Corporations

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Recommended Citation
https://scholar.smu.edu/smulr/vol45/iss1/8

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TEXAS courts rendered several noteworthy decisions in the area of Texas corporation law during the current annual Survey period. In particular, the decisions addressed corporate disregard, shareholder derivative actions, director indemnification claims, and application of the Texas Deceptive Trade Practices Act to the sale of securities.

I. CORPORATE DISREGARD

The tendency of Texas courts to disregard the corporate entity has long been recognized and appears to have continued unabated, notwithstanding recent legislative pronouncements to the contrary. During the current Survey period many courts have continued to follow the rationale espoused by the supreme court in *Castleberry v. Branscum*, but only one has cited the

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2. In 1989, the Texas legislature adopted amendments to the Texas Business Corporation Act with respect to the liability of shareholders of a corporation for the obligations of the corporation. In particular, the relevant statutes read as follows:

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

   (1) any contractual obligation of the corporation on the basis of actual or constructive fraud, or a sham to perpetrate a fraud, unless the obligee demonstrates that the holder, owner, or subscriber caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on obligee primarily for direct personal benefit of the holder, owner, or subscriber.


   Additionally, “the laws of the jurisdiction of incorporation of a foreign corporation shall govern the liability, if any, of shareholders of the foreign corporation for the debts, liabilities, and obligations for which the shareholders of the foreign corporation are not otherwise liable by statute or agreement.” Tex. Bus. Corp. Act Ann. art. 8.02A (Vernon Supp. 1991); see Gray & Sergesketter, Corporations, Annual Survey of Texas Law, 44 Sw. L.J. 225, 226-27 (1990).

3. 721 S.W.2d 270 (Tex. 1986). *Castleberry* permits disregarding of the corporate fiction (or piercing the corporate veil) when the corporate form has been used as part of a basically unfair device to achieve an inequitable result, [and more specifically:] (1) when the fiction is used as a means of perpetrating fraud [including constructive fraud, which is defined as the breach of some legal or equitable duty]; (2) where a corporation is organized and operating as a mere tool or business conduit of another corporation [the alter ego theory]; (3) where the corporate fiction is resorted to as a
In most circumstances, the statutes eliminate actual and constructive fraud and sham to perpetrate a fraud as bases for piercing the corporate veil and holding shareholders liable for the contractual obligations of the corporation.

In addition, the Supreme Court of Texas recently gave its imprimatur to the filing of additional lawsuits against potential shareholder defendants until the applicable statute of limitations has expired following the entry of a judgment with respect to the underlying cause of action. In Matthews Construction Co. v. Rosen Matthews Construction Company entered into a contract in March 1979 with Houston Pipe & Supply Company (HP&S) of which Harvey Rosen was president and sole shareholder. Matthews sued HP&S on June 21, 1979, for breach of the contract and obtained a judgment for approximately $300,000 on July 26, 1982. Unable to collect on the judgment against HP&S, Matthews sought to pierce the corporate veil by filing suit against Rosen on February 20, 1984, and was subsequently awarded damages by the trial court. Relying on “well-settled Texas law” the court of appeals determined that constructive fraud, sham to perpetrate a fraud, and alter ego were not separate causes of action that could withstand the affirmative defense of statute of limitations. Such corporate disregard theories are only a means for the injured party to pursue a remedy against an additional defendant who would otherwise be immune. The court of appeals held that although the period of limitations should be suspended to provide the claimant with his day in court, it should not be tolled if the effect is to provide the claimant with an additional opportunity to bring the same cause of action against another defendant after he has exhausted his original process. Consequently, even though Matthews was able to pierce the corporate veil, he was not able to secure a judgment against Rosen since the statutory limi-
The Supreme Court of Texas reversed the court of appeals, however, and held that once Matthews filed suit against HP&S in June 1979, the limitations period was tolled as to HP&S's alter ego until final judgment. Although the court acknowledged the need for reasonable limitations periods "so that the opposing party has a fair opportunity to defend while witnesses are available," the court permitted Matthews to commence a separate suit against Rosen, which was the basis for this action, more than five years following the underlying breach of contract.

In the interest of judicial efficiency and finality, claimants seeking to pierce the corporate veil based upon alter ego should be required to join the potential alter ego defendant if a separate suit against the alter ego defendant is not commenced prior to the running of the statute of limitations. Recently, the Texas legislature has sought to improve the business climate in Texas by providing the shareholders of Texas corporations with more certainty of limited liability for the contractual obligations of the corporation. However, once again Justice Spears has apparently attempted to facilitate the ability of plaintiffs to pierce the corporate veil of Texas corporations and disregard the limited liability aspects granted by the Texas legislature.

In Zahra Spiritual Trust v. United States, a case involving reverse piercing of the corporate veil, various corporations brought suit against the United States to quiet title to real property and discharge Federal tax liens placed on the property as a result of a federal tax jeopardy assessment. The corporate structure with respect to the plaintiffs-appellants was complex.

Fadhlalla Haeri and Hamid Jafar formed and operated a partnership, Project Development Company (PDC), until Mr. Haeri decided "to abandon the business world and devote his time to studying and teaching the Islamic faith." After making his decision, Mr. Haeri transferred his forty-seven percent ownership interest in PDC to Mr. Jafar who subsequently formed the Haeri Trust with Mr. Haeri as its sole beneficiary. Mr. Jafar funded the Haeri Trust with, inter alia, forty-seven shares of PDC, 500 shares of Dar Al-Hikmah N.V., Inc. and all the shares of Mudin, Inc.

