Corporations and Partnerships

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MANY significant legislative and case law developments in Texas partnership, corporation, and securities law occurred during the current annual Survey period. The enactment of the Texas Revised Limited Partnership Act (TRLPA) and the enactment of director liability limitation and indemnification amendments to the Texas Business Corporation Act (TBCA) highlighted the legislative developments. Several notable Texas Supreme Court decisions highlighted the case law developments.

I. LEGISLATIVE DEVELOPMENTS

A. Partnership Law

The most significant partnership law development during the Survey period was the Texas Legislature's enactment of the Texas Revised Limited Partnership Act. TRLPA, the product of a multi-year project of the Partnership Law Committee of the State Bar of Texas, renovated, modernized, and replaced the Texas Uniform Limited Partnership Act (TULPA), which had served as the law in Texas since 1955. Enacted primarily in response to the creative and greatly expanded use of limited partnerships in the real estate and oil and gas industries, TRLPA combines flexibility and limited partner protection to the advantage of both promoters of and investors in these partnerships.
prominent Texas industries. TRLPA also borrows several concepts from Texas corporate law that further enhance TRLPA's usefulness. In general, TRLPA deemphasizes the role of the certificate of limited partnership filed with the secretary of state, increases the importance of the partnership agreement in establishing the relationships among partners, and eliminates questions concerning interpretation of pre-TRLPA concepts that have become anachronisms or were susceptible to multiple interpretations.

1. Effective Date. TRLPA became effective on September 1, 1987, and governs (i) all limited partnerships formed on or subsequent to the effective date, and (ii) all foreign limited partnerships that transact business in Texas, but have not qualified to do so prior to the effective date. Importantly, TRLPA contains a transitional rule that provides that domestic limited partnerships formed prior to the effective date and foreign limited partnerships that qualified to transact business in Texas prior to the effective date need not comply with TRLPA until September 1, 1992. These limited partnerships, however, may elect to have the provisions of TRLPA govern them by filing a certificate of amendment indicating such an election with the secretary of state and conforming their certificates of limited partnership (in the case of domestic limited partnerships) or applications for registration as a foreign limited partnership (in the case of foreign limited partnerships) to TRLPA’s requirements.


Flexibility is to give partners and drafters of their agreements wide leeway to create structures and relationships tailored to their financial, control, tax and other desires. Flexibility is achieved largely through an enhanced role for the partnership agreement, discussed below. A number of rigid features of prior law are eliminated, e.g., the requirement of unanimous votes of limited partners for certain actions, the prohibition on services rendered as a limited partner's contributions, and the requirement that all limited partners, their residence addresses and their contribution and profit shares be listed in the certificate filed with the Secretary of State.

Limited partner protection is to give limited partners a better opportunity to protect their investment by monitoring the general partner(s) management, by having veto power over various actions of the general partner(s), and by participating (to an extent) in the control of the partnership, all without sacrificing their own limited liability. (See Sec. 3.03 and its comment.) A limited partner who is also a lender to the partnership may take a security interest in partnership property (Sec. 1.10). For the first time, the right of a limited partner to bring a derivative suit on behalf of the partnership, e.g., against a general partner for mismanagement or fiduciary breach, is recognized by statute (Art. 10).

7. Among the corporate law concepts first found in TRLPA are (i) reservation of name prior to the time of formation, id. § 1.04(b); (ii) maintenance of a registered office and registered agent in Texas, id. § 1.06(1)-(2); (iii) provisions for service of process, id. § 4.01; (iv) form of initial contributions by limited partners, id. § 1.07(a)(4)(A); (v) classes of partnership interests, id. § 1.07(a)(1)(D); (vi) mergers and consolidations, id. § 2.11; (vii) derivative lawsuits, id. §§ 10.01-.05.

8. See id. introductory comment.

9. Id. § 13.02(a)(1).

10. Id. § 13.02(a)(2).

11. Id. § 13.02(a)(3).
partnerships) to meet the requirements imposed by TRLPA.\textsuperscript{12} It is expected that many preexisting partnerships will make the election in order to obtain the advantages offered by TRLPA.\textsuperscript{13}

2. \textit{Role of Partnership Agreement.} As noted above, a primary goal of TRLPA was to permit contractual flexibility among the partners of a limited partnership. TRLPA achieves this goal by building three grades of contractual control into the statute.\textsuperscript{14} The first grade covers matters that are specified either to be governed by "the partnership agreement"\textsuperscript{15} or to be governed by the statute "unless otherwise provided in the partnership agreement."\textsuperscript{16} While the partnership agreement in these instances may be written or oral and need not be formal, the statute will control only in the absence of such an agreement.\textsuperscript{17} The second grade covers several important matters that may be governed contractually only by a \textit{written} agreement; otherwise the statute controls.\textsuperscript{18} The third grade covers matters that are specified to be governed by the statute and do not provide the "unless otherwise provided in the partnership agreement" option.\textsuperscript{19} The statute implicitly controls in these cases even if the partners have reached a contrary agreement.\textsuperscript{20}

