agreement was ambiguous and presented an issue for the jury on the fact question of whether the parties intended to be bound by the letter agreement.89 The court of appeals noted the familiar rule that, "if a contract is worded so that it can be given a certain or definite legal meaning, then it is not ambiguous, and . . . a trial court errs when it submits the question of the parties' intent to the jury."90

In determining whether the letter agreement was unambiguously binding on the parties, the court first considered Foreca v. GRD Development Co.91 In Foreca, the parties had entered into an agreement that stated it was "subject to legal documentation."92 The Foreca court held that making an agreement "subject to legal documentation" did not unambiguously state an intention not to be bound to the agreement.93 According

82. Id. (emphasis added).
83. See id.
84. Id.
85. Id.
86. John Wood, 26 S.W.3d at 15-16.
87. Id. at 16.
88. Id.
89. Id.
90. Id.
91. 758 S.W.2d 744 (Tex. 1988).
92. John Wood, 26 S.W.3d at 16 (quoting Foreca).
93. Id. at 16-17.
to the court in *John Wood*, the phrase “subject to legal documentation” could either be a reference to a condition to the formation of a future contract or it could refer to a future memorial to an already existing contract.94 As a result, it was understandable that the *Foreca* court found ambiguity and submitted the issue to a jury.95 However, the *John Wood* court noted that in the case *sub judice*, the letter agreement expressly stated that it was “not binding,” except for “certain enumerated paragraphs.”96 Thus, the *John Wood* court distinguished *Foreca* based on the difference in the language used.

The *John Wood* court next considered *Murphy v. Seabarge, Ltd.*97 In *Murphy*, the agreement, like the agreement in *John Wood*, expressly provided that it was “not intended to be a binding contract.”98 The *John Wood* court noted, however, that the *Murphy* court found that the parties' actions after the agreement was entered into raised a fact issue as to the parties' intent to be bound.99 In *Murphy*, despite the express statement denying any intent to be bound, the plaintiff began performing under the agreement by paying himself a management fee and thereby creating a fact issue as to the parties' intent to be bound.100 In *John Wood*, on the other hand, there was no issue of “partial performance” and, indeed, “it is the complete lack of performance that gave rise to this lawsuit.”101

The *John Wood* court next reviewed *Coastal Corp. v. Atlantic Richfield Co.*102 (“*Coastal Corp.*”) and *RHS Interests, Inc. v. 2727 Kirby Ltd.*103 (“*RHS Interests*”), and found the facts in these cases more similar to the facts in *John Wood*, than those in *Foreca* or *Murphy*.104

In *Coastal Corp.*, the parties prepared (but never signed) an agreement providing that “nothing in this Agreement shall be binding upon any of the parties until this Agreement is executed by all of the parties by their duly authorized officers.”105 Thus, the *Coastal Corp.* court held that because the document memorializing the parties' agreement expressly required that it be executed to be binding, and because the parties in fact never executed the agreement, no contract existed.106

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94. Id. at 17.
95. Id.
96. Id.
97. 868 S.W.2d 929 (Tex. App.—Houston [14th Dist.] 1994, writ denied).
98. *John Wood*, 26 S.W.3d at 17 (citing *Murphy*, 868 S.W.2d at 933).
99. Id. (citing *Murphy*, 868 S.W.2d at 933).
100. *Murphy*, 868 S.W.2d at 938.
102. 852 S.W.2d 714 (Tex. App.—Corpus Christi 1993, no writ).
103. 994 S.W.2d 895 (Tex. App.—Houston [1st Dist.] 1999, no pet.).
104. See *John Wood*, 26 S.W.3d at 18.
105. Id. at 17 (citing *Coastal Corp.*, 852 S.W.2d at 717).
106. 852 S.W.2d at 717. While the letter agreement in *Coastal Corp.* involved an agreement to sell stock at a time when the statute of frauds applied to such agreements, section 8.113 of the current Texas Business and Commerce Code makes clear that the statute of frauds does not apply to the sale or purchase of a security. See *Tex. Bus. & Com. Code Ann.* § 8.113 (West 2000). See also *Tex. Bus. & Com. Code Ann.* § 26.01 (West 2000) (codifying the statute of frauds). Since technically an oral agreement would be sufficient to
In RHS Interests, the parties entered into a letter agreement that provided “[t]his offer is a summary of a transaction to be fully described in an Earnest Money Contract . . . This letter serves only as an offer . . . and is not binding as an agreement unless and until a fully executed Earnest Money Contract is signed.” 107 The Earnest Money Contract was never executed. The RHS Interests court held that there was no binding contract because “[a] deal would be consummated only by ‘the execution of the binding Purchase and Sale Agreement.’” 108