Dar Al-Hikmah and Mudin corporations held real property on which the Haeris, their guests and servants lived at no cost, and both corporations paid for the personal living expenses of the Haeris. The Federal Government asked the court to hold the two corporate entities, Dar Al-Hikmah N.V., Inc. and Mudin, Inc., accountable for the tax obligations of the Haeris who

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11. Id. at 442.
12. Matthews Constr. Co. v. Rosen, 796 S.W.2d 692, 694 (Tex. 1990); see also Nelson v. Schanzer, 788 S.W.2d 81, 86 (Tex. App.—Houston [14th Dist.] 1990, writ denied) (court held filing against alter ego corporation tolled running of limitations against individual owner of alter ego corporation).
13. Matthews, 796 S.W.2d at 694 (citing Moreno v. Sterling Drug, Inc., 787 S.W.2d 348, 351 (Tex. 1990)).
15. 910 F.2d 240 (5th Cir. 1990).
16. Id. at 241.
were not shareholders of record of those entities.\textsuperscript{17}

In this reverse piercing case, the district court found three bases for disregarding the corporate fictions of Dar Al-Hikmah and Mudin — alter ego, illegal purpose, and sham to perpetrate fraud.\textsuperscript{18} The court of appeals determined that under Texas law a reverse piercing case is permitted only where the basis for piercing the corporate veil is alter ego and not illegal purpose or sham to perpetrate a fraud.\textsuperscript{19} The Federal Government could thus reach the assets of Dar Al-Hikmah and Mudin only upon showing an alter ego relationship between the Haeris and the corporations. No doubt existed as to the extensive relationship and unity between the corporations and the Haeris.\textsuperscript{20} Since the Haeris were not shareholders of Dar Al-Hikmah or Mudin, the extensive relationship alone did not establish an alter ego basis for piercing the corporate veil.\textsuperscript{21} Texas courts will not treat a corporation and an individual as one unless the individual has an ownership interest in the corporation.\textsuperscript{22} The court remanded the case to the district court to determine whether, under Texas trust law, the Haeris had a present ownership interest in the Haeri Trust and whether such ownership interest was sufficient to conclude that the Haeris were shareholders of Mudin and Dar Al-Hikmah.\textsuperscript{23}

In a recent case before the Texas Supreme Court, Justice Spears, over a strong dissent, extended the alter ego basis for piercing the corporate veil by using a restricted review of the evidence. In \textit{Mancorp, Inc. v. Culpepper}\textsuperscript{24} Mancorp, Inc. (Mancorp), as contractor, sued Culpepper Properties, Inc. (CPI), as owner, and John C. Culpepper, Jr. (Culpepper), as the sole shareholder of CPI on the basis of alter ego.\textsuperscript{25} The suit alleged breach of a con-

\textsuperscript{17} Normally, the corporate veil is pierced to permit creditors of the corporation to recover from the corporation’s shareholders for the debts of the corporation. In \textit{Zahra}, however, the court was asked to pierce the corporate veil and hold the corporations liable for the debts of the Haeris — a reverse piercing case.

\textsuperscript{18} \textit{Id.} at 243.

\textsuperscript{19} \textit{Id.} at 244; see Zisblatt v. Zisblatt, 693 S.W.2d 944, 953 (Tex. App.—Fort Worth 1985, writ dism’d); Dillingham v. Dillingham, 434 S.W.2d 459, 462 (Tex. Civ. App.—Fort Worth 1968, writ dism’d); American Petroleum Exch. v. Lord, 399 S.W.2d 213, 216–17 (Tex. Civ. App.—Fort Worth 1966, writ ref’d n.r.e.).

\textsuperscript{20} \textit{Zahra}, 910 F.2d at 245.

\textsuperscript{21} \textit{Id.}

\textsuperscript{22} \textit{Id.} at 246.

\textsuperscript{23} \textit{Id.}


\textsuperscript{25} Observance of corporate formalities was an important factor in the majority’s decision. \textit{Id.} Because, as noted in the dissenting opinion of Justices Phillips and Hecht, the trial occurred prior to August 28, 1989, the effective date of \textsc{Tex. Bus. Corp. Act Ann. art. 2.21A} (Vernon Supp. 1991), these amendments to the Texas Business Corporation Act were not applicable in this case. The amendment states in relevant part:

A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted shall be under no obligation to the corporation or to its obligees with respect to . . . (3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of [the Texas Business Corporation] Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by [the Texas Business Corporation] Act or by the arti-
construction contract under which Mancorp built the First Bank Galleria building for CPI. The jury found against CPI and, by piercing the corporate veil on the basis of alter ego, held Culpepper jointly liable. The trial court, however, rendered judgment notwithstanding the verdict on the finding of alter ego, which judgment was affirmed by the court of appeals. The Texas Supreme Court reversed the decision and remanded the alter ego finding for further consideration.

Citing Sherman v. First National Bank,26 Garcia v. Insurance Co. of Pa.,27 and Williams v. Bennett,28 the Texas Supreme Court adopted the evidentiary standard that, when reviewing an no evidence basis for overturning a finding that a shareholder is liable for the obligations of a corporation as its alter ego, an appellate court is limited to reviewing only the evidence tending to support the jury’s verdict and must disregard all other evidence to the contrary.29 Then, if more than a scintilla of evidence supports the jury’s findings, the jury’s findings must be upheld.30 On this basis, the Texas Supreme Court reversed the court of appeals for drawing inferences from the evidence that tended to support the trial court’s judgment.31

The dissent correctly pointed out that the no evidence review standard contains an inherent inconsistency between the test for alter ego and its limited evidentiary review. "If a jury must consider the total dealings between a corporation and an individual before it can find alter ego, it is hardly appropriate to review the propriety of an affirmative finding by looking only to those dealings which might imply alter ego."32 Justices Phillips and Hecht in their dissent noted that courts, in no evidence reviews, have also acknowledged the inherent inconsistencies and have called for a reform of the review standard.33 Therefore, extension of the no evidence review standard to alter ego reviews would be clearly improvident. The legal sufficiency of evidence to support an alter ego finding should be determined by reviewing all the evidence, not just evidence and inferences most favorable to the finding.34

