Corporations

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UNLESS the Texas Supreme Court acts soon, the corporation, as a distinct legal entity, separate from its shareholders, officers, and affiliates, is in serious danger in Texas. During this Survey period, the Texas courts evidenced an increasingly alarming trend of disregarding the corporation in situations for which no predictable basis can be ascertained. These cases leave corporate practitioners unable to advise their clients as to the proper means of ensuring the continued effi-
cacy of the corporate shield. Moreover, these cases appear to undo the legislative efforts that were undertaken in 1989, 1993, and 1997, through the various amendments of Article 2.21 of the Texas Business Corporation Act ("TBCA"), to further protect the corporate form. Article 2.21 was originally amended to counteract the business uncertainty created following the now infamous "alter-ego" decision by the Texas Supreme Court in Castleberry v. Branscum. Additional amendments were made to Article 2.21 in an attempt "to 'curb the creativity of the bench and bar' in ignoring the plain import of the statute that unequivocally makes shareholders, shareholder's affiliates, and affiliates of the corporation unavailable as sources of repayment for contractual obligations of the corporation or torts arising from those contractual obligations." That "creativity" has, in fact, remained unabated. As a result, an increasingly bewildering array of "veil-piercing" theories with indeterminate elements have developed. The worst of these is the "single business enterprise" theory. In Part II, we discuss this disturbing theory and its increasing use during this Survey period.

Despite the Texas courts' increasing willingness to ignore the corporate form based on uncertain criteria in "veil-piercing" cases, the Texas courts are paradoxically (but properly) strict in requiring the corporation to observe statutory requirements applicable to their continued existence. In Part III, we discuss how the lapse of the corporate form under statute, if not timely revived, may permanently extinguish certain rights of the entity.

3. TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon 2003). Article 2.21 provides, in relevant part, that:

[a] holder of shares, ... or any affiliate thereof or of the corporation shall be under no obligation to the corporation or to its obligees with respect to ... any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, ... or affiliate is or was the alter-ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetuate a fraud, or similar theory, unless the obligee demonstrates that the holder, ... 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 ... or affiliate.

It should be noted that for corporations formed on or after January 1, 2006, for corporations formed before January 1, 2006 that self-elect, and for all corporations as of January 1, 2010, the Texas Business Organizations Code ("TBOC") replaces Article 2.21 as controlling law. This change in no way affects the law substantively, however, as the requirements of the TBOC are identical to those of Article 2.21. See TEX. BUS. ORGS. CODE ANN. §§ 21.223–225 (Vernon 2005).


6. West & Chao, supra note 4, at 1397. Following the second round of amendments to Article 2.21 in 1993, the Fifth Circuit noted the continued resistance of the Texas Supreme Court to follow the requirements of Article 2.21. See W. Horizontal Drilling, Inc. v. Jonnet Energy Corp., 11 F.3d 65, 69 (5th Cir. 1994) (citing Mancorp, Inc. v. Culpepper, 802 S.W.2d 226, 228 (Tex. 1990) and stating that "[w]e recognize that the Texas Supreme Court seems to be ignoring the amendments to Article 2.21 and continues to permit a failure to observe corporate formalities as a means of proving alter-ego").
In previous Surveys, we have sought to give practical advice to corporate attorneys concerning the clear and informed drafting of agreements. This year is no exception. In Part IV, we discuss the fact that, contrary to popular belief, it is indeed possible, in the right circumstance and with the right words, to contractually waive fraud and misrepresentation claims based upon extra-contractual representations.

II. THE JUDICIALLY DISCRETIONARY CORPORATION—DISREGARDING THE CORPORATE FORM BASED UPON THE "SINGLE BUSINESS ENTERPRISE" THEORY

Texas courts have long purported to protect the corporate form and its sanctity; courts repeatedly stress the importance of the corporation as an entity separate and distinct from its officers, directors, shareholders and subsidiaries. Nevertheless, the Texas courts also have long recognized the judicial power to disregard the separate existence of the corporate entity (or to "pierce the corporate veil") in certain circumstances based on the wrongful conduct of the corporation's shareholders. Attempts to impose liability on parent corporations, shareholders, or affiliates have been and continue to be successful based on the alter-ego, single business enterprise, and joint business enterprise theories of corporate veil-piercing. The similarities, differences, and muddled relationship between the alter-ego and single business enterprise theories, in particular, have been the subject of previous criticism. The very existence of the single busi-

9. See, e.g., Cementos de Chihuahua, S.A. de C.V. v. Intermodal Sales Corp., 162 S.W.3d 581, 585-86 (Tex. App.—El Paso 2005, no pet. h.) ("Generally, a court will not disregard the corporate fiction... except where it appears the corporate entity... is being used as a sham to perpetrate a fraud, to avoid liability, to avoid the effect of a statute, or in other exceptional circumstances."). See also West & Chao, supra note 4, at 1406 n.88.
11. See 20 ROBERT W. HAMILTON, ET AL., TEXAS PRACTICE: BUSINESS ORGANIZATIONS § 26.22, at 442 (2d ed. 2004) ("The 'single business enterprise' doctrine in Texas law is essentially an end-run around limitations developed in connection with piercing the corporate veil."). The designed limitations discussed by Hamilton would certainly include the limitations of Article 2.21, which was developed in specific response to the uncertainty created by the Texas Supreme Court's decision in Castleberry, 721 S.W.2d 270 (Tex. 1986). See also West & Treadway, supra note 10, at 805-11.
ness enterprise theory, under Texas law, is questionable. Despite its dubious foundation, courts of appeals in Texas have employed the single business enterprise theory to pierce the corporate veil and continue to do so.

A. THE INAPPROPRIATE USE OF "SINGLE BUSINESS ENTERPRISE" IN TORT CASES IN WHICH NO WRONGFUL ACT WAS COMMITTED

In purely tort-based veil-piercing cases, Texas courts continue to properly employ common-law theories of veil piercing to avoid the corporate shield despite Article 2.21. The use of the "single business enterprise" theory as one such common-law basis for liability, however, is a relatively new and disturbing development in Texas law. According to one court's characterization, "under the single business enterprise theory, one corporation may be held liable for the debts of another corporation where (i) the two corporations share a common business purpose and (ii) the corporations have integrated their resources to achieve that common business purpose." Unlike its relative, the alter-ego theory of veil piercing, which requires some wrongful conduct by the shareholder, the single business enterprise theory treats the sanctity of the corporate form as a mere balancing test between non-exhaustive, non-exclusive factors.