While acknowledging that “a binding contract may be formed if the parties agree on the material terms, even though they leave open other provisions for later negotiation,” 109 and that “a letter of intent may be binding even though it refers to the drafting of a future, more formal agreement,” 110 the John Wood court held that the letter agreement in question clearly and unequivocally expressed the parties’ intent not to be bound. 111

Although the court clearly reached the correct result, it is disturbing that the court found it necessary to engage in so much analysis over what would appear to a corporate practitioner to be patently obvious in this case, i.e., as the court finally declares, “not binding in this case means exactly that, not binding.” 112

In addition to considering ICO’s claim that the letter agreement was a binding agreement of sale and purchase, the John Wood court also considered ICO’s claim that the good faith negotiation clause, which was expressly binding on the parties pursuant to the terms of the letter agreement, was breached. 113 The good faith negotiation clause provided: “Each of the Sellers and the Purchaser shall cooperate and work in good faith and do all acts and things as the other party may, either before or after the Closing Date, reasonably require to effectively carry out or better evidence or perfect the full intent and meaning of this Letter

effect a sale of securities, it makes sense to include a provision like that of Coastal Corp. in drafts of stock purchase agreements in order to avoid a claim that the parties have a binding oral agreement that the unsigned draft agreement memorializes.

107. John Wood, 26 S.W.3d at 17 (citing RHS Interests, 994 S.W.2d at 897).

108. Id. at 17-18 (citing RHS Interests, 994 S.W.2d at 897). The John Wood court also discussed two cases from other jurisdictions on the issue of whether the use of the term “not binding” is ambiguous. See Feldman v. Allegany Int’l, Inc., 850 F.2d 1217, 1219 (7th Cir. 1988) (holding was a contract clearly not binding where a provision stated that the parties “understood that this is not a binding agreement and the obligations and rights of the parties shall be set forth in the definitive agreement executed by the parties”); Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 70 (2d Cir. 1989) (finding references in letter of intent to the fact that negotiations might fail and that the binding agreement was to be completed at a future date, conclusively established that the parties did not intend to be bound by letter of intent).


110. Id. at 19 (citing Foreca, 758 S.W.2d at 746).

111. Id. at 20.

112. Id.

113. Id.
ICO claimed that the damages awarded by the jury for breach of contract were the same measure of damages that should be awarded for the failure of the Wood Group to enter into the definitive agreement it had agreed to negotiate in good faith. Citing the 7th Circuit's decision in Venture Associates Corp. v. Zenith Data Systems Corp., ICO sought to use the language in Venture Associates to show that but for the Wood Group's "bad faith, the parties would have made a final contract." Thus, the "damages for a breach of an agreement to negotiate [are] . . . the same as the damages for breach of the final contract that the parties would have signed had it not been for the defendant's bad faith."

The John Wood court declined to rely on Venture Associates, however, because it was based on Illinois law and not Texas law. According to the John Wood court, under Illinois law, an agreement to negotiate toward the formation of a contract is an enforceable obligation, whereas "under Texas law an agreement to negotiate in the future is unenforceable, even if the agreement calls for a 'good faith effort' in the negotiations." Furthermore, the John Wood court found this particular good faith negotiation clause "too vague to be enforceable as a contractual obligation." Citing the Texas Supreme Court's decision in Northern Natural Gas Co. v. Conoco, Inc., the John Wood court held that in order for a breach of a good faith provision to give rise to damages, it must be tied to another binding obligation created by the letter agreement.