Using a two-step analysis for proving alter ego, the Supreme Court found first that all of the pieces of evidence tending to show alter ego taken together constituted more than the scintilla of evidence required for supporting a finding by the jury that there was such unity between the corporation

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27. 751 S.W.2d 857, 858 (Tex. 1988).
28. 610 S.W.2d 144, 145 (Tex. 1980).
30. Id.
31. Id. at 158.
32. Id. at 161 n.1 (Phillips & Hecht, JJ., dissenting).
33. Id.
34. Id.
and the individual that the separateness of the corporation had ceased.\textsuperscript{35} Secondly, more than a scintilla of evidence existed to support a finding that failure to pierce the corporate veil would result in injustice or inequity.\textsuperscript{36}

Even using the majority's articulated evidentiary standard, the paucity of alter ego evidence is overwhelming. Rather than basing their conclusions on clear inferences of an alter ego relationship gleaned from the evidence, the majority appears to merely rely on evidence which gives, at best, an ambiguous inference as to the nature of the relationship. The court found sufficient facts to meet the first test, that there was such unity between the corporation and the individual that the separateness of the corporation had ceased.\textsuperscript{37}

The first basis to satisfy this initial test involved failure to follow corporate formalities.\textsuperscript{38} CPI's observance of corporate formalities is not entirely clear, and even if it was, that alone is not enough to imply alter ego.\textsuperscript{39}

Secondly, the court relied on payment of CPI's debts by Culpepper.\textsuperscript{40} Even if the evidence supported the finding that Culpepper personally paid for CPI's debts, this evidence runs counter to the reasons alter ego is alleged. If CPI had been paying for Culpepper's debts or Culpepper had commingled funds with CPI, this would have been indicative of Culpepper stripping CPI of its assets for his benefit. Culpepper should be rewarded, not punished, for increasing the net worth of CPI and its ability to pay its liabilities when he personally paid CPI's debts. Instead the court punishes Culpepper by making him personally liable for all debts of CPI.

Culpepper's business card provided a third basis for meeting the initial test.\textsuperscript{41} The statement on Culpepper's business card, "Culpepper Properties, Inc., John C. Culpepper, Jr., his self,"\textsuperscript{42} is at best ambiguous. It is more of an indication of the separate capacities in which Culpepper operated his separate businesses. Culpepper had one business card that served all of his purposes instead of a separate card for each business. This is indicative of the lengths to which the majority is willing to stretch the inference.

Lastly, the court emphasized the statement that Culpepper personally backed the project.\textsuperscript{43} This basis is also very weak in its inference of an alter ego relationship. Because Culpepper had personally guaranteed the construction loan, he was correct in stating that he was "behind the project."\textsuperscript{44} However, such a statement cannot be interpreted to mean that CPI and Culpepper are one in the same entities, especially since the contract with Mancorp was signed with CPI by Culpepper as President. As the dissent

\textsuperscript{35} Id. at 158.
\textsuperscript{36} Id. According to the majority, inequity in contract cases frequently results from reasonable reliance on the financial backing of the corporation's owners should the corporation become insolvent. Id.
\textsuperscript{37} Mancorp, 34 Tex. Sup. Ct. J. at 157-58.
\textsuperscript{38} Id. at 157.
\textsuperscript{39} See Torregrossa v. Szelt, 603 S.W.2d 803, 804 (Tex. 1980).
\textsuperscript{40} Mancorp, 34 Tex. Sup. Ct. J. at 157-58.
\textsuperscript{41} Id. at 158.
\textsuperscript{42} Id.
\textsuperscript{43} Id.
\textsuperscript{44} Mancorp, 34 Tex. Sup. Ct. J. at 158.
points out, "[t]he jury could reasonably have suspected that John Culpepper treated [CPI] as his alter ego... but it could not have inferred alter ego from this record."\(^{45}\)

The second test, that failure to pierce the corporate veil would result in injustice or inequity, was based on 1) Mancorp relying on Culpepper's misleading representations to the effect that he was "behind the project," and 2) the mortgage company foreclosing on the project and two of the project's creditors remaining unpaid.\(^{46}\) No doubt exists that Mancorp's contract was with CPI, not Culpepper. If Mancorp was concerned about CPI's ability to perform the contract, Mancorp should have acted as CPI's construction lender did in obtaining Culpepper's personal guaranty. As Mancorp did not, it therefore unreasonably relied on Culpepper being personally liable for the project. Nevertheless, the court grants Mancorp Culpepper's personal guaranty, though not bargained for, due to the perceived injustice that otherwise would have occurred. That, however, is not the injustice. If any injustice exists it is in providing the equivalent of personal guaranties to those who do not give a commensurate exchange of value. If a person bargains to receive a personal guaranty, a commensurate exchange of value normally is required. Those persons who have the foresight to obtain such guaranties are placed at a disadvantage when courts are willing to grant those plaintiffs who must rely solely on alter ego the equivalent of the stockholder's personal guaranty.

II. DERIVATIVE ACTIONS

Generally, an individual shareholder of a Texas corporation does not have a separate and independent cause of action for injuries suffered by the corporation that result in the depreciation of the value of the shareholder's shares.\(^{47}\) The courts have found an exception to this rule, however, where the shareholder has a cause of action for personal damages as a result of the breach of a duty owed directly by a person to the shareholder, whether arising from contract or otherwise.\(^{48}\) While most courts have viewed this as an exception to the general rule, at least one court during the Survey period correctly recognized it as an otherwise separate cause of action that is not dependent upon the relationship of the parties to the corporation.\(^{49}\) Whether the wrong is against the corporation solely or against the shareholder personally determines the party that may bring the cause of action.\(^{50}\) Recently, some courts in Texas have blurred this distinction by permitting shareholders to bring actions in their individual capacity for what are in essence wrongs against the corporation. As in the corporate disregard cases discussed above, this trend has resulted in the erosion of the concept of the corporation as a separate legal entity.