13. Commentators have previously noted that the origins and continued justifications for the single business enterprise theory are anachronistic. See Robert F. Gray, Jr. et al., Corporations, 46 SMU L. Rev. 1171, 1175-76 (1993) (noting that "[t]he theory has outlived any usefulness that it once might have had" and calling Texas courts' continued disregard for the corporate form "extremely dangerous").
15. This occurs, for instance, when TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon 2003) does not apply. Article 2.21 applies only to claims based on contractual obligations and any claims related to or arising from contractual obligations.
16. As we have previously argued, however, tort claims that relate to or arise from the negotiation of contractual obligations, such as fraud or negligent misrepresentation related to a contact's subject matter, should be covered by Article 2.21. West, supra note 8, at 1226-30; West & Treadway, supra note 10, at 814-16; West & Nelson, supra note 7, at 804-09; West & Chao, supra note 4, at 1403-08; West & Stasny, supra note 7, at 726-27.
17. See, e.g., Paramount Petroleum Corp., 712 S.W.2d at 536-37.
PHC-Minden, LP v. Kimberly-Clark Corp.\(^{21}\) exemplifies how the single business enterprise theory may lead to liability for a parent corporation or stockholder that has engaged in no fraudulent or wrongful course of conduct. In PHC-Minden, the plaintiff's estate brought a products-liability wrongful-death claim in Texas state court against Kimberly-Clark for its role in manufacturing Kotex tampons, which allegedly caused the toxic-shock syndrome that led to the plaintiff's death. Kimberly-Clark filed a third-party claim in Texas state court against PHC-Minden, LP ("MMC"), a Louisiana limited partnership and a subsidiary of Province Healthcare Company ("Province") for violation of the duty of care to its patient, the plaintiff. MMC responded with a motion for special appearance, claiming lack of personal jurisdiction. The lower court denied the special appearance without filing findings of fact or conclusions of law. On interlocutory appeal, the Texas Court of Appeals in Tyler upheld the denial because MMC's parent corporation, Province, operated hospitals in Texas. The court concluded that Province's Texas operations could be imputed to MMC under the single business enterprise theory of piercing the corporate veil.\(^{22}\)

To reach this conclusion, the court examined a series of factors, including: "(1) common employees, (2) common offices, (3) centralized accounting, (4) payment of wages by one corporation to another corporation's employees, (5) common business name, (6) services rendered by the employees of one corporation on behalf of another corporation, (7) undocumented transfers of funds between corporations, and (8) unclear allocation of profits and losses between corporations."\(^{23}\) But without clear guidance and out of the magic box of judicial discretion and "equity," the court found that MMC and its parent corporation, Province, functioned as a single business enterprise:

In summary, the record shows that Province and MMC have at least one common employee and that Province pays certain MMC employees, although the salaries are intercompany payables. The names of the two companies are similar, and Province employees provide various services to assist MMC in its operations. Province exercises control over MMC's revenues and expenditures and oversees MMC's operations, financial performance, and completion of strategic initiatives. Further, Province audits MMC's financial goals to determine if MMC will be able to meet these goals. Considering the totality of this evidence, we conclude that Province and MMC have integrated their resources to achieve a common business purpose.\(^{24}\)


\(^{22}\) Id. at *1-4.

\(^{23}\) Id. at *4.

\(^{24}\) Id. at *6.
The *PHC-Minden* decision implies that all that is required to pierce the corporate veil is a discussion of multiple factors, the choice of which is seemingly at the court's discretion. Furthermore, the factors that the court discussed are common to most parent-subsidiary relationships and do not suggest any wrongdoing. Indeed, no allegation of wrongful use of the limited liability form was attributed to either entity. Rather, the court's characterization simply suggests an efficient business structure. A message easily taken from this decision is that, under Texas common law, little or no actual certainty exists for the ability of the corporate form to shield a shareholder from liability.  

**B. THE INAPPROPRIATE USE OF "SINGLE BUSINESS ENTERPRISE" IN CONTRACT RELATED CASES IN WHICH ARTICLE 2.21 CONTROLS**

As stated repeatedly in previous Surveys, the recent use of common-law veil-piercing theories to impose liability on shareholders or parent companies often occurs in clear contravention of the obvious intent of Article 2.21 of the TBCA.  

One case decided during this Survey period and another case pending appeal demonstrate a clear need and opportunity for the Texas Supreme Court to unambiguously extinguish the inappropriate application of common-law veil-piercing theories to Texas cases covered under Article 2.21.  

Claims arising out of commercial interactions (i.e., contract-related claims) often take the form of tort claims relating to the process of forming the agreement (i.e., negligent misrepresentation or fraud). Indeed, "many of the same operative facts that can give rise to a cause of action for breach-of-contract may also give rise to causes of action for business

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25. Another case decided during the Survey period presents an interesting question as to which state's laws apply to "veil-piercing" issues. In *DDH Aviation. L.L.C.*, 2005 WL 770595, at *6, the court held that "Texas law applies to determine whether [a Texas limited liability entity's] form should be disregarded, while Delaware law applies to determine whether [a Delaware corporation's] corporate form should be disregarded." The authors are not persuaded that other courts follow this formulation. Nor are the authors convinced that a veil-piercing claim will necessarily be viewed as an "internal affair" as to which the courts will automatically defer to the law of the state of incorporation. For a recent discussion of the breadth of the "internal affairs doctrine," see generally VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005), as reviewed in *Preservation of Delaware's Internal Affairs Doctrine*, Edwards Angell Palmer & Dodge LLP Corporate Law and Litigation Bulletin (2005) (on file with the authors).  


27. The single business enterprise theory, in particular.  


29. See *Michiana Easy Livin' Country, Inc. v. Holten*, 168 S.W.3d 777, 791 (Tex. 2005) ("[I]n cases dealing with commerce, a plaintiff often has the option to sue in either contract or tort.").
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While pure tort claims unrelated to the creation or breach of a corporate contractual obligation are clearly free from the requirements of Article 2.21, tort claims arising from or related to corporate contractual obligations are unambiguously subject to Article 2.21. Article 2.21 requires that:


31. See West, supra note 8, at 1227; West & Treadway, supra note 10, at 815-16; West & Chao, supra note 4, at 1407-08; West & Nelson, supra note 7, at 804-09. See also West & Stasny supra note 7, at 727 (suggesting time specific language to use to incorporate Article 2.21 into a contract).

32. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003) (emphasis added).

33. Id. (emphasis added).

34. Id. art. 2.21(B) (emphasis added). "Single business enterprise" is, if extant, a common-law theory of liability.

35. 129 S.W.3d 74 (Tex. 2003). See West & Nelson, supra note 7, at 808-09.

36. See also West & Stasny supra note 7, at 764 (suggesting time specific language to use to incorporate Article 2.21 into a contract).