3. \textit{Formation of a Limited Partnership.} A major shortcoming of TULPA was its requirement that the certificate of limited partnership set forth a large amount of information concerning the limited partnership and its partners. For example, TULPA required that the certificate of limited partnership specify the name and residence of each limited partner, as well as the particulars of contributions that the limited partners might have made or agreed to make in the future.\textsuperscript{21} TULPA also was cumbersome in that any change in the information set forth in the certificate of limited partnership required the limited partnership to file an amendment to reflect such change.\textsuperscript{22} Compounding these difficulties was TULPA's general requirement that each limited partner sign and swear to the initial certificate of

\textsuperscript{12} Id. § 13.02(c).
\textsuperscript{13} Id. introductory comment.
\textsuperscript{14} Id.; see also id. § 1.02 comment (definition of partnership agreement).
\textsuperscript{15} Id.; see, e.g., id. § 3.01(b) (admission of new limited partners) and § 4.03(a) (rights and restrictions of a general partner).
\textsuperscript{16} Id. introductory comment; see, e.g., id. § 5.02(b) (enforceability of promised contributions by limited partners), § 5.02(d) (release of obligations to make contributions or return improper distributions), § 7.02(a)(1) (assignability of partnership interests), and § 7.02(a)(2) (nondissolution by assignment of an interest).
\textsuperscript{17} Id. introductory comment.
\textsuperscript{18} Id.; see, e.g., id. § 3.02 (creation of classes or groups of general partners with different rights), § 4.01(a) (admission of additional general partners after formation of the partnership), § 4.05 (creation of classes or groups of limited partners with different rights), § 5.04 (sharing of distributions), § 6.03 (withdrawal rights of limited partners), and § 11.02 (indemnification of a general partner).
\textsuperscript{19} Id. introductory comment; see, e.g., id. § 6.02(a) (general partner's power to withdraw at any time), and § 10.01 (limited partner's right to bring a derivative suit).
\textsuperscript{20} Id. introductory comment.
\textsuperscript{21} Id. art. 6132a, § 3(a)(1) (Vernon 1970).
\textsuperscript{22} Id. §§ 3(a)(1), 26(a)(2).
limited partnership and each amendment thereto. As a consequence, many limited partnerships, particularly publicly traded master limited partnerships with hundreds or thousands of limited partners, found these initial filing and amendment requirements unduly burdensome and chose to organize themselves in states other than Texas.

TRLPA responded to the shortcomings of TULPA by fundamentally changing the nature of the certificate of limited partnership from a detailed disclosure document to merely a basic notice filing. Under TRLPA, the certificate of limited partnership need set forth only the following matters: (i) the limited partnership’s name, (ii) its registered office address, (iii) its registered agent and the address thereof for service of process, (iv) the address of the location at which the limited partnership keeps its records for inspection purposes, and (v) each general partner’s name, mailing address and street address. This streamlining of the certificate of limited partnership requirements acknowledges the reality that persons evaluating whether to extend credit or otherwise deal with a limited partnership seldom rely solely on a certificate of limited partnership in order to determine whether to do business with the entity. To obtain facts concerning the capital and finances of the partnership and other pertinent matters, persons dealing with the limited partnership instead, as they should have under TULPA, must examine the partnership agreement together with other information that the limited partnership provides them. In this regard, the expanded requirement of a written partnership agreement and the obligation to keep partnership records (as described below) are expected to benefit persons dealing with the partnership in these efforts to evaluate the financial viability of the limited partnership.

Furthermore, TRLPA simplified the process of forming a limited partnership and amending the certificate of limited partnership by eliminating TULPA’s requirement that every partner, whether general or limited, sign the initial certificate of limited partnership and every amendment thereto. Under TRLPA, only the general partners must sign the initial certificate and only one general partner’s signature is necessary to effect an amendment of the certificate. Furthermore, although TRLPA carries over the TULPA provision that each person who signs a certificate of limited partnership or certificate of amendment does so under oath subject to penalties of perjury, TRLPA does not require that the signatures be acknowledged by a notary.

23. Id. § 3(a)(1).
25. Id. § 2.01(a) comment.
26. Id. § 2.01(a).
27. Id. § 2.01(a) comment.
28. Id.
29. Id.
30. Id. § 2.01(a) and comment.
31. Id. § 2.04.
public.\textsuperscript{32}

TRLPA also clarifies prior law regarding the time at which a limited partnership is deemed formed. TULPA considered the limited partnership formed when there had been substantial compliance in good faith with the certificate, filing, and fee requirements of the statute.\textsuperscript{33} In instances where the parties filed no certificate, however, the substantial compliance test was troublesome and unpredictable. TRLPA established a bright line test in this regard by providing that a limited partnership cannot be formed unless and until the general partners have filed the certificate of limited partnership, and then, only if the entity complies substantially with the requirements of formation.\textsuperscript{34} In addition, TRLPA goes beyond TULPA by deeming limited partners to be admitted to the limited partnership upon the latter of (i) the formation date of the limited partnership, or (ii) the admission date stated in the records of the limited partnership (or if the records state no such date, then on the date that the person's admission is first reflected in the records of the limited partnership).\textsuperscript{35}