\(^{45}\) Id. at 163 (emphasis in original).
\(^{46}\) Id. at 158-59.
\(^{48}\) Id. at 408, 168 S.W.2d at 222.
\(^{49}\) Faour v. Faour, 789 S.W.2d 620, 621 (Tex. App.—Texarkana 1990, writ denied).
\(^{50}\) Id. at 622.
In *Bush v. Brunswick Corp.* shareholdes of ICO intervened in a suit against Brunswick Corporation and its wholly owned subsidiary, ICO Transitory, Inc. (Transitory). The suit alleged anticipatory breach of a merger agreement whereby Brunswick, through a merger of its subsidiary into ICO, was to acquire all the shares of ICO stock for $7.00 per share. The court framed the issue as whether the parties to the merger agreement intended the shareholders to have an independent cause of action for the diminution in the value of their shares of ICO stock as a result of an alleged anticipatory breach of the merger agreement by Brunswick and Transitory. ICO sued Brunswick and Transitory for the alleged breach. Brunswick then filed a special exception alleging that the decrease in the value of the ICO shares could only have affected the individual shareholders of ICO, and thus ICO lacked standing or a justiciable interest to recover for the decreased value. The seven majority shareholders of ICO filed a petition in intervention seeking class certification and damages for the diminution in the value of their shares caused by Brunswick's alleged anticipatory breach of the merger agreement. In reviewing the terms of the merger agreement, the trial court held that the shareholders were not parties to the agreement or third party beneficiaries entitled to bring suit to enforce it, and struck the shareholders' petition in intervention. Based upon some hypertechnical analysis of the language of the agreement, the court of appeals reversed the trial court and held that the shareholders were third party beneficiaries of the merger agreement and were not barred from bringing suit for a breach of the agreement. In effect, this decision means that shareholders of Texas corporations are allowed to bring suit against potential acquirors for breach of acquisition agreements between their corporations and the acquiring entity. In all likelihood, this decision will result in another disincentive for anyone seeking to acquire a Texas corporation.

When two corporations enter into a merger agreement, the shareholders of the company to be acquired generally are not parties to the agreement. Since the board of directors of an acquired Texas corporation is responsible to ensure that the best interests of the corporation's shareholders are achieved, the acquired corporation is the appropriate body to negotiate and enter into the merger agreement that is subsequently approved by its shareholders. In *Bush*, however, a contract dispute between Brunswick, Transitory, and ICO evolved and breathed life into the "Frankenstein monster" of the merger agreement.
a class action suit.\textsuperscript{59} Ample opportunity to attack any transaction is thereby granted to various parties under various theories. ICO additionally had the right to sue for its damages sustained under the terms of the unfulfilled merger agreement. Also, ICO could have pursued the remedy of specific performance against Brunswick and Transitory to recoup the diminution in ICO's stock value. With those remedies, both ICO and its shareholders were well protected. However, the court has apparently now authorized the corporation's shareholders as another protected class that may seek damages independently for the breach of a corporate contract through the class action mechanism.

In \textit{Eye Site, Inc. v. Blackburn} \textsuperscript{60} the Texas Supreme Court held that a sole dissenting shareholder had standing to bring a shareholder's derivative suit against the other shareholders.\textsuperscript{61} The defendants argued that the plaintiff lacked standing because, under Texas Rule of Civil Procedure 42(a), a plaintiff may not maintain a derivative suit if "the plaintiff does not fairly and adequately represent the interests of the shareholders similarly situated . . . ."\textsuperscript{62} The defendants argued that the requirements of rule 42(a) had not been met since there were no other shareholders similarly situated. The trial court agreed and dismissed the suit, and the court of appeals affirmed.\textsuperscript{63}

The suit arose after two optometrists formed a corporation to provide eye care services and gave the plaintiff twenty-five percent of the shares of stock of the corporation in return for the plaintiff's help in obtaining financing for the corporation. When the two original shareholders became disillusioned with the plaintiff's ability to obtain financing, they formed a new corporation and dissolved the old one. The new corporation obtained financing and opened thirty-eight new stores, all without the plaintiff's involvement. The plaintiff filed a shareholder's derivative suit on behalf of the old corporation, claiming that the other two shareholders had diverted business opportunities to their new corporation.

In an opinion written by Justice Cook, the Texas Supreme Court reversed the court of appeals, reasoning that neither rule 42(a) nor the rule's legislative history indicated any intention to preclude a sole dissenting shareholder from maintaining a derivative action.\textsuperscript{64} The purpose of the rule, the court continued, was to prevent a shareholder from bringing a derivative suit "without fairly and adequately representing 'similarly situated' shareholders."\textsuperscript{65} Noting that the rule places no minimum on the number of "similarly situated" shareholders required to maintain a suit, the court held that "if the plaintiff is the only shareholder 'similarly situated', he is in compliance with

\textsuperscript{60} 796 S.W.2d 160 (Tex. 1990).
\textsuperscript{61} \textit{Id.} at 163.
\textsuperscript{62} \textit{Id.} at 161 (citing TEX. R. CIV. P. 42(a)).
\textsuperscript{64} \textit{Eye Site}, 796 S.W.2d at 162.
\textsuperscript{65} \textit{Id.}
both the letter and the purpose of the rule.\textsuperscript{66} The court concluded by questioning the wisdom of construing the rule in such a way that would prevent a shareholder from enforcing his or her rights.\textsuperscript{67} In light of the fact that the corporation in this case was the damaged entity and, therefore, the proper party to bring the suit rather than the shareholder in his individual capacity, the court appears to have reached the correct result. To have held otherwise, while following the general rule in \textit{Massachusetts v. Davis},\textsuperscript{68} would have left an aggrieved shareholder of a corporation that has been damaged by all of his fellow shareholders without a cause of action.