37. Id. art. 2.21(B) (emphasis added). "Single business enterprise" is, if extant, a common-law theory of liability.

38. 129 S.W.3d 74 (Tex. 2003). See West & Nelson, supra note 7, at 808-09.

The Texas Supreme Court, in Southern Union Co. v. Edinberg, reaf-
firmed Article 2.21 as the "exclusive" means of imposing liability on a parent, shareholder, or affiliate for corporate contractual obligations. The court declined to validate the "single business enterprise" theory, noting instead that:

We need not decide today whether a theory of "single business enterprise" is a necessary addition to Texas law regarding the theory of alter-ego for disregarding corporate structure and the theories of joint venture, joint enterprise, or partnership for imposing joint and several liability. That is because whatever label might be given to the City's attempt to treat the Valero entities as a single entity, Article 2.21 of the Texas Business Corporation Act controls, and the questions submitted to the jury were intended to embody the requirements of Article 2.21.

While unequivocally establishing that Article 2.21 is the exclusive means of imposing liability on parent corporations, shareholders, and affiliates for another corporation's contractual obligations, the Texas Supreme Court did not address the additional statutory language making Article 2.21 the exclusive means of imposing liability on parent corporations, shareholders, or affiliates for "any matter relating to or arising from" a corporation's contractual obligation. We have consistently argued in past Surveys that the phrase "any matter relating to or arising from" a corporation's contractual obligations in Article 2.21 clearly covers tort claims that arise from or relate to an underlying contract. Specifically, we argued that "fraud, fraudulent inducement and negligent misrepresentation, when committed... in connection with a contractual obligation being entered into by a corporation... are all 'matter[s] relating to or arising from the obligation' as specifically contemplated by Article 2.21." A number of Texas cases support this reading of Article 2.21.

One case decided during this Survey period, *De La Hoya v. Coldwell Banker Mexico, Inc.*, ignored the clear precedent of the Texas Supreme

36. *S. Union Co.*, 129 S.W.3d at 84.
37. *Id.* (internal citations omitted).
38. West & Chao, *supra* note 4, at 1408.
39. *See In re J.D. Edwards World Solutions Co.*, 87 S.W.3d 546, 551 (Tex. 2002) (holding that whether a contract was fraudulently induced is a matter "involving... arising under or related to" the contract) (internal quotation marks removed); Haase v. Glazner, 62 S.W.3d 795, 798 (Tex. 2001) ("Fraudulent inducement... is a particular species of fraud that arises only in the context of a contract and requires the existence of a contact as part of its proof."); Menetti v. Chavers, 974 S.W.2d 168, 174 (Tex. App.—San Antonio 1998, no pet.) (finding that claims of fraud and negligence, along with claims of breach-of-contract, all "relate to or arise from a contractual obligation and therefore fall under the amended article 2.21."); Pabich v. Kellar, 71 S.W.3d 500, 508 (Tex. App.—Fort Worth 2002, no pet.) (holding that a tortious interference claim arising from a settlement agreement was subject to Article 2.21); El Polio Loco, S.A. de C.V. v. El Polio Loco, Inc., 344 F. Supp. 2d 986, 988-89 (S.D. Tex. 2004) (holding that tort claims were connected to the performance of the agreement so that a choice of law clause requiring "[a]ll disputes which may arise in connection with the performance of this Agreement" applied). *See also* West & Chao, *supra* note 4, at 1408 n.39 (citing cases that give an expansive reading of the terms "relating to or arising from").
40. 125 F. App'x 533 (5th Cir. 2005).
Court in *Southern Union Co.* and the plain language of Article 2.21, even while citing to the statute and the case. *De La Hoya* involved a series of real-estate transactions carried out in Mexico between 1999 and 2001. Plaintiffs claimed misappropriation of their escrow funds by Coldwell Banker LuLu Jacobsen and Associates (the "Cabo franchise"), a franchisee of Coldwell Banker Affiliates de Mexico, S.A. de C.V. ("CBAM"). Plaintiffs filed their original action in Texas state court, asserting, among other causes of action, breach-of-contract and negligence against a number of defendants, including CBAM, its parent corporation, Coldwell Banker Mexico, Inc. ("CBMI"), and its ultimate owner, Richard A. Smith ("Smith").41 The defendants removed the case to federal court based on diversity, claiming that several of the defendants had been improperly joined to defeat diversity. The district court agreed and dismissed several defendants, including CBMI and Smith. The plaintiffs then appealed.42

The primary issue on appeal was whether CBMI and Smith had been improperly joined in the suit. According to the court, joinder of CBMI and Smith was only improper if there was no "reasonable basis on which the district court [could] predict that plaintiffs might be able to recover against [CBMI and Smith]."43 The plaintiffs’ claim against CBAM was premised on the fact that the agreement creating the Cabo franchise specifically gave CBAM “the right to inspect, review and audit all franchise financial records, including those related to ancillary services.”44 Despite this power and the knowledge that the Cabo franchise had misappropriated escrow funds in the past, the plaintiffs alleged that CBAM “fail[ed] to control the Cabo franchise’s escrow activities” under the franchise agreement.45 The plaintiffs’ only claim against CBMI and Smith, however, was “that CBMI and Smith are liable for CBAM’s failure to act under the ‘single business enterprise theory.’” Therefore, the viability of the “plaintiffs’ claims against [CBMI and Smith] depend[ed] on the viability of their claims of single business enterprise and CBAM’s liability.”46

As to CBAM’s liability, the court noted that “[i]n Texas, where a party has a right to control the activities of another (created either contractually or through actual exercise of control), that party has a concomitant duty to exercise that control reasonably.”47 The court found “that a right of control arguably arose from the franchise agreement, CBAM’s exercise of control, or a combination of the two, and CBAM’s knowledge and failure to timely act on that knowledge arguably breached that duty.”48

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41. *Id.* at 534-35. Smith served as President of both CBMI and CBAM and was 100% owner of CBMI and 1% owner of CBAM. *Id.* at 534.
42. *Id.* at 535.
43. *Id.* at 536 (citing 28 U.S.C. § 1441(b) (2005) and Smallwood v. Ill. Cent. R.R., 385 F.3d 568, 572-73 (5th Cir. 2004)).
44. *Id.* at 535.
45. *Id.* at 536.
46. *Id.*
47. *Id.*
48. *Id.* at 540.
To determine CBMI's liability, however, the court simply reviewed and considered yet another version of the oft-quoted "list of non-exhaustive factors" test for a finding of single business enterprise, including: "(1) common employees; (2) common offices; (3) centralized accounting; (4) payment of wages by one corporation to the other's employees; (5) common business name; (6) services rendered by the employees of one corporation on behalf of the other; (7) undocumented transfers of funds between corporations; (8) unclear allocations of profits and losses between corporations; and (9) common ownership."49 The court further explained that "[e]vidence of less than all of these factors can sustain a finding of single business enterprise."50 Similar to PHC-Minden, the court had little trouble finding "several single business enterprise factors . . . sufficient to establish a reasonable basis for recovery against CBMI and Smith under that theory."51