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114. Id. at 20 n.3. Clearly the reference to "before or after the Closing Date," is bizarre language for a nonbinding letter of intent contemplating a definitive document to supersede it.
116. 96 F.3d 275 (7th Cir. 1996).
117. Id. at 278.
118. John Wood, 26 S.W.3d at 21 (quoting Venture Assoc., 96 F.3d at 278).
119. Id.
120. Id. (citing Radford v. McNeny, 104 S.W.2d 472, 474-75 (Tex. 1937); Maranatha Temple, Inc. v. Enter. Prods. Co., 893 S.W.2d 92, 104 (Tex. App.—Houston [1st Dist.] 1994, writ denied)).
121. Id. at 21 (citing Richter v. Bank of Am. Nat'l Trust and Sav. Ass'n, 939 F.2d 1176 (5th Cir. 1991) (holding that agreement by bank to negotiate in good faith toward a reasonable restructure of the plaintiff's debt was too indefinite to enforce)).
122. 986 S.W.2d 603, 606-07 (Tex. 1998). In Northern Natural Gas, the Texas Supreme Court held that the obligation of good faith imposed on agreements covered by the Uniform Commercial Code pursuant to Tex. Bus. & Com. Code section 1.203, "does not support an independent cause of action for the failure to perform or enforce in good faith." Id. at 606.
123. John Wood, 26 S.W.3d at 22. Other states differ on whether good faith clauses in letters of intent are treated as binding. Like Texas law, Massachusetts law does not treat good faith clauses in letters of intent as binding on the parties where the letter of intent specifically states that it is not intended to create any binding legal obligation. See Schwanbeck v. Federal-Mogul Corp., 412 Mass. 703 (1992); Lafayette Place Assocs. v. Boston Redevel. Auth., 427 Mass. 509 (1998); Rosenfield v. U.S. Trust Co., 195 N.E. 323 (Mass. 1935). Under Illinois law, a good faith clause in a letter of intent can be binding on the parties if the parties intended to be legally bound. See Venture Assoc., 96 F.3d 275, 277 (7th Cir. 1996). Similarly, under New York law, parties may use letters of intent and good faith clauses to bind themselves if the parties intend to be bound. See Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc., 145 F.3d 543 (2d Cir. 1998).
Finally, ICO argued that the jury's damage award could also be supported on the basis of a breach by the John Wood Group of the no shop and confidentiality provisions in the letter agreement.\textsuperscript{124} Apparently, John Wood had continued to negotiate with the party to whom it eventually sold NDT, even though it waited until after the no shop provision expired to actually enter into a transaction with this party.\textsuperscript{125} The \textit{John Wood} court held, however, that the breach of these provisions would not support the "benefit of the bargain damages" awarded by the jury.\textsuperscript{126} The court also held that the liquidated damages award specifically provided for in the letter agreement for a breach of the no shop provision could not be sustained as it was impossible to tell whether the jury awarded the liquidated damages as a result of the breach of the nonbinding agreement or as a result of a breach of these provisions which were binding.\textsuperscript{127} Therefore, the court remanded ICO's claim for breach of the no shop and confidentiality provisions and the liquidated damages award to the trial court for further proceedings.\textsuperscript{128}

3. \textit{Lockheed Martin Corp. v. Gordon}\textsuperscript{129}

\textit{Lockheed} involved the often heavily negotiated issue of which liabilities a purchaser agrees to assume in an asset acquisition agreement involving a sale of all or substantially all of the assets of a selling corporation. In \textit{Lockheed}, workers exposed to silica and silica-containing dust sued for personal injuries resulting therefrom.\textsuperscript{130} One of the original defendants was Wedron Silica Company, the alleged supplier of the silica compounds to the foundries at which the workers had been exposed.\textsuperscript{131} Wedron had sold all of its assets in 1979 to Martin-Marietta Corporation pursuant to an asset purchase agreement.\textsuperscript{132} Lockheed Martin thereafter became a successor-in-interest to Martin-Marietta Corporation, presumably as the result of a merger of Martin-Marietta into Lockheed Corporation.\textsuperscript{133} Lockheed Martin had filed a motion for summary judgment in the trial court based on the 1979 asset purchase agreement between Wedron and Martin-Marietta, arguing that Martin-Marietta had neither expressly nor impliedly assumed liability for Wedron's contingent torts in...

\textsuperscript{124} \textit{John Wood}, 26 S.W.3d at 22-23.
\textsuperscript{125} \textit{Id.} at 14-15.
\textsuperscript{126} \textit{Id.} at 23.
\textsuperscript{127} \textit{Id.}
\textsuperscript{128} See \textit{id.} ICO also claimed it was entitled to damages based on its fraudulent inducement claim. ICO claimed in effect that it had been fraudulently induced to enter into the letter agreement on the Wood Group's false representation that it would sell NDT for book value, when in fact the Wood Group was intending to extract a higher price. The court quickly dismissed this claim because it was based on the assumption that ICO had in fact entered into a binding contract. If there was no binding agreement, ICO could not have been fraudulently induced to enter into it. \textit{Id.} at 24.
\textsuperscript{129} 16 S.W.3d 127 (Tex. App.—Houston [1st Dist.] 2000, no pet. h.).
\textsuperscript{130} \textit{Id.} at 130.
\textsuperscript{131} \textit{Id.} at 130-31.
\textsuperscript{132} \textit{Id.} at 131.
\textsuperscript{133} \textit{Id.}
the 1979 agreement, and that in the absence of such a contractual assumption, Martin-Marietta, and therefore Lockheed Martin, had no successor liability as the purchaser of assets from Wedron. The workers also moved for summary judgment on the basis that Martin-Marietta had in fact assumed such liabilities. The trial court had rendered summary judgment in favor of the workers that Lockheed Martin was "contractually liable for any damages adjudicated against Wedron Silica Company of Delaware with respect to [the workers] alleged cause of action." On appeal, the court held that Martin-Marietta (and therefore Lockheed Martin) had only assumed "ordinary course of business liabilities and obligations" under the 1979 agreement, that tort liabilities are not in the "ordinary course of business," and that, in the absence of an express or implied assumption of those liabilities in the 1979 agreement, there was no successor liability imposed on Martin-Marietta (or its successor-in-interest, Lockheed Martin) as the purchaser of Wedron's assets.