In a concurring opinion, Justice Gonzalez agreed with the result but disagreed with the notion that a shareholder must represent any sort of class at all in order to have standing to bring a derivative suit.\textsuperscript{69} Justice Gonzalez pointed out that the provision of the Texas Business Corporation Act that enumerates the requirements for maintaining a derivative suit contains no requirement that a plaintiff must represent any other shareholders.\textsuperscript{70} Rather, rule 42(a) only comes into play when there are other similarly situated shareholders who would constitute a class. Justice Gonzalez concluded that only if such a class exists would a plaintiff be required to fairly and adequately represent that class.\textsuperscript{71} Justice Gonzalez's opinion articulates the better analysis to be used in shareholder derivative suits by not examining rule 42(a) if a class is not present and instead focusing solely on the Texas Business Corporation Act.

In \textit{Faour v. Faour}\textsuperscript{72} a corporation filed suit to collect a debt owed to the corporation by a minority shareholder. The shareholder filed a counterclaim against the corporation and its president, claiming that the president had breached his fiduciary duties by failing to hold shareholders and directors meetings, suppressing the payment of dividends, allowing the dissipation of corporate assets, failing to supply requested financial records, making improper corporate loans, and causing the corporation's stock to decline in value.

The Texarkana court of appeals in a succinct and scholarly decision held that an officer of a corporation owes a fiduciary duty to the corporation and not to any shareholder individually.\textsuperscript{73} An officer owes fiduciary duties to the corporation and, thus, to the shareholders in a collective sense, but no fiduciary relationship exists between the officer and an individual shareholder absent some express contract or other special relationship between the officer and the shareholder.\textsuperscript{74} The court reasoned that, even though individual shareholders suffer indirectly through loss of corporate earnings and de-

\begin{itemize}
  \item \textsuperscript{66} Id. at 163.
  \item \textsuperscript{67} Id.
  \item \textsuperscript{68} See supra note 47 and accompanying text.
  \item \textsuperscript{69} 796 S.W.2d at 163 (Gonzales, J., concurring).
  \item \textsuperscript{70} Id. (citing TEX. BUS. CORP. ACT ANN. art. 5.14 (Vernon 1980)).
  \item \textsuperscript{71} Id at 164.
  \item \textsuperscript{72} 789 S.W.2d 620 (Tex. App.—Texarkana 1990, writ denied).
  \item \textsuperscript{73} Id. at 621.
  \item \textsuperscript{74} Id. at 621-22.
\end{itemize}
creases in the value of their shares of stock, the cause of action for injury to
the corporation vests in the corporation, not in the individual shareholders.\textsuperscript{75} A shareholder's derivative suit brought in the name of the corporation
is the proper method to recover for damages to the corporation.\textsuperscript{76} Here, the
shareholder had clearly counterclaimed individually and not derivatively.\textsuperscript{77} The
court found no evidence of any fiduciary relationship between the presi-
dent and the shareholder other than the corporate relationship,\textsuperscript{78} but noted
that a shareholder may sue to protect individual rights, notwithstanding an
additional cause of action vested in the corporation.\textsuperscript{79} An individual share-
holder's cause of action arises only where there is a violation of a contractual
or other duty owed directly to the shareholder.\textsuperscript{80}

\textit{Thywissen v. Cron}\textsuperscript{81} interpreted the duties owed by shareholders to each
other in dealing with corporate assets. H.J. Thywissen and Myrven H. Cron
formed Flexbin Corporation, which subsequently acquired the machinery
and inventory of Krafcor in exchange for $150,000 in cash and a note for
approximately $283,000. Concerned that Flexbin's note might be trans-
ferred to a competitor, Thywissen negotiated into the sales contract a right
of first refusal requiring Krafcor to offer the note to Thywissen if Krafcor
intended to sell, assign, or transfer the note. Thywissen obtained the right of
first refusal in his name alone, but he did so with Cron's consent and under-
standing that such right was an asset of Flexbin Corporation in the same
manner that the note was a liability.

Twenty months later, Thywissen and Cron sold their Flexbin Corporation
stock to Augusta Bag. Since the note was not reacquired by the closing date
of the sale of stock, the sales contract provided that the right of first refusal
would be a separate asset and not part of the stock sale. In the meantime,
Krafcor filed for bankruptcy and Flexbin offered to purchase its note for
$92,000. After approval by the bankruptcy court of the offer, Thywissen
notified Augusta Bag of his intent to exercise the right of first refusal. Au-
gusta Bag agreed to pay Thywissen $184,000 in exchange for canceling the
note, and Thywissen paid Krafcor as debtor in possession $92,000 to obtain
Flexbin's note. The transaction netted Thywissen $92,000, of which he of-
ferred to pay Cron $7,213. As a former forty percent stockholder of Flexbin,
Cron sued Thywissen to recoup his proportionate share of the gain on the
transaction. The trial court granted recovery to Cron for his share of the
note proceeds, and the court of appeals affirmed.\textsuperscript{82}

Although initial review of various aspects of the case may raise concerns
about Texas corporate law, the basis for the holding does comport with prior

\begin{itemize}
\item \textsuperscript{75} \textit{Id.} at 622.
\item \textsuperscript{76} \textit{Faour}, 789 S.W.2d at 622.
\item \textsuperscript{77} \textit{Id.} (citing pleading requirements for derivative suit set forth in TEX. BUS. CORP. ACT
ANN. art. 5.14(B)(2) (Vernon 1980)).
\item \textsuperscript{78} \textit{Id.} at 623.
\item \textsuperscript{79} \textit{Id.} at 622.
\item \textsuperscript{80} \textit{Faour}, 789 S.W.2d at 622.
\item \textsuperscript{81} 781 S.W.2d 682 (Tex. App.—Houston [1st Dist.] 1989, writ denied).
\item \textsuperscript{82} \textit{Id.} at 687.
\end{itemize}
cases. The evidence established that the right of first refusal was a corporate asset. This corporate asset was excluded from the sale of Flexbin Corporation’s stock to Augusta Bag, and thereafter Thywissen held this asset as a corporate trustee for all former shareholders. As corporate trustee, Thywissen owed a fiduciary duty to deal fairly with the shareholders with respect to the corporate asset and the disposition of any proceeds generated therefrom.83 Based on the foregoing, the court correctly required Thywissen to tender proceeds from an asset held in his name to his former fellow shareholders.