Nevertheless, CBMI and Smith argued that the single business enterprise theory was inapplicable under the Texas Supreme Court's holding in Southern Union Co., which specifically applied Article 2.21 to claims of single business enterprise. The Fifth Circuit, however, distinguished Southern Union Co., suggesting that its holding only refused to apply the single business enterprise theory to impose "the contracts of one corporation to an affiliated corporation . . . because [A]rticle 2.21 requires a showing of actual fraud and the single business enterprise theory does not."52 According to the Fifth Circuit, unlike the plaintiff in Southern Union Co., the plaintiffs in De La Hoya were not seeking recovery based on CBAM's contractual obligations but "based on CBAM's alleged negligence."53 Accordingly, the Fifth Circuit sustained the plaintiffs' joiner of CBMI and Smith and defeated diversity.54

While correctly noting that Article 2.21 covers "contractual obligations," the court seemingly ignored that it also covers "any matter relating to or arising from" contractual obligations.55 The negligence claim in De La Hoya directly arose out of the contractual right of control that CBAM was granted as a result of the creation of the Cabo franchise that

49. Id. at 538 (citing Bridgestone Corp. v. Lopez, 131 S.W.3d 670, 681-82 (Tex. App.—Corpus Christi 2004, pet. granted, judgm't vacated w.r.m.)). The Fifth Circuit allowed the single business enterprise argument on appeal, even though it was not raised in the lower court because the "allegations of joint enterprise and alter-ego suffice to also claim single business enterprise liability." Id. at 537 (citing Rio Grande Valley Gas Co. v. City of Edinburg, 59 S.W.3d 199, 208-10 (Tex. App.—Corpus Christi 2000, pet. granted), rev'd on other grounds, 129 S.W.3d 74 (Tex. 2003)). The unpredictability of the single business enterprise theory is further evidenced by the disparate pleading requirements in various courts. Compare De La Hoya, 125 F. App'x at 536-38, with Coleman v. Klöckner & Co. AG, 180 S.W.3d 577, 586-87 (Tex. App.—Houston [14th Dist.] 2005, no pet. h.); Glas v. Adame, 178 S.W.3d 307, 307-14 (Tex. App.—Houston [14th Dist.] 2005, pet. denied).


51. Id. at 539-40.
52. Id. at 538.
53. Id. at 539.
54. Id.
55. See TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003).
it allegedly failed to exercise or actually exercised without reasonable care. The franchise agreement is the defining connection between the Cabo franchise and CBAM, which were otherwise owned independently. It is difficult to imagine what the legislature meant by a matter "relating to or arising from" a contractual obligation if it did not encompass a negligence claim based either on the right of control found in an agreement or the exercise of actual control arising from the relationship created under that agreement. Clearly, all of the claims against CBAM related to or arose from the existence of the franchise agreement between the Cabo franchise and CBAM. As a result, any attempt to hold CBMI or Smith liable for such contract-related tort claims should have been under Article 2.21 and not under common-law veil-piercing theories (including the single business enterprise theory).\textsuperscript{56} While the Fifth Circuit was admittedly determining whether CBMI and Smith had been improperly joined under the very low threshold of "any reasonable basis," the court should have required allegations and evidence that CBMI and Smith "caused [CBAM] to be used for the purpose of perpetrating and did perpetrate an actual fraud . . . for [CBMI's and Smith's] direct personal benefit."\textsuperscript{57} The wrongly-evoked single business enterprise theory required no such showing, and none was offered. Article 2.21 clearly should have been applied and, in the authors' view, this case, and any case failing to apply Article 2.21 in similar circumstances, is wrongly decided.\textsuperscript{58}

III. LAPSE OF THE CORPORATE FORM AS EXTINGUISHING CORPORATE CLAIMS

The statutory existence of the corporation, as an entity separate from the persons who own, control, and operate it, functions both to protect its shareholders from personal liability and, in some cases, to prevent those same shareholders from attaining the benefits of property and claims belonging to the corporation.\textsuperscript{59} While the Texas courts easily disregard the corporate form when it is used as a shield to protect shareholders from

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\textsuperscript{56} West & Chao, supra note 4, at 1408.


\textsuperscript{58} A similar case is Nat'l Plan Adm'rs, Inc. v. Nat'l Health Ins. Co., 150 S.W.3d 718 (Tex. App.—Austin 2004, pet. granted), decided toward the end of the previous Survey period and currently on appeal to the Texas Supreme Court. National Plan Administrators involved a tort claim arising entirely out of a series of contractual agreements. Id. at 729. The case appears to have been primarily decided on a procedural issue—failure to specifically object to the jury charge on the basis that Article 2.21 controlled. Id. at 744. The decision is nonetheless troubling because it recognizes the single business enterprise theory as a valid theory (indeed, De La Hoya cites this case as support for the theory, 125 F. App'x at 538) and because readers will easily miss the nuance that this was a procedural decision. National Plan Administrators presents a timely opportunity for the Texas Supreme Court to put a bullet in this theory and to perhaps clarify the scope of Article 2.21 to the extent that the procedural-waiver issues can be overcome.

\textsuperscript{59} See Brock v. Baskin-Robbins USA Co., 113 F. Supp. 2d 1078, 1092 (E.D. Tex. 2000) (holding that the corporation itself, not corporate shareholders, is the only "person" able to seek recovery for harms done to the corporation); Wingate v. Hajdik, 795 S.W.2d 717, 719 (Tex. 1990) ("A corporate stockholder cannot recover damages personally for a wrong done solely to the corporation, even though he may be injured by that wrong.").
liability for the acts of the corporation, the courts are not so willing to disregard the corporate form when the shield is being used by defendants from whom the putative corporation is seeking payment. As a creature of statute, the corporation's continued existence requires adherence to the statutes that give it life. Failure to statutorily maintain the corporate form may have serious repercussions, including the extinguishment of claims that the corporation could have brought during its existence.

We have discussed in previous Surveys the process by which corporate privileges may be statutorily revoked. If the corporate charter is forfeited for failure to comply with the Tax Code, the entity becomes a "dissolved corporation." Unlike a delinquent corporation, whose right to sue or defend in a court of law is suspended, a dissolved corporation has three years from the date of dissolution during which it may sue or be sued. Thus, if the dissolved corporation files a bankruptcy petition during the three-year period, the debtor is allowed to "sue and defend in Texas courts for the purpose of liquidating and distributing its assets."  