There was an interesting choice of law discussion as to whether Delaware, Maryland or Texas law governed the issue. While the court concluded that Delaware law controlled, the court nevertheless proceeded to demonstrate that the result would be the same regardless of which law governed. This discussion provides valuable guidance to corporate practitioners as to the differences between Delaware, Maryland and Texas law on the issue.

The court began its analysis by referring to the Third Restatement of the Law of Torts for Products Liability, which restates the general rule that a purchaser of the assets of a business is not subject to the liability caused by the defective products sold by the seller unless:

(a) in acquiring the assets, the successor agrees to assume liability;
(b) the acquisition results from a fraudulent conveyance to escape liability for the debts or liabilities of the predecessor;
(c) the acquisition constitutes a consolidation or merger with the predecessor; or
(d) the acquisition results in the successor becoming a continuation of the predecessor.

The court noted that while both Delaware and Maryland recognize all four exceptions to the general rule of non-liability, Texas only recognizes the first two exceptions. The court further noted that under the Texas Business Corporation Act, a "purchase of all or substantially all of the assets of the seller's corporation does not make the acquiring [entity] responsible or liable for any liability or obligation of the selling corporation

134. Id. at 130-31.
135. Lockheed, 16 S.W.3d at 131.
136. Id.
137. Id. at 139.
138. Id. at 134 n.4.
140. Id., as quoted in Lockheed, 16 S.W.3d at 134.
unless the acquiring entity assumes the liability or the obligation, or unless another statute expressly provides to the contrary. According to the court, Texas had effectively eliminated the third and fourth exceptions to the general rule of non-liability for purchasers of all or substantially all of the assets of a selling corporation. As far as the court was concerned, however, the only exception implicated in this case, under either Maryland, Delaware or Texas law, was the first one, i.e., the purchaser agrees to assume the liability. The court observed that in Delaware and Maryland, the assumption of a contingent liability by a purchaser of assets from a selling corporation can be either express or implied, but in Texas the assumption must be express.

Turning to the 1979 purchase agreement, the court concluded that there was no express or implied assumption of the tort liability to the workers under either Maryland or Delaware law and likewise no express assumption of such liability under Texas law. The 1979 agreement, which neither party had claimed was ambiguous, was examined in its entirety to ascertain and effectuate the intent of the parties as expressed in the instrument. In reviewing the entire agreement "to harmonize and give effect to all of its provisions, so that none will be rendered meaningless," the court noted that a number of the clauses and provisions in the agreement reflected the basic understanding of the parties that the purchaser was buying assets and liabilities of a corporation as shown on a specified balance sheet. In addition, the court found that the seller had specifically retained liability for all of its then "known and anticipated torts." But at the heart of the dispute was Section 5 of the Agreement. Section 5(D) of the agreement identified liabilities being assumed by Martin-Marietta as follows:

D. Except as provided below, as of the Closing Date, Wedron shall assign to [Martin-Marietta] and [Martin-Marietta] shall assume all of the obligations and liabilities of Wedron on the Closing Date including:

142. Id. at 134 (citing TEX. BUS. CORP. ACT ANN., art. 5.10 § (B)(2) (Vernon Supp. 2000)). The court also noted that Article 5.10(B)(1) eliminates the "de facto merger" doctrine, the third exception under the Restatement. TEX. BUS. CORP. ACT ANN. art. 5.10 § (B)(1) (Vernon Supp. 2000). In Mudgett v. Paxson Mach. Co., 709 S.W.2d 755, 758-59 (Tex. Civ. App.—Corpus Christi 1986, writ ref’d n.r.e.), the Corpus Christi Court of Appeals rejected the "mere continuation" theory, the fourth exception recognized by the Restatement, as contrary to the legislative intent of article 5.10(B). Lockheed, 16 S.W.3d at 135.