In *O’Neill v. Church’s Fried Chicken, Inc.*84 the Court of Appeals for the Fifth Circuit allowed a former shareholder to recover, from the surviving corporation, attorneys’ fees incurred in an action brought derivatively against the former directors.85 The shareholder claimed that the directors breached their fiduciary duties in implementing certain defensive measures to ward off a tender offer that ultimately was completed. In that case, Biscuit Investments, Inc. (Biscuit) announced a cash tender offer at $8.00 per share for all the outstanding shares of Church’s stock. The offer expired on February 19, 1989. Church’s directors determined the offer was not in the best interests of the shareholders and recommended that the shareholders reject it. In addition, the directors attempted to stall the takeover by adopting a poison pill device and establishing golden parachutes for senior executives. Seeking the court’s permission to proceed derivatively, O’Neill alleged that the board’s opposition to the tender offer was an improper attempt at entrenchment and a breach of their fiduciary duties of care and loyalty to the shareholders. She prayed for an injunction to facilitate the acquisition of Church’s through a tender offer and the recovery of attorneys’ fees. She also sought a preliminary injunction for the removal of the poison pill.

On January 18, 1989, the board announced its decision that a sale of Church’s would be in the best interests of the shareholders and that a thirty-day auction would be concluded on February 18, 1989. On February 15, 1989, Biscuit tendered a revised bid for all the outstanding shares of Church’s stock at $11.00 per share. The directors approved the revised bid and eliminated the poison pill. On March 21, 1989, the tender was completed, and Biscuit mailed payment directly to all Church’s shareholders, thus rendering O’Neill’s derivative action moot. On March 17, 1989, O’Neill petitioned the district court for attorneys’ fees and expenses against Church’s. The trial court awarded O’Neill approximately $412,000.86 The court noted that Texas law allows shareholders who pursue a successful derivative action to recover their attorneys’ fees from the corporation if they show that they conferred a substantial benefit to the corporation through their efforts.87 Although the board’s decision to approve the tender

83. Id. at 686.
84. 910 F.2d 263 (5th Cir. 1990).
85. Id. at 264.
86. Id. at 265.
87. Id.
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offer rendered O'Neill's action moot, the district court held that the burden
is on the corporation to show no causal connection between the share-
holder's action and the decision of the directors to approve Biscuit's offer. The
district court found that O'Neill's prosecution of her suit did in fact affect
the board's decision to sell, resulting in an increased value of Church's
stock and a substantial benefit to Church's and its shareholders. On ap-
peal, Church's conceded that O'Neill's prosecution of her lawsuit would jus-
tify a judgment for fees against the selling shareholders on a common benefit
theory. Church's contended, however, that the district court erred in finding
that the corporation, rather than the individual shareholders, received a sub-
stantial benefit. Church's argued that paying the higher price to acquire the
stock actually injured the current owner of Church's.

In reviewing the district court's decision, the Fifth Circuit considered the
cases cited by Church's, which seemed to hold that a plaintiff could not
recover attorneys' fees where payment by the corporation would not act as a
conduit for shifting fees to the beneficiary class of shareholders. The Fifth
Circuit distinguished these cases, however, on the basis that O'Neill brought
the lawsuit as a derivative claim. The Fifth Circuit concluded that since
any misconduct on the part of the directors in reacting to the tender offer
would harm all shareholders in proportion to their share of ownership,
O'Neill's action was a derivative claim, and as such, the benefit may be
deemed to have accrued to the corporation.

The result appeared to contravene the traditional purpose of the common
benefit rule. The present shareholder, who was forced to pay the higher
price and thus enjoyed no benefit from the action, would be taxed for
O'Neill's cost instead of the former shareholders who did benefit. The court
reasoned, however, that a purchaser of a corporation also purchased its lia-
Biscuit was certainly aware of O'Neill's derivative actions. As such, Biscuit could have accounted for the cost of any potential fee
awards in the calculation of its tender offer or could have otherwise made
arrangements to shift the cost of fees to the former shareholders. The
Fifth Circuit further justified its holding by noting that O'Neill had no other
practical means to recover her expenses in producing the common benefit
that her derivative action bestowed.

This decision will present potential tender offerors with another potential

88. Church's, 910 F.2d at 266. The principle followed by the district court was estab-
lished in Delaware. See McDonnell Douglas Corp. v. Palley, 310 A.2d 635 (Del. 1973);
Chrysler Corp. v. Dann, 43 Del. Ch. 252, 223 A.2d 384 (1966); Rosenthal v. Burry Biscuit
Corp., 209 A.2d 459 (Del. Ch. 1949). In Barton v. Drummond Co., 636 F.2d 978, 984-85 (5th
Cir. 1981), this principle was deemed applicable under Delaware law as applied
by the Fifth Circuit.

89. Church's, 910 F.2d at 266.

90. Christensen v. Kiewit-Murdock Inv. Corp., 815 F.2d 206 (2d Cir. 1987), cert. denied,

91. Church's, 910 F.2d at 267.

92. Id.

93. Id.

94. Id.

95. Church's, 910 F.2d at 267.
liability to include in determining an offering price. If the tender offeror's bid is increased as a result of the actions of a derivative suit, then, following the court's analysis, an offeror would be well advised to decrease its bid by a cost per share equal to the amount of potential fee awards. As with any potential liability, factoring this cost will be both subjective and subject to uncertainty. This case serves as a warning: If you bid for a Texas corporation that is or may be affected by a shareholder's derivative suit, then factor into your bid the fees and expenses of such suit. This is a trap for the unwary and a disincentive for anyone seeking to acquire a Texas corporation.