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60. The lapse of the corporate form as affecting rights and liabilities has been addressed in several previous Surveys. See, e.g., Glenn D. West & Christopher M. Fairman, Corporations, 53 SMU L. REV. 773, 775 (2000) (discussing "whether a suit brought against a corporation could be maintained if the corporation had dissolved thirty years earlier"); West, supra note 8, at 1222-25 (discussing the interaction between the "forfeiture of [a] corporation's charter by the Secretary of State under the Texas Tax Code and ... the Texas three-year survival statute applicable to 'dissolved corporations' pursuant to the Texas Business Corporation Act").

61. Failure to statutorily maintain the corporate form has serious repercussions, including the extinguishment of claims that the corporation could have brought during its existence.

62. The initial process of forfeiture of corporate privileges is as follows:

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.

West, supra note 8, at 1223 (internal citations omitted). The possible extent of officer liability under section 171.255 of the Tax Code was also a topic of previous discussion. See West & Chao, supra note 4, at 1399-1401.


64. Id. art. 7.12(F)(1)(e).

65. A delinquent corporation is a corporation whose corporate privileges, but not corporate charter, have been forfeited by the Comptroller for failure to file its franchise tax report or pay its franchise taxes. Tex. Tax Code Ann. § 171.255 (Vernon Supp. 2005).

assets as a ‘dissolved corporation.’”\(^67\) Furthermore, any claims by or against the corporation before dissolution are preserved during the three-year survival period.\(^68\) During this Survey period, there were two cases in which the failure of an entity to maintain legal status as a corporation and the failure to bring claims within the three-year window resulted in the extinguishment of previously available claims.

**In re American Heartland Sagebrush Securities Investments, Inc.**\(^69\) involved the disputed debtor status of a dissolved corporation seeking to recover preference payments through a bankruptcy proceeding. The debtor, Sagebrush Securities & Financial Services, Inc., was a Texas corporation formed on May 26, 1987. On August 8, 1995, the Secretary of State of Texas officially forfeited Sagebrush’s corporate charter for failure to file a franchise tax report. Although Sagebrush filed tax returns for 2001-2004, the entity remained a dissolved corporation.\(^70\)

An SEC investigation into Sagebrush and its alleged affiliated entities revealed that all entities involved were “mere d/b/a’s created and controlled by [Philip D.] Phillips, [founder/majority owner of Sagebrush], who fraudulently depict[ed] them as registered broker-dealers.”\(^71\) A Chapter 11 proceeding was filed on June 21, 2005, nearly ten years after the date of dissolution. Citing **In re ABZ Insurance Services, Inc.**,\(^72\) the United States Bankruptcy Court for the Northern District of Texas held that “if the three year period expires before filing bankruptcy, the purported corporate debtor ceases to be a person within the meaning of section 109 of the Bankruptcy Code eligible to file bankruptcy.”\(^73\) Since the three-year window between dissolving the corporation and bringing the claims as a debtor in bankruptcy had lapsed, Sagebrush was found not to be an eligible debtor and thus unable to seek the return of improperly made payments.\(^74\)

**Emmett Properties, Inc. v. Halliburton Energy Services, Inc.**\(^75\) involved the contested liability of multiple parties in the contamination of certain real estate. Emmett Properties, Inc. and Trend, L.P. both owned real property in close proximity to property owned by Halliburton Energy Services, Inc. Emmett became a dissolved corporation on February 12, 1999. On June 13, 2002—three years and four months after Emmett’s status as a dissolved corporation commenced—Emmett and Trend both filed suit, asserting numerous claims against Halliburton and its predecess-

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67. West, *supra* note 8, at 1224. The right of a dissolved corporation to sue and defend in the bankruptcy context likely includes “any attendant adversary proceedings necessary to (i) collect its assets, (ii) pay or satisfy its debts and (iii) liquidate its business.” *Id.*

68. TEX. BUS. CORP. ACT ANN. art. 7.12(A)(2).


70. *Id.* at 851.

71. *Id.* at 850 (citing the SEC’s complaint in the pending case of SEC v. Phillips, No. 2-05CV-107-J (N.D. Tex.)).


74. *Id.*

sors in interest. 76

Defendants filed a motion to dismiss/motion for partial summary judgment to dismiss all of Emmett's claims based on its status as a dissolved corporation. On September 30, 2003, a hearing was held on defendants' motion, and all of Emmett's claims were dismissed. The same day as the hearing, Emmett's corporate charter and privileges were reinstated after it paid its delinquent franchise taxes. On appeal, Emmett argued that, although its claims were extinguished after the three-year window expired, its claims were revived following reinstatement of its charter and privileges. 77 The Texas Court of Appeals for the Fourteenth District in Houston disagreed: "[t]he Tax Code does not state a corporation's extinguished claims are revived." 78

In re American Heartland and Emmett Properties offer a stern lesson. If not cured within three years, an involuntary dissolution and subsequent lapse in the corporate form will result in the extinguishment of any claims that the corporation could have brought before dissolution. 79

IV. DRAFTING CORPORATE AGREEMENTS—AVOIDING FRAUD CLAIMS THROUGH THE EFFECTIVE USE OF NONRELIANCE CLAUSES

During this Survey period, the Texas courts continued to reinforce their long-standing commitment to holding parties to the express terms of their written contracts. Texas courts specifically enforced forum-selection, arbitration, and damage-limitation clauses, despite claims in a number of these cases for unconscionability, mutual mistake, and misunderstanding. 80 Indeed, the Texas Supreme Court reiterated that "[a]bsent fraud, misrepresentation or deceit, a party is bound by the terms of the contract he signed, regardless of whether he read it or thought it had different terms." 81

In last year's Survey, we noted that it is possible, in a carefully crafted agreement between sophisticated parties, to defeat any later extra-contractual claim of "fraud, misrepresentation or deceit" that might otherwise deprive a party of the benefit of the bargained-for contractual limitations on remedies and representations provided in the written agreement. 82 While we provided a number of specific drafting suggestions to avoid extra-contractual claims in last year's Survey, we noted that the suggested clauses were in addition to and not in lieu of the "standard

76. Id. at 367-69.
77. Id. at 367-70.
78. Id. at 370.
79. Id.; In re Am. Heartland, 334 B.R. at 853.
82. West & Stasny, supra note 7, at 722-23.
disclaimer of reliance on extra-contractual representations” clause. In view of the large number of cases decided during this Survey period addressing the validity of nonreliance clauses, we will specifically provide drafting guidance on disclaimer-of-reliance clauses this year.