4. **Fees.** In a further effort to simplify the formation process, the legislature changed the fee for filing an initial certificate of limited partnership.\textsuperscript{36} TULPA had provided for a sliding-scale fee structure of one-half of one percent (1/2%) of the total limited partner contributions, with minimum filing fee of $100 and a maximum filing fee of $2,500.\textsuperscript{37} TRLPA requires a flat fee of $750 for filing an initial certificate of limited partnership.\textsuperscript{38}

5. **Name.** Under TULPA, the name of the limited partnership could not contain the surname of a limited partner unless a general partner had the same surname.\textsuperscript{39} TRLPA is more liberal than TULPA in this regard in that it permits a limited partnership's name to include a limited partner's name if the limited partnership operated under the name before the limited partner joined the partnership.\textsuperscript{40} However, TRLPA also is slightly more restrictive than TULPA in that it imposes the additional requirements that the name must contain the words "Limited Partnership," "Limited," or the abbrevia-

\textsuperscript{32} Id. TRLPA also includes provisions regarding execution by attorney-in-fact and execution by judicial order. Id. §§ 2.04(b), 2.05.

\textsuperscript{33} Id. § 3(b).

\textsuperscript{34} Id. § 2.01(b). It should be noted that this provision was not intended to change existing case law such as Garrett v. Koepke, 569 S.W.2d 568, 570-71 (Tex. App.—Dallas 1985, writ ref’d n.r.e.), and Shindler v. Marr & Assoc., 695 S.W.2d 699, 703 (Tex. App.—Houston [1st Dist.] 1985, writ ref’d n.r.e.), that may shield putative limited partners with limited liability when there has been a defective filing of (or failure to file) a certificate of limited partnership, however, TRLPA § 3.04 now deals with such a situation in detail. TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 2.01(b) comment (Vernon Supp. 1988).

\textsuperscript{35} Id. § 3.01(a).

\textsuperscript{36} Id. § 12.01(c).

\textsuperscript{37} Id. art. 6132a, § 3(a)(2) (Vernon Supp. 1988).

\textsuperscript{38} Id. art. 6132a-1, § 12.01. The fee for filing a certificate of amendment, a certificate of cancellation, a restated certificate of limited partnership, or a correction certificate is $250. Id.

\textsuperscript{39} Id. art. 6132a, § 6(a) (Vernon 1970).

\textsuperscript{40} Id. art. 6132a-1, § 1.03(1)(B) (Vernon Supp. 1988).
tion "L.P." or "Ltd." as its last words or letters.\footnote{Id. \S 1.03.} Furthermore, the name of the limited partnership (i) cannot contain a word or phrase that indicates or implies that the entity is a corporation or that it is organized other than for a purpose stated in its partnership agreement;\footnote{Id. \S 1.04; cf. Tex. Bus. Corp. Act. Ann. art. 2.06 (Vernon 1980).} and (ii) cannot be the same or deceptively similar to the name of a corporation or limited partnership that exists under the laws of Texas or, unless a written consent has been obtained, a name that has been reserved or registered for a corporation or limited partnership.\footnote{Id. \S 1.05.}

6. \textit{Reservation of Name.} One of the many corporate law concepts that TRLPA adopted to fill a void in TULPA is a reservation of name provision.\footnote{Id.; cf. Tex. Bus. Corp. Act. Ann. arts. 2.07, 2.08 (Vernon 1980 & Supp. 1988).} TRLPA permits the reservation of a limited partnership name for successive 120-day periods, without an intervening waiting period.\footnote{Id. \S 1.06(b)(h) (Vernon Supp. 1988). Provisions are included for the resignation of a registered agent. \textit{Id.} \S 1.06(f).} TRLPA also allows a foreign limited partnership not currently authorized to do business in Texas to register its name and thereby prevent others from forming or registering a limited partnership with the same name in Texas.\footnote{Id. \S 1.04; cf. Tex. Bus. Corp. Act Ann. art. 2.06 (Vernon 1980).}

7. \textit{Registered Office; Registered Agent; Service of Process.} TRLPA also borrowed the corporate law concepts of a registered office and a registered agent to fill a void in TRLPA.\footnote{Id. \S 1.04; cf. Tex. Bus. Corp. Act Ann. art. 2.06 (Vernon 1980).} TRLPA requires that domestic, as well as foreign, limited partnerships subject to TRLPA maintain within the state a registered office and a registered agent for purposes of service of process.\footnote{Tex. Rev. Civ. Stat. Ann. art. 6132a-1, \S 1.04 (Vernon Supp. 1988).} Service of process, notice, or demand on either a general partner of the limited partnership or the registered agent of the limited partnership constitutes effective service on the limited partnership under TRLPA.\footnote{Tex. Rev. Civ. Stat. Ann. art. 6132a, \S 7 (Vernon 1970).}

8. \textit{Liability for False Statements in the Certificate.} TRLPA has modified prior law concerning false statements in the certificate in several ways to afford limited partners additional protection and to clarify the specific events that give rise to liability based on such statements. Under TULPA, any general or limited partner who signed a certificate of limited partnership that the partner knew contained a false statement at the time of filing exposed itself to liability to any person who relied on the false statement.\footnote{Id. \S 1.04; cf. Tex. Bus. Corp. Act Ann. art. 2.06 (Vernon 1980).} Similarly, if the partner learned of such a false statement and had sufficient time to amend the certificate before a party relied on the misstatement, the partner...
could incur liability to any person who relied on the false statement.  