In Horton v. Robinson the El Paso court of appeals addressed the validity of an individual shareholder's cause of action against other shareholders who breach a contract or fiduciary duty owed directly by them to the aggrieved shareholder, which breach results in damage to the corporation. In Horton three individuals, Robinson, Horton, and Griggs, entered into a shareholders' agreement upon the formation of a financial services corporation. Pursuant to the terms of their agreement, each would own twenty percent of the corporation's stock, and profits were to be "distributed prorata, 33 1/3 each." After a disagreement with Horton and Griggs, Robinson left the corporation. Pursuant to the agreement, Robinson continued to request his share of the corporation's profits and sued Horton, Griggs, and the corporation to recover damages for the breach by Horton and Griggs of the shareholders' agreement. In addition, Robinson claimed that Horton and Griggs breached an independent fiduciary duty owed to him.

The court acknowledged the general proposition that individual shareholders have no cause of action to recover damages sustained by a corporation. The court, however, held Robinson's pleading sufficient to support a recovery in his individual capacity based upon the breach of Horton's fiduciary relationship to Robinson. The fact that Horton had been Robinson's attorney, together with the fact that Horton had violated the shareholders' agreement formed the basis of the court's holding. In affirming the trial court's determination that Horton and Griggs were liable in their individual capacities and reversing the trial court's determination that the corporation violated fiduciary duties or committed a civil conspiracy, the court correctly noted that a corporation cannot be held liable for the acts of a principal that are not referable to corporate business or authorized by the corporation.

96. 776 S.W.2d 260 (Tex. App.—El Paso 1989, n.w.h.).
97. Id. at 262.
98. Id. at 263; see Massachusetts v. Davis, 140 Tex. 398, 168 S.W.2d 216 (1942), cert. denied, 320 U.S. 210 (1943); Group Medical & Surgical Serv., Inc. v. Leong, 750 S.W.2d 791 (Tex. App.—El Paso 1988, writ denied).
99. Horton, 776 S.W.2d at 263.
100. Id. The court cited the general rule discussed by the San Antonio court of appeals in Morrison v. St. Anthony Hotel, San Antonio, 290 S.W.2d 246 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.), in which the court stated that "in a proper case, where a majority stockholder has abused its discretion and has maliciously suppressed the payment of dividends, a stockholder may assert a cause of action for damages and may compel the declaration of dividends." Id.
101. Id. at 267 (citing Rhodes, Inc. v. Duncan, 623 S.W.2d 741 (Tex. App.—Houston [1st Dist.] 1981, no writ)).
In finding that Horton, Robinson's long-time friend and former attorney, had breached a fiduciary duty to his fellow shareholder, thus allowing Robinson to recover damages sustained by the corporation, the court followed the language of the Texas Supreme Court in *Kinzbach Tool Co. v. Corbett-Wallace Corp.*102 and *Thigpen v. Locke.*103 The *Horton* court held that the term “fiduciary” includes informal relations that may arise from moral, social, domestic, or purely personal relationships when it is determined that one party trusts and relies upon another, and is not limited to those “technical fiduciary relations.”104 If Texas courts followed this reasoning, the general rule that individual shareholders have no cause of action to recover damages sustained by a corporation105 would be swallowed by what many Texas courts perceive as the exception.106 This would permit the rule to become the exception.

### III. Director Indemnification Claims

In *University Savings Association v. Burnap,*107 a case of first impression, the Houston court of appeals provided helpful insight into the indemnification provisions of the Texas Business Corporation Act. Walter S. Burnap was a shareholder, officer, and director of Austin Savings Association (ASA). Burnap participated in the negotiation of the sale of a number of shares of ASA common stock prior to an offer made by University Savings Association (University) to merge with and thus acquire all the shares of ASA stock. Seven individual shareholders of ASA sued Burnap alleging various violations of federal and state securities laws in connection with the sales of their shares of stock prior to the announcement of the offer by University. The complaint alleged that as a director of ASA, Burnap owed a duty to the shareholders to disclose the pending negotiations with University. Burnap won each of the cases on motions for summary judgment.

University denied Burnap's subsequent request for indemnification under the by-laws of ASA. The by-laws provided for indemnification of any party defendant if “such person is made a party solely by reason of his being or having been a director, officer or employee of this association . . . .”108 University denied indemnification because the complaint did not allege that Burnap acted illegally or violated a duty as an officer, director, or employee of ASA. University argued that Burnap's alleged unlawful activity could not have been the performance of a duty of a director. If Burnap had been acting solely as a shareholder, he would have had no duty to advise shareholders of his plans to sell his stock.109 The critical question in examining this

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102. 138 Tex. 565, 160 S.W.2d 509 (1942).
103. 363 S.W.2d 247 (Tex. 1962).
104. *Horton,* 776 S.W.2d at 265.
106. *See supra* notes 47-50 and accompanying text.
107. 786 S.W.2d 423 (Tex. App.—Houston [14th Dist.] 1990, n.w.h.).
108. *Id.* at 424.
109. *Id.* at 426.
type of issue should be whether the claimant would have been named as a defendant if he was not a director and not whether the claimant was acting within his capacity as a director. The facts are clear that but for Burnap being a director, he would not have been named a defendant.\textsuperscript{110} Holding in favor of Burnap, the court of appeals analogized the interpretation of indemnification provisions with the determination of an insurance company's duty to defend under an insurance contract.\textsuperscript{111} Specifically, the court held that the duty to defend an action is determined as a matter of law solely from the face of the pleadings in light of the provisions of the contract.\textsuperscript{112}