As noted in our discussion of Article 2.21 in Part II, disputes involving business contracts in Texas often involve not only claims for breach-of-contract, but also tort claims for negligent misrepresentation and fraud. In general, tort claims may not be sustained if they are based solely upon the breach of duties imposed by the contract or seek a remedy based only on the benefit of the bargain made in the contract. An exception to this rule arises, however, when a party to a contract fraudulently induces another party to enter into that contract, because the duty not to induce “another to enter into a contract through the use of fraudulent misrepresentations . . . is separate and independent from the duties established by the contract itself.” The Texas Supreme Court has held that “tort damages are recoverable for a fraudulent inducement claim irrespective of whether the fraudulent representations are later subsumed in a contract or whether the plaintiff only suffers an economic loss related to the subject matter of the contract.”

Once a breach-of-contract claim relating to a corporate obligation is converted into or coupled with a tort claim, the plaintiff can recover potential exemplary damages not only from the corporate obligor, but also from the corporate obligor’s officers, whom were involved in the negotiation of the related contract. While “Texas law generally imposes liability on corporations, not individual employees or officers of those corporations,” Texas courts continued to emphasize during this Survey period that corporate officers, even while acting solely in their capacity as corporate representatives, can be held personally liable for any tortious conduct in which they directly participated on behalf of their corporate employers. This imposition of individual liability is virtually automatic

83. Id. at 722.
84. See Michiana Easy Livin’ Co., Inc. v. Holten, 168 S.W.3d 777, 791 (Tex. 2005). See also supra notes 29-30 and accompanying text.
87. Formosa Plastics Corp. USA, 960 S.W.2d at 47.
in any case in which the corporate officer directly and knowingly participates in a "fraud" or other intentional tort. In negligence cases, however, it requires a finding that the individual officer had "an independent duty of reasonable care apart from the employer's duty."

In any sophisticated business transaction, there is a substantial exchange of information between the parties, both before and during the contract negotiation; however, the exchanged information is not necessarily intended to be an actual "representation" by one party to the other. A "representation" is "a presentation of fact . . . made to induce someone to act." Indeed, many statements made during the negotiation of a business transaction are intended to be "merely informational, and . . . not meant by either party to supplant the sophisticated purchaser's own research as the ultimate basis for his purchasing decision."

Nevertheless, many of these informational statements become the basis for claims of fraud and negligent misrepresentation when the terms of the otherwise fairly bargained-for contract are, in hindsight, deemed to provide insufficient recourse to the aggrieved party.

A cause of action for fraud based on statements made by another party, requires only that the plaintiff show:

(1) a material misrepresentation was made, (2) it was false when made, (3) the speaker knew it was false, or made it recklessly without knowledge of its truth and as a positive assertion, (4) the speaker made it with the intent that it should be acted upon; and (5) the party acted in reliance and suffered injury as a result.

The alleged misrepresentation in a fraud action must concern an existing fact not "a promise to do something in the future" unless "the promise is made with no intention of performing it at the time it was made." A claim for fraud may also be based upon the failure to disclose an existing fact (as opposed to an actual misrepresentation about an existing fact) if

90. Tri v. J.T.T., 162 S.W.3d 552, 562-63 (Tex. 2005); Morrow, 2005 WL 2621555, at *4. While not clear, negligent misrepresentation appears to qualify as a situation in which an independent duty is presumed to exist. See Gen. Elec. Capital Corp., 415 F.3d at 391. In past Surveys, we have urged, so far in vain, that the Texas courts should recognize that Article 2.21 of the TBCA protects corporate officers from both fraud and negligent-misrepresentation claims that arise in the context of the negotiation of a corporate contractual arrangement. West & Treadway, supra note 10, at 814-15; West & Chao, supra note 4, at 1403-08; West & Nelson, supra note 7, at 804-09.
92. Id.
93. Id.
the "particular circumstances impose a duty on the party to speak and he deliberately remains silent." Fraud by nondisclosure requires proof that:

1. a party conceals or fails to disclose a material fact within the knowledge of that party;
2. the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth;
3. the party intends to induce the other party to take some action by concealing or failing to disclose the fact; and
4. the other party suffers injury as a result of acting without knowledge of the undisclosed fact.\(^9\)

Texas courts generally recognize four circumstances in which a duty to disclose arises:

1. when there is a fiduciary relationship;
2. when one voluntarily discloses information, the whole truth must be disclosed;
3. when one makes a representation, new information must be disclosed when that new information makes the earlier representation misleading or untrue; and
4. when one makes a partial disclosure and conveys a false impression.\(^9\)

A duty to disclose can also arise, however, "if the seller fails to disclose material facts which would not have been discoverable by a purchaser exercising ordinary care and diligence, or which could not have been uncovered by reasonable investigation and inquiry."\(^9\)

A claim for negligent misrepresentation is substantially similar to a traditional claim for fraud, except that the plaintiff is not required to show that the misrepresentation was made "knowingly or recklessly."\(^9\)

To sustain a claim of negligent misrepresentation a plaintiff must instead prove that:

1. the defendant, in the course of his business, profession, or employment, or in another transaction in which he had a pecuniary interest, supplied to the plaintiff false information for guidance in a business transaction,
2. the defendant failed to exercise reasonable care or competence in obtaining or communicating the information,
3. the plaintiff justifiably relied on the information, and
4. the defendant's negligent misrepresentation proximately caused the plaintiff to suffer the pecuniary loss.\(^1\)


Like a traditional claim for fraud, the false information that is the subject of the negligent misrepresentation must relate to an "existing fact." Similarly, as with a traditional fraud claim, to sustain a negligent-misrepresentation claim, the plaintiff must prove reliance on the defendant's misrepresentation.

While "fraud in the inducement prevents a contract, including merger and disclaimers of reliance, from coming into being," Texas courts have nevertheless upheld the "power of contracting parties to create contractual provisions that disclaim reliance on prior representations or promises." While these seemingly conflicting statements have led some to presume that it is impossible to eliminate "fraud" claims by contractual disclaimers, Texas courts are clear that "[i]f the contract and circumstances of its formation evince clear and specific intent to disclaim reliance on prior representations, then the element of reliance in a fraudulent-inducement claim is negated as a matter of law." As noted during prior Survey periods, however, a disclaimer-of-reliance clause is not valid unless it is "an important part of the basis of the bargain, not an incidental or 'boiler plate' provision, and is entered into by parties of rel-

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atively equal bargaining position.” These requirements for the existence of a valid disclaimer clause have led to some confusion in the case law, particularly in cases involving “as is” clauses and unsophisticated parties.

During this Survey period, the Texas courts decided a number of cases addressing the efficacy of “disclaimer-of-reliance,” “merger,” and “as is” clauses to defeat extra-contractual claims of fraud, fraudulent inducement, and negligent misrepresentation. A number of these cases provide guidance for effective drafting to ensure enforceability of these clauses in a contract involving sophisticated parties who have determined to allocate risk under the express terms of their contract.