TRLPA offers a limited partner considerably more protection in this regard than did TULPA. First, TRLPA has removed the requirement that limited partners execute the initial certificate of limited partnership, or any amendment thereto. Accordingly, it will be rare that anyone other than a general partner will face exposure to liability for a false statement in the certificate of limited partnership. Second, TRLPA has adopted a materiality standard for such false statements, which provides that no liability can attach unless the certificate contains a material misstatement or there is a material omission from the certificate. Third, TRLPA contains a safe harbor provision that protects a partner who corrects a misstatement in or omission from the certificate, or cancels the certificate, within 30 days after the partner knew or should have known of the misstatement or omission.

9. Recordkeeping Requirements and Access of Limited Partners to Information. Since the short-form certificate of limited partnership generally sets forth only the identity of the general partners and matters respecting the partnership itself, TRLPA requires that the partnership agreement or other written partnership records must set forth many other important matters, such as (i) a description of the contribution made by each partner, (ii) the times at which additional contributions are to be made, (iii) the events requiring the limited partnership to be dissolved and its affairs wound up, (iv) the date on which each partner became a partner, and (v) correct and complete books and records of account of the limited partnership. The partnership must keep the partnership agreement at its principal office. In addition, a list of all partners and their addresses, class and ownership percentages, copies of the partnership agreement, the certificate of limited partnership, all amendments and restatements thereto, the limited partnership's federal income tax returns for the past six tax years, and correct, complete books and records of the limited partnership must be made available to a partner upon request.

10. Liability of Limited Partners. Limited partner protection is an overriding objective of TRLPA. Consistent with this objective, TRLPA exposes a limited partner to personal liability only in those cases when the limited partner agrees to be liable for such liability, or when equitable concepts of estoppel and justified detrimental reliance by a creditor require the imposition of personal liability on a limited partner. TRLPA carries over TULPA's general rule that the obligations of the limited partnership do not

51. Id.
52. Id. art. 6132a-1, § 2.01(a) (Vernon Supp. 1988).
53. Id. § 2.08(a).
54. Id. §§ 2.08(b), 2.08 comment.
55. Id. § 2.08(b), 2.08 comment.
56. Id. § 3.03.
57. Id.
58. Id. introductory comment.
59. Id. § 3.03.
bind the limited partner, but preserves the traditional exception to this general rule that a limited partner may incur personal liability if he or she participates in the control of the business. Under TULPA, this liability extended only to persons transacting business with the limited partnership who reasonably believed that the limited partner was a general partner. In contrast, TRLPA provides limited partners additional protection by narrowing the persons to whom liability extends to include only persons who transact business with the limited partnership with actual knowledge of such limited partner's participation in control. Additionally, TRLPA expands the list of activities statutorily defined as not constituting taking part in control of the business to include a non-exclusive laundry list of additional activities, including: (i) acting as a partner of a partnership that is a general partner of the limited partnership; (ii) indemnifying a general partner as permitted under TRLPA; (iii) voting on the removal of a general partner; and (iv) changing the scope of the limited partnership's business.

11. Person Erroneously Believing Himself or Herself to be a Limited Partner. Not surprisingly, the situation frequently arises that a person has invested in an enterprise with the expectation of becoming a limited partner in the enterprise, but for some reason, either the enterprise did not become a limited partnership or the person did not become a limited partner. This situation creates the risk that the person might be held accountable as a general partner. TULPA addressed this situation by providing that such a person will not, by reason of his or her exercise of the rights of a limited partner, be considered a general partner of the enterprise so long as the person promptly renounced his or her interest in the profits of the enterprise upon the ascertainment of the mistake. TRLPA expands TULPA in this area by providing an investor a choice of alternatives when faced with this situation. TRLPA generally provides that a person who erroneously, but in good faith, believes that he or she has made a contribution to and has become a limited partner in a limited partnership is not liable as a general partner or otherwise obligated if, within a reasonable period of time after ascertaining the mistake, the person either (i) withdraws from participation in future profits of the enterprise by executing and filing a certificate declaring his or her withdrawal; (ii) executes and files an appropriate certificate of

60. Id.; cf. id. art. 6132a, § 8 (Vernon 1970).
61. Id. art. 6132a-1, § 3.03(a) (Vernon Supp. 1988). As a practical matter, this liability extends only to a limited partner who has day-to-day control of the operations of the business because of the extensive safe-harbor provisions. See id. § 3.03(b).
62. Id. art. 6132a, § 8(a) (Vernon 1970).
63. Id. art. 6132a-1, § 3.03 (Vernon Supp. 1988).
64. Id. § 3.03(a)(b). Furthermore, if the limited partnership is qualified as an investment company under the Investment Company Act of 1940, then the limited partner's safe harbor also extends to (i) electing directors or trustees of the investment company, (ii) approving or terminating investment advisory or underwriting contracts, (iii) approving auditors; and (iv) acting on any matters that the Investment Company Act of 1940 requires to be approved by the holders of beneficial interests in the investment company. Id.
65. Id. art. 6132a, § 12 (Vernon 1970).
66. Id. art. 6132a-1, § 3.04 (Vernon Supp. 1988).
limited partnership or amendment thereof; or (iii) executes and files a statutorily prescribed statement of status, known as "Filing Pursuant to Subdivision (2) of Subsection (a) of Section 3.04, Texas Revised Limited Partnership Act."\textsuperscript{67}