IV. THE TEXAS SECURITIES ACT AND THE DECEPTIVE TRADE PRACTICES ACT

In \textit{Frizzell v. Cook}\textsuperscript{113} the San Antonio court of appeals held that an individual can bring an action for securities fraud under the Deceptive Trade Practices Act (DTPA), and that such a cause of action is not pre-empted by the Texas Securities Act (TSA).\textsuperscript{114} The plaintiff retained the defendants, a brokerage firm and certain of its employees, to provide investment and counselling services with regard to life insurance proceeds received upon the death of the plaintiff's husband. The plaintiff alleged that the defendants engaged in tortious conduct in connection with the services provided, including misrepresentations relating to specific sales and purchases of securities, and the "churning" of her account.\textsuperscript{115}

The court noted that the cumulative provisions of the DTPA prevent a violation of a law other than the DTPA from automatically becoming a violation of the DTPA.\textsuperscript{116} Specifically, the DTPA provides that the actions of a person which constitute a violation of another law may also be the basis for a DTPA action if such acts are proscribed by the DTPA, but no double recovery under the DTPA and the other law may result from the same acts.\textsuperscript{117} Although the rights and remedies of the TSA are in addition to any other right or remedy that may exist at law or in equity, the court noted that the DTPA contains no exemptions for securities transactions.\textsuperscript{118}

The court then examined certain defenses to the TSA, compared those defenses with certain defenses provided in the DTPA, and found no funda-

\textsuperscript{110} If ASA had been an entity governed by the Texas Business Corporation Act, then the bylaws would not have even been required to be consulted. By statute, a corporation is obligated to indemnify a director against reasonable expenses incurred by him in connection with a proceeding in which he was named a defendant because he is or was a director if he was wholly successful, on the merits or otherwise, in the defense of the proceeding. \textsc{Tex. Bus. Corp. Act} Ann. art. 2.02-1H (Vernon Supp. 1991). As the bylaws and the statute are similar, this decision is indicative of the outcome that would have been reached if the statute was at issue.

\textsuperscript{111} \textit{University Savings Association}, 786 S.W.2d at 426.

\textsuperscript{112} \textit{Id.}

\textsuperscript{113} 790 S.W.2d 41 (Tex. App.--San Antonio 1990, writ denied).

\textsuperscript{114} \textit{Id.} at 47.

\textsuperscript{115} \textit{Id.} at 42-43.

\textsuperscript{116} \textit{Id.} at 44.

\textsuperscript{117} \textit{Frizzell}, 790 S.W.2d at 44.

\textsuperscript{118} \textit{Id.} at 44-45.
mental inconsistency between them.\textsuperscript{119} In particular, the TSA contains a due diligence defense that precludes liability if the plaintiff knew about the alleged untruth or omission, or if the defendant did not know about the untruth or omission, and could not have known about it with the exercise of reasonable care.\textsuperscript{120} Similarly, the DTPA provides that a cause of action arises where a "deceptive practice constitutes a producing cause of actual damages".\textsuperscript{121} The court found that there can be no producing cause of damages if the plaintiff knew about the untruth or omission,\textsuperscript{122} and that the clear language of the DTPA provides a defense when a defendant fails to disclose information that the defendant did not know.\textsuperscript{123} Another DTPA defense arises when a defendant gives a consumer notice of the defendant's reliance on written information provided by a third party, so long as the defendant did not know and could not reasonably have known such information contained false statements.\textsuperscript{124} Thus, the court concluded that under both the TSA and the DTPA, a plaintiff who knows of an untruth or omission may not recover in a cause of action based upon that untruth or omission.\textsuperscript{125} Similarly, under both statutes, a defendant is not liable for his failure to disclose information that he did not know and could not have known with the exercise of reasonable care. According to the San Antonio court of appeals, statutory defenses provided by the TSA and DTPA defenses are consistent.\textsuperscript{126}

Based on the theory that the statute most recently enacted prevails, the court concluded that the DTPA would control over the TSA regardless of whether the defense provisions were consistent.\textsuperscript{127} Because the legislature enacted the relevant provisions of the DTPA after the enactment of the relevant provisions of the TSA, a plaintiff could still maintain a DTPA action for securities fraud even if inconsistencies are found to exist.\textsuperscript{128} Finally, the court concluded that, while there can be only one recovery for the same deceptive act, because of the chronological order of enactment of the relevant provisions of the statutes, and because of their cumulative provisions, actions for securities fraud could arise under the statutes.\textsuperscript{129}

With the specter of treble damages now overhanging all securities transactions in Texas, the economic development of business in Texas is being further threatened by the same Texas courts that have exhibited a propensity to disregard the corporate identity with respect to contractual obligations. In light of the courts' lack of recognition of the legislative response in article

\textsuperscript{119} Id.
\textsuperscript{120} Id. (citing TEX. REV. CIV. STAT. ANN. art. 581-33 A(2) (Vernon Supp. 1991)).
\textsuperscript{121} Frizzell, 790 S.W.2d at 45 (citing TEX. BUS. & COM. CODE ANN. § 17.50(a) (Vernon 1987)).
\textsuperscript{122} Id.
\textsuperscript{123} Id. (citing TEX. BUS. & COM. CODE ANN. § 17.46(b)(23) (Vernon 1987)).
\textsuperscript{124} Id. (citing TEX. BUS. & COM. CODE ANN. § 17.506(a)(2) (Vernon 1987)).
\textsuperscript{125} Frizzell, 790 S.W.2d at 45.
\textsuperscript{126} Id.
\textsuperscript{127} Id.
\textsuperscript{128} Id.
\textsuperscript{129} Id. at 46.
2.21 of the Texas Business Corporation Act to the Castleberry decision, the authors are not hopeful that any legislative response to correct the court's decision in Frizzell will be followed by the courts.