The first case, Steinberg v. Brennan, involved breach-of-contract and fraud claims arising from a stock purchase agreement entered into between Steinberg and Brennan. Under the stock purchase agreement, Brennan agreed to transfer shares of common stock of the United American Companies, Inc. (“UAC”) to Steinberg. Steinberg paid the stipulated purchase price but did not receive the shares. Steinberg sued Brennan for breach-of-contract for Brennan’s failure to deliver the shares under the stock purchase agreement. Steinberg also sued Brennan for fraud alleging “that Steinberg entered into the agreement in reliance upon Brennan’s false representations of UAC’s viability.” The fraud claim specifically alleged that Brennan “represented to Steinberg that [UAC]...
was a viable, healthy corporation that had just raised $7 million from the sale of its stock by Jefferies & Company, an investment banking company." Further, Steinberg submitted a handwritten note faxed to him four days before entering into the agreement that evidenced these representations. Steinberg claimed that these representations were false, "that UAC was in fact in dire straits." Brennan moved for summary judgment on the fraud claim based on Steinberg's inability to "establish the fifth element of his fraud claim, reliance, because the parties included an effective disclaimer-of-reliance in the Stock Purchase Agreement."

The district court centered its analysis on the Texas Supreme Court's decision in Schlumberger Technology Corp. v. Swanson. In Schlumberger, the court held that parties could contractually agree that they were not relying on prior representations made during contract formation as long as the "contract and the circumstances of its formation evince clear and specific intent to disclaim reliance on prior representations." The Schlumberger court "found such clear and specific intent where sophisticated parties, represented by competent counsel, included an emphatic, particularized disclaimer-of-reliance in a contract that resolved a dispute over the valuation of an interest in a dissolving joint venture." In applying these principles to the facts in Steinberg, the district court noted that, while the provisions of the stock purchase agreement "conspicuously and straightforwardly rule[d] out reliance on prior representations, . . . [t]here is no indication, however, that the relevant sections were drafted specially for this transaction, and likewise no evidence concerning the role of counsel or the existence of any prior disputes or negotiations." As a result, the district court was required to determine "whether under Schlumberger, the structure and language of a contract may demonstrate a sophisticated party's clear and unequivocal intent to disclaim reliance on prior representations, when central facts of Schlumberger—e.g., assistance of counsel, prior dispute, and tailored drafting are absent." Relying on a number of Fifth Circuit decisions applying Schlumberger, the district court concluded that "idiosyncratic drafting and other characteristic facts of Schlumberger are not a prerequisite for a finding of clear and unequivocal intent under that case." Instead, "such intent may be discerned from the totality of the circumstances, and in particular from the text and structure of the contract at issue." Applying that rule to the facts presented in Steinberg, the district court concluded that the stock purchase agreement and the "surrounding facts

113. Id. at *3.
114. Id.
115. Id.
116. 959 S.W.2d 171 (Tex. 1997).
117. Steinberg, 2005 WL 1837961, at *3.
118. Id.
119. Id. at *4.
120. Id.
121. Id. at *5
122. Id.
demonstrate[d] Steinberg's clear and unequivocal intent to rely upon his own research and assessment rather than Brennan's representations."123

In so concluding, the district court noted that the stock purchase agreement not only contained "an omnibus merger clause," but also specific provisions that directly contradicted Steinberg's "alleged reliance on prior representations."124 For instance, the agreement contained a number of representations from Steinberg concerning his sophistication and opportunity to verify information concerning the company. Further, the agreement specifically provided that there were "[n]o representations as to the Company's business or prospects."125 According to the district court, the relevant provisions of the stock purchase agreement were "so straightforward and so central to the agreement that a party of Steinberg's professed sophistication would have to be negligent or duplicitous to sign the agreement without intending to acquiesce to them."126

In Simpson v. Woodbridge Properties, LLC,127 the Dallas Court of Appeals made shorter work of the extra-contractual claims of fraud and negligent misrepresentation arising from a real estate purchase agreement. In the purchase contract, the parties included a "merger" or "entire agreement" clause stating: "The Parties shall not be bound by any stipulations, representations, agreements or promises, oral or otherwise not printed or inserted in written form in the Agreement."128 Affirming the trial court's grant of summary judgment in favor of the defendant, the appeals court, without the lengthy analysis of the district court in Steinberg, held that the forgoing provision "negated the reliance element essential to each of [plaintiff's] causes of action."129 Similarly, in Texas Motor Coach, L.C. v. Blue Bird Body Co.,130 the court found the "merger clause in the contract to be outcome determinative of whether Texas Motor [could] withstand Blue Bird's Motion for Summary Judgment on the tort claims."131 Despite claims of fraudulent inducement, the court con-

123. Id. at *6.
124. Id.
125. Id.
126. Id. at *7.
127. 153 S.W.3d 682 (Tex. App.—Dallas 2005, no pet. h.). See also Aetna Cas. & Sur. Co. v. Aniero Concrete Co., 404 F.3d 566, 584 (2d Cir. 2005) (stating that "when a disclaimer-of-reliance is as specific as the one before the Danann court, however, it 'destroys the allegations in the plaintiff's complaint that the agreement was executed in reliance upon ... contrary oral representations'").
128. Simpson, 153 S.W.3d at 683.
129. Id. at 684.
131. Id. at *7. The "merger" clause provided as follows: Entire Agreement: This Contract represents and incorporates the entire understanding of the parties hereto. There are no representations, inducements, side-agreements or understandings except as specifically set forth in this Contract. No person is authorized by Blue Bird to make any such additional representations, inducements, or side-agreements. And terms or conditions stated in any order submitted by dealer or accepted by Blue Bird that contradict the terms of this Contract shall be null and void. This Contract cancels and supersedes all prior contracts between the parties.
cluded as follows:

The Court finds that the merger clause bars reliance and that the Plaintiffs cannot recover for fraud or negligent misrepresentation. The language of the merger clause specifically states that there are no representations or inducements except as set forth in the contract. The parties were sophisticated business persons represented by counsel. If the prior representations were an inducement for entering into the agreement, Plaintiffs should have so specified. This was not a form contract with boiler plate language. Summary Judgment should be granted for the defendant on all claims.\(^1\)

The conclusion from these cases is that an explicit and expansive “waiver of reliance” set forth in a contract between sophisticated parties is generally enforceable in Texas, such that the parties may rely on the contractual limitations to their representations and liabilities. While other states are not as clear,\(^1\) the trend appears to be moving away from the idea that “fraud vitiates every contract”\(^1\) and toward the principles of freedom of contract and justifiable expectations of sophisticated parties.\(^1\)

As we have seen, “fraud” is not limited to just those situations that involve reprehensible, flagrant and deliberate deceit. This judicial move toward freedom of contract is, thus, beneficial for sophisticated contracting parties intending to predictably define their rights, liabilities, and obligations by contract rather than open themselves up to a less clear and less defined body of tort law to which their bargain was deliberately not made subject.\(^1\)

A recent case by the Third Circuit applying Delaware law illustrates this trend and appears to take the freedom-of-contract principle between sophisticated parties to its furthest reaches. In *MBIA Insurance Corp. v. Royal Indemnity Co.*,\(^1\) the court upheld the enforceability of provisions

\(^{132}\) Id. at *8.