The statutorily prescribed statement of status allows an investor under such circumstances time to rectify the problems regarding his or her status in the enterprise without having to immediately renounce his or her interest in the profits of the partnership.\textsuperscript{68} The statement of status must contain (i) the limited partnership's name, (ii) the name and mailing address of the signer of the statement, (iii) a statement that the signer obtained an interest in the limited partnership, (iv) a statement that the person has attempted to cause a general partner to file an accurate certificate of limited partnership and that the partner has not done so, and (v) a statement that the partnership is filing a written statement of status in accordance with the statute and that the person signing it claims status as a limited partner of the partnership.\textsuperscript{69} The statement of status remains effective for 180 days.\textsuperscript{70} If the enterprise does not file the certificate of limited partnership or certificate of amendment on or before the expiration of such period, the person filing the statement has no further protection from liability and must, within ten days after the expiration of the 180-day period, withdraw from participation in future profits of the enterprise as described above or sue in court demanding the execution and filing of the certificate of limited partnership or an appropriate amendment therein.\textsuperscript{71}

Failure to comply with the provisions described above will result in the investor being treated as a general partner for purposes of liability to third parties transacting business with the partnership if (i) the investor knew or should have known either that no certificate of limited partnership had been filed or that the certificate of limited partnership inaccurately referred to the investor as a general partner, and (ii) the third party both reasonably believed, based on the investor's conduct, that the person was a general partner at the time of the transaction and extended credit to the enterprise in reasonable reliance on the credit of the investor.\textsuperscript{72}

12. \textit{Classes and Voting of Partners}. TRLPA expressly provides that a limited partnership can establish classes of general and limited partners that have different rights, powers, and duties, provided that these different classes are set forth in a written partnership agreement.\textsuperscript{73} Furthermore, TRLPA permits the future creation of additional classes of partners with certain rights, powers, and duties so long as the right of the limited partnership to

\begin{itemize}
  \item \textsuperscript{67} Id. § 3.04(a).
  \item \textsuperscript{68} Id.
  \item \textsuperscript{69} Id. § 3.04(a)(2).
  \item \textsuperscript{70} Id. § 3.04(b).
  \item \textsuperscript{71} Id. If an action is brought within the applicable period and is diligently prosecuted to conclusion, the person bringing it continues to be protected from liability until the action is finally decided adversely to that persons. Id.
  \item \textsuperscript{72} Id. § 3.04(c).
  \item \textsuperscript{73} Id. § 3.02.
\end{itemize}
do so is set forth in a written partnership agreement.\textsuperscript{74} The limited partnership can express these rights by either establishing the rights in the partnership agreement or describing the rights at the time of the formation of the partnership.\textsuperscript{75} Under TULPA, all limited partners as a class had equal rights, powers, and duties, unless the certificate provided for one limited partner having priority over another limited partner with respect to one or more particular matters.\textsuperscript{76} TRLPA generally provides limited partnerships with the opportunity to utilize more flexible capitalization structures similar to those afforded to Texas corporations.\textsuperscript{77}

13. \textit{Rights, Powers, and Liabilities of General Partners.} TRLPA carries over the TULPA concept that a general partner of a limited partnership has the same liabilities to third persons as a partner in a general partnership.\textsuperscript{78} TRLPA, however, expressly permits limited partners to broaden or restrict a general partner's rights and powers to bind the limited partnership with respect to third parties and its rights, powers, and liabilities to the limited partnership and the limited partners.\textsuperscript{79}

14. \textit{Admission of Additional Partners.} TULPA required that all limited partners consent to the admission of a new general partner and provided that the terms of the certificate of limited partnership controlled whether additional limited partners may become partners of the partnership.\textsuperscript{80} TRLPA provides more flexibility concerning the admission of new or additional general or limited partners by permitting the limited partnership to admit additional general partners and limited partners either by unanimous written consent of the partners or by such other action as is provided in a written partnership agreement, rather than the certificate of limited partnership.\textsuperscript{81}

15. \textit{Contributions.} TRLPA expands the permissible forms of contributions by a limited partner to include not only cash and property\textsuperscript{82} but also past services rendered to the partnership, notes, and other cash obligations.\textsuperscript{83} TRLPA overcomes a major deficiency of TULPA in this regard by expressly authorizing many of the modern forms of financing (e.g., letters of credit and negotiable paper) that limited partners frequently desire to utilize as their contributions.\textsuperscript{84} TRLPA permits these expanded forms of contributions be-
cause they are as capable of adding realizable value to limited partnerships as are cash or property.\textsuperscript{85} Importantly, TRLPA excludes promises of future services from the valid forms of contribution.\textsuperscript{86} Future services traditionally have been viewed as the type of consideration most prejudicial to creditors because creditors consider such services valuable only if the enterprise remains a going concern.\textsuperscript{87} To the extent that these services remain unperformed, they may be totally valueless on liquidation.\textsuperscript{88}

TRLPA also makes significant changes to a limited partner's obligations to make contributions to the limited partnership.\textsuperscript{89} Under TRLPA a promise by a limited partner to make a contribution to a limited partnership is not enforceable unless set out in writing and signed by the limited partner, and, unless the partnership agreement states otherwise, the partner or the partner's legal representative or successor must satisfy the required contribution to the limited partnership notwithstanding the partner's death, disability, or other change in circumstances.\textsuperscript{90} In addition, a partnership agreement may provide that a partner who fails to make a contribution required by an enforceable promise will subject his or her interest in the limited partnership to specified consequences, which may take the form of reduction of the interest in the limited partnership, subordination of the interest to that of the other partners, a forced sale of the interest, forfeiture of the interest, redemption or sale of the partnership interest, or other penalties.\textsuperscript{91}

TRLPA requires that, unless the partnership agreement states to the contrary, all partners must consent to the compromise or release of a partner's obligation to make a contribution or to return cash or property received in violation of TRLPA or the partnership agreement in order for the compromise or release to be enforceable against the limited partnership.\textsuperscript{92} A creditor of the limited partnership, however, who acts in reasonable reliance on that obligation, after the partner signs a writing that reflects the obligation and before amendment or cancellation thereof, may enforce the original obligation against the obligor partner.\textsuperscript{93} Of course, a general partner remains liable to persons other than the partnership and the other partners notwithstanding the compromise or release.\textsuperscript{94}

\textsuperscript{85}\textsuperscript{86}\textsuperscript{87}\textsuperscript{88}\textsuperscript{89}\textsuperscript{90}\textsuperscript{91}\textsuperscript{92}\textsuperscript{93}\textsuperscript{94}
16. Profits, Losses and Distributions. TULPA contained a hodgepodge of provisions regarding profits, losses, and distributions. First, TULPA required the certificate of limited partnership to contain a statement of the share of profits or other compensation by way of income allocable to each limited partner by reason of his or her contribution.\textsuperscript{95} Second, TULPA permitted limited partners to receive their shares of the profits only if the limited partnership's assets exceeded all of its liabilities.\textsuperscript{96} Third, TULPA did not distinguish between allocation of profits, losses, distributions, and actual distributions of income.\textsuperscript{97} TRLPA improves on TULPA in this regard by providing that, in the absence of a written agreement, the partnership must allocate profits and losses based on the proportional interests of the partners set forth in the partnership records, or if none, in proportion to the partner's capital accounts.\textsuperscript{98} Similarly, in the absence of a written agreement, the partnership must distribute cash and other assets that are in return of capital according to the agreed value stated in the records of the partnership.\textsuperscript{99} For distributions other than those in return of capital the limited partnership must make such distributions based on the percentages used for allocation of profits and losses.\textsuperscript{100} TRLPA also modifies the rules governing the liability of a limited partner for receiving an improper distribution and draws a distinction between interim distributions and distributions upon withdrawal of a partner.\textsuperscript{101}

17. Partners, Transaction of Business with the Partnership. TULPA permitted limited partners to loan money to and transact business with the limited partnership, to receive an account of claims against the partnership, and to collect a pro rata share of the limited partnership's assets, but dampened a limited partner's incentive to do so by prohibiting a limited partner from holding any partnership property for collateral purposes, or receiving any conveyance, payment, or release from liability from the partnership or a general partner.\textsuperscript{102} Contravention of these prohibitions constituted fraud against the partnership's creditors.\textsuperscript{103} TRLPA adds much needed flexibility to these types of transactions by providing that, unless the partnership agreement states differently, the partnership may borrow money from and transact business with any partner on such terms that may be mutually agreed by the parties, and the partner will possess the same rights and obligations as a nonpartner.\textsuperscript{104}

18. Assignment of Partnership Interest. TRLPA simplifies and clarifies the

\begin{footnotesize}
95. Id. art. 6132a, § 3(1)(I).
96. Id. § 16.
97. Id. art. 6132a-1, § 5.04 Comment.
98. Id. § 5.03.
99. Id. § 5.04.
100. Id.
101. Id. §§ 6.01, .04, .07.
102. Id. art. 6132a, § 14(a) (Vernon 1970).
103. Id. § 14(b).
104. Id. art. 6132a-1, § 1.10 (Vernon Supp. 1988).
\end{footnotesize}
process of assigning partnership interests. The primary simplification is that under TRLPA the partnership agreement may provide in advance for the handling of an assignment of a partnership interest. Additionally, TRLPA clarifies the status of an assignor of a limited partnership interest by providing that, unless contrary to the provisions in the partnership agreement, the assignor continues to have the status of a partner and this status includes all the unassigned powers of a partner until the assignee becomes a partner. The assignee may become a limited partner if either the partnership agreement permits or all the partners consent. If the assignee becomes a limited partner, he or she obtains all the rights and powers assigned, but also subjects himself or herself to the restrictions and liabilities of the partnership agreement and TRLPA. In this regard, the assignee limited partner assumes the assignor's obligation, if any, to make future capital contributions. Liabilities unknown to the assignee and unascertainable from the partnership agreement, however, do not bind the assignee. Irrespective of whether the assignee becomes a limited partner, the assignment will not release the assignor from liability for its financial obligations to the limited partnership.

19. Mergers and Consolidations of Limited Partnerships. TRLPA breaks new ground by providing a comprehensive statutory framework that enables a domestic limited partnership to merge or consolidate with another limited partnership simply by executing a written agreement and having the resulting limited partnership file a prescribed certificate of merger with the Secretary of State on behalf of each domestic limited partnership that is a party to the merger or consolidation. The certificate of merger acts as a certificate of cancellation for all of the limited partnerships in the merger or consolidation, excluding the surviving partnership. Upon an effective filing of the certificate of merger that the TRLPA requires, Texas law considers all partnerships other than the surviving or resulting partnership in the merger or consolidation terminated. The resulting limited partnership retains all property, real, personal and mixed, and all other things belonging to each of those partnerships merged or consolidated. In addition to the property, the resulting partnership retains all debts, liabilities, and duties of those partnerships and these obligations may be enforced against the resulting partnership as if the resulting partnership had incurred or contracted them.

105. Id. § 7.02.
106. Id.
107. Id. § 7.04(a).
108. Id.
109. Id.
110. Id. § 7.04(c).
111. Id.
112. Id. § 2.11(d).
113. Id. § 2.11(c).
114. Id. § 2.11(f).
115. Id.
20. **Withdrawals by Partners.** TULPA contained no provisions regarding a partner's withdrawal from a limited partnership. Such a right, however, was implied with respect to general partners under the Texas Uniform Partnership Act (TUPA)\(^{117}\) and limited partners under provisions in TULPA that dealt with substituted limited partners and return of contribution.\(^{118}\) Under TRLPA, a general partner has the power to withdraw from a limited partnership at any time by giving written notice to the other partners.\(^{119}\) If this action violates the partnership agreement, however, the partnership may recover damages from the partner.\(^{120}\) In addition to other available remedies, the partnership may effect that damages recovery by retaining funds distributable to the withdrawing general partner.\(^{121}\) Unless a written partnership agreement provides otherwise, when a general partner ceases to be a general partner the partnership also may either convert the general partner's interest to that of a limited partner subject to any withdrawal liability or pay the value of that partner's interest to the withdrawing general partner in cash or secure that value by court approved bond.\(^{122}\)

In the event that the partners convert the withdrawing general partner's interest to that of a limited partner, the limited partnership may choose to provide compensation or an interest in the partnership to any replacement general partner by reducing the proportional interest of the withdrawing general partner pro rata with all other partners.\(^{123}\) After amending the certificate of limited partnership to reflect the general partner's withdrawal as a general partner, the withdrawing general partner may vote as a limited partner.\(^{124}\) The withdrawing general partner may vote only if the members of the class of limited partners that have the least voting rights with respect to the matter may also vote.\(^{125}\) The withdrawing general partner may not, however, vote on the admission or compensation of any general partner replacing the withdrawing general partner.\(^{126}\) Furthermore, the general partner loses all voting rights if his withdrawal violates the partnership agreement.\(^{127}\)

Personal liability does not attach to a withdrawing general partner under TRLPA for partnership debt incurred after his withdrawal unless the creditor reasonably believed that the partner remained a general partner at the time of the creation of the debt.\(^{128}\) In this regard, reasonable basis for believing that a withdrawing general partner remains a general partner exists if either (i) the creditor was a creditor of the partnership when the general

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117. *Id.* § 31(2).
118. *Id.* art. 6132a-1, § 6.02 (Vernon Supp. 1988).
119. *Id.* § 6.02(a).
120. *Id.*
121. *Id.* § 6.02(b).
122. *Id.* § 6.02(c).
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.* § 6.02(d).
128. *Id.*
partner withdrew or had extended credit to the partnership within two years before the general partner withdrew and the creditor did not know or have notice that the general partner had withdrawn, or (ii) the creditor knew that the general partner was a general partner in the partnership prior to the withdrawal and did not know or have notice of the withdrawal.\(^{129}\)

Under TRLPA a limited partner may withdraw by giving a six month written notice to each general partner, unless a written partnership agreement provides otherwise or specifies the time for dissolution and winding up of the limited partnership.\(^{130}\) The limited partner may send the notices to the addresses of the general partners as stated in the partnership agreement.\(^{131}\)

21. **Dissolution and Winding Up.** TRLPA modifies the dissolution provisions of TULPA to provide more flexibility to the limited partnership in the event of a dissolution.\(^{132}\) For example, limited partnerships under TRLPA may provide in their partnership agreements for the automatic reconstitution of the limited partnership and continuation of its affairs after a dissolution if at least one general partner remains that desires to continue the business.\(^{133}\) Furthermore, TRLPA expressly permits such a reconstitution and continuation within 90 days after dissolution, even absent a provision in the partnership agreement, if the remaining partners unanimously agree to continue the limited partnership’s business.\(^{134}\)

TRLPA also improves on TULPA by expressly dealing with what happens after dissolution if no one continues the limited partnership.\(^{135}\) Under TRLPA, the dissolution of the partnership triggers a process that requires the winding up of the partnership’s affairs by the remaining general partners who have not wrongfully dissolved the limited partnership as soon as reasonably practicable, unless the partners reconstitute the partnership as discussed above.\(^{136}\) Alternatively, a court, upon a showing of cause, may wind up the limited partnership’s affairs.\(^{137}\) Furthermore, limited partners are now encouraged to involve themselves in the winding up of the partnership’s affairs under TRLPA because such activity will not subject them to liability beyond that in existence before the commencement of the winding up process.\(^{138}\)

22. **Foreign Limited Partnerships.** TULPA contained provisions that gen-

\(^{129}\) Id. § 6.03.

\(^{130}\) Id.

\(^{131}\) Id.

\(^{132}\) See id. §§ 8.01-05.

\(^{133}\) Id. § 8.03(1).

\(^{134}\) Id. § 8.03(2). In the event that no general partners remain, the limited partners can agree to appoint one or more new general partners. Id.

\(^{135}\) Id. § 8.04(a).

\(^{136}\) Id. This feature can prove to be especially useful in the context of a reorganization of a limited partnership in bankruptcy. Id. § 8.04 comment.

\(^{137}\) Id. § 8.04(a). In order to accomplish this, a partner (or his or her legal representative or assignee) must apply to the court for a winding up of the limited partnership, whereupon the court may appoint a trustee to proceed with a liquidation of the limited partnership. Id.

\(^{138}\) Id. § 8.04(c).
erally dealt with the qualification and regulation of foreign limited partnerships that desired to transact business in Texas, but generally failed to provide foreign limited partnership the degree of certainty necessary for them to be comfortable in the Texas environment because there existed no requirement for foreign partnership qualification. \[18\] TRLPA expands the law regarding foreign limited partnerships and provides badly needed certainty. Borrowing heavily from concepts of Texas corporation law, TRLPA requires all foreign limited partnerships transacting business in Texas to register with the Secretary of State. \[19\] TRLPA also prohibits a foreign limited partnership from bringing an action in Texas until it registers and pays all required fees in the event that it fails to so register. \[20\] The failure to register also would allow the Texas Attorney General to bring a suit to enjoin the foreign limited partnership from transacting business in Texas. \[21\]

In an effort to provide more certainty to foreign limited partnerships in light of the potentially harsh consequences resulting from failure to qualify, TRLPA contains a nonexclusive list of twelve activities that do not constitute “transacting business” in Texas. \[22\] This list parallels a similar list for foreign corporations under Texas corporation law. \[23\] TRLPA also clarifies existing law by providing that the laws of a foreign limited partnership’s state of formation will govern all matters relating to organization, internal affairs, and the liability of partners of foreign limited partnerships (whether or not registered). \[24\] Under TULPA, an unregistered foreign limited partnership doing business in Texas could be considered a general partnership. \[25\]

It should also be noted that TRLPA departs from TULPA by not requiring a foreign limited partnership to submit its certificate of limited partnership as part of its application to transact business. \[26\] All that TRLPA requires in the foreign limited partnership’s application is information similar to that required of a domestic limited partnership plus the following: (i) a statement of its business to be conducted in Texas, (ii) the name of its state of formation, (iii) a statement that it validly exists as a limited partnership in such state, and (iv) an appointment of the secretary of state of Texas as agent for service of process. \[27\]

139. Id. art. 6132a, § 32. TULPA did not attempt to address the consequences of a foreign limited partnership’s failure to qualify to transact business in Texas. Id.
140. Id. art. 6132a-1, § 9.02(a).
141. Id. § 9.07.
142. Id. § 9.08.
143. Id. § 9.02(b).
144. TEX. BUS. CORP. ACT ANN. art. 8.01(b) (Vernon Supp. 1988).
145. TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 9.01(a) (Vernon Supp. 1988). This is known as the internal affairs doctrine. Id. comment. It should be noted, however, that TRLPA only addresses foreign limited partnerships formed under the laws of another state of the United States. See id. § 1.02 comment. Whether Texas courts will accord limited liability to “limited partners” of entities formed in foreign countries is a determination left to choice of law rules. Id.
146. See id. § 9.01.
147. Id. § 9.02(a).
148. Id.
23. *Derivative Actions.* While the Texas Business Corporation Act (TBCA) has for many years granted shareholders of a corporation the right to bring a derivative suit in the event that the corporation or its officers and directors have failed to pursue a right of the corporation,¹⁴⁹ TULPA was devoid of statutory authority that would grant a limited partner a similar right against the limited partnership and its general partners. TRLPA improves on TULPA in this regard by expressly granting a limited partner a conditional right to bring a derivative action if the general partners with authority to bring an action on behalf of the limited partnership have refused to bring action or if the limited partner’s effort to cause those general partners to bring action is