143. Lockheed, 16 S.W.3d at 135 n.6.

144. Id. at 135.

145. Id.

146. Id. (citing TEX. BUS. CORP. ACT ANN., art. 5.10 § (B)(2) (Vernon Supp. 2000); Mudgett, 709 S.W.2d at 758-59)). The court also noted that this expressed assumption requirement had long been the law in Texas. Id. (citing Southwestern Gas, Light & Power Co., v. Jay, 275 S.W. 735, 736 (Tex. Civ. App.—El Paso 1925, writ ref’d)).

147. Lockheed, 16 S.W.3d at 135.

148. Id.

149. Id.

150. Id. at 137.
(i) The liabilities and obligations of Wedron on the Balance Sheet, except to the effect such liabilities and obligations shall have been discharged or satisfied prior to the Closing Date;
(ii) The liabilities and obligations of Wedron that have arisen in the ordinary course of business prior to the Closing Date and have not been discharged or satisfied by Wedron prior to the Closing Date;
(iii) The liabilities and obligations of Wedron under the pension plans covering hourly employees, labor agreements, employment contracts and future obligations in respect of Wedron’s employees set forth in Exhibits H and I;
(iv) The liabilities and obligations of Wedron under the Wedron Silica Company Retirement Plan for Salaried Employees (“Salaried Plan”) in respect of the participants under such Plan as of the Closing Date (other than those participants who terminated employment with Wedron prior to the Closing Date), it being understood that such liabilities and obligations will be transferred in accordance with the requirements of Federal law to a separate pension plan to be maintained by Martin Marietta, as set forth in Section 11.E; and
(v) The liabilities and obligations of Wedron under all leases of real property, or mining claims described in Exhibits A-1 or A-2; leases of equipment, machinery and tangible personal property described in Exhibit B-1; material contracts, agreements and commitments described in Exhibit D and any other agreements, contracts and commitments entered into by Wedron in the ordinary course of business;

provided, however, that [Martin-Marietta] shall not assume any other material obligation or liability of Wedron (i) that does not appear on the Balance sheet, (ii) that has not been disclosed to [Martin-Marietta] under this Agreement, or (iii) to which [Martin-Marietta] has not specifically consented in writing on or before the Closing Date to assume as of the Closing Date.151

Lockheed maintained that, pursuant to Section 5(D) of the agreement, Martin-Marietta assumed only limited liabilities related to the “day-to-day operating” of the business being acquired, not “contingent tort liabilities.”152 The workers, relying on clause (ii) of Section 5(D), claimed that their injuries were a “liability that Wedron incurred in the ordinary course of its business of supplying sand to the foundries and that Martin-Marietta, therefore, assumed that liability.”153 Lockheed argued that the workers, by relying directly on clause (ii), were ignoring the qualification to all of the specified clauses set forth in the introduction to Section 5(D), i.e., the proviso that read: “Except as provided below, as of the Closing Date...” and in the final proviso that followed the five specific clauses which states:

151. Id. at 136-37.
152. Id. at 137.
153. Lockheed, 16 S.W.3d at 137.
Provided, however, that [Martin-Marietta] shall not assume any other material obligation or liability of Wedron (i) that does not appear on the Balance sheet, (ii) that has not been disclosed to [Martin-Marietta] under this Agreement, or (iii) to which [Martin-Marietta] has not specifically consented in writing on or before the Closing date to assume as of the Closing Date.\footnote{154}

The workers countered that the last proviso only modified clause (v) of Section 5(D), and not all of Section 5(D).\footnote{155} The court rejected the workers interpretation of the final proviso, concluding that such an interpretation would render “meaningless the introduction to Paragraph D.”\footnote{156} Rather, the court concluded that the final proviso modified all of the clauses proceeding it.\footnote{157}

Under either the Maryland or Delaware “express or implied assumption of liabilities” standard or the Texas “express assumption of liabilities” standard, the court held that there was no assumption by Martin-Marietta of liability for the contingent tort related to the workers’ alleged injuries.\footnote{158} The only liabilities assumed by Martin-Marietta, according to the court’s reading of the agreement, were those that arose in the ordinary course of business, which the court held not to include tort liabilities, at least in the context of the specific agreement and the language of Section 5(D).\footnote{159}

\footnote{154}{Id.}
\footnote{155}{Id. at 139.}
\footnote{156}{Id. The court also noted that the final proviso “appears flush at the margin and directly beneath the introduction to Paragraph D.” Id.}
\footnote{157}{Id.}
\footnote{158}{Id.}
\footnote{159}{Lockheed, 16 S.W.3d at 140.}