\(^{134}\) *Bates*, 31 N.E.2d at 556. *See also* Davis, *supra* note 106, at 485.

\(^{135}\) *See* Comport, *supra* note 133, at 1031.

\(^{136}\) *See id.* *See also* Davis, *supra* note 106, at 485 (discussing the various public-policy reasons in favor of and opposed to upholding waiver-of-reliance-clauses).

contractually waiving any defense based on fraud, despite the apparently conceded fact that the contract (in this case a series of insurance policies) had been obtained as a result of a "spectacular fraud." Since "[t]he Delaware Supreme Court ha[d] apparently not addressed the standards for an effective waiver of a defense based on fraud in the inducement," the Third Circuit had to determine how the Delaware Supreme Court would rule on this issue. The closest Delaware precedent was Norton v. Poplos, in which the Delaware Supreme Court found that a "standard integration clause" was not a "reliable indicium of intent to waive a fraudulent inducement defense." According to the Third Circuit, "[t]he boilerplate nature of the parties agreement weighed heavily in the Norton Court's calculus." Indeed, the Norton Court stated: "We see no reason why a court of equity should enforce a standard 'boiler plate' provision that would permit one who makes a material misrepresentation to retain the benefit resulting from that misrepresentation at the expense of an innocent party." Subsequent Delaware Chancery Court cases have, in fact, "read Norton as turning on the relative unsophisticated disposition of the parties" and have upheld anti-reliance clauses where "the provisions were comprehensive and detailed." The Third Circuit then considered the degree of comprehensiveness and detail in the waiver provisions in the insurance policies at issue. Royal Indemnity, the issuer of the policies, argued that, to be enforceable, a waiver clause needed to be both clear and specific. According to Royal Indemnity, "Delaware courts will refuse to enforce even a clear waiver of fraud unless it sets forth the particular representations on which the induced party agreed not to rely." The Third Circuit disagreed, holding that "[t]he lack of specificity in Royal's waivers does not make them any less clear." According to the Third Circuit:

Given the potential for misrepresentation from each side of the agreement, the safer route is to leave parties to their own devices, enforcing the agreement they actually fashion. This rule will make for less prolix disclaimers and reduce the likelihood that an intended allocation of the risk of fraud will be frustrated by unintentional omission from a long and tedious list of representations. . . . When sophisticated parties include a broad but unambiguous anti-reliance clause in their agreement, the Delaware Supreme Court will likely indulge in the assumption that they said

139. Id. at 214.
140. Id.
141. 443 A.2d 1 (Del. 1982).
142. MBIA Ins. Corp., 426 F.3d at 215.
143. Id. (citing Norton, 443 A.2d at 7).
146. Id. at 218
what they meant and meant what they said.\(^{147}\)

In light of the clarity with which Texas courts and a number of other states have stated the standard by which sophisticated parties may reliably waive reliance on extra-contractual tort claims, it is up to the parties to determine whether they want to make this disclaimer a part of their deal.\(^{148}\) To avoid any risk that a sample clause written here could become “boiler plate,” we have resisted the urge to provide sample language and suggest that these clauses be “hammered out by sophisticated parties aided by consummate legal professionals.”\(^{149}\)

Given the differing views of the courts in various states on the issue of the enforceability of anti-reliance clauses, we again remind practitioners to be especially vigilant in the wording of choice-of-law clauses. As we noted in the 2004 Survey, a choice-of-law clause that only applies a particular state’s law to the “construction and interpretation of the agreement” will not cover tort claims for fraud or misrepresentation arising out of that contract or its negotiation.\(^{150}\) Several cases decided during this Survey period re-emphasized that point.\(^{151}\) We direct our readers to the 2005 Survey for our suggested clause to clearly and effectively encompass both tort and contract claims in a choice-of-law clause.\(^{152}\)

\(^{147}\) Id.

\(^{148}\) For suggested guidelines in crafting your agreement, see Glenn D. West, Avoiding Extra-Contractual Fraud Claims in Portfolio Company Sales Transactions—Is “Walk-Away” Deal Certainly Achievable for the Seller?, WEIL, GOTSHAL & MANGES, LLP PRIVATE EQUITY ALERT (Mar. 2006) (on file with the authors).

\(^{149}\) Id. As a bargaining concession, corporate-acquisition agreements often explicitly except “fraud” from the exclusive remedy provision that otherwise makes the indemnification provisions of the agreement the exclusive remedy for any breach. In an agreement containing an otherwise enforceable nonreliance clause and an otherwise exclusive set of remedies with “caps” and “baskets,” what does an exception for “fraud” mean? The most common explanation is that, with respect to the actual representations set forth in the agreement, as opposed to any extra-contractual representations, fraud eliminates the limitations on the contractual remedies otherwise set forth in the “caps” and “baskets.” There are a number of concerns with this explanation. First, as has been previously discussed in this Article, fraud is a broad concept that is not limited to flagrant and deliberate deceit. So, is an exception for fraud a representation that everything that should have been represented has been represented? Second, fraud constitutes a tort, and this permits punitive damages as a remedy. In a contract that has otherwise limited a party’s remedy for breach to contractual damages only, does a fraud exception open the door to tort-damage claims, including possible punitive damages? Third, does a fraud exception present a possible conflict with the waiver-of-reliance clause itself, thereby re-opening claims of fraud based on extra-contractual representations? See Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc., No. 02 Civ. 7689, 2005 WL 832050, at *3 (S.D.N.Y. Apr. 12, 2005) (“express carve-out for causes of action arising from fraud renders [exclusive remedies provision] meaningless” if action is based upon fraud.). If the “fraud” exception means that a deliberate and knowing breach of one of the specific contractual representations expressly set forth in the agreement will not be subject to the “caps” and “baskets” otherwise limiting overall damage claims, our suggestion is that the agreement say exactly that and not rely on a general exception as to “fraud.” See West & Stasny, supra note 7, at 721-25; West & Nelson, supra note 7, at 814-17.

\(^{150}\) West & Nelson, supra note 7, at 817.


\(^{152}\) West & Stasny, supra note 7, at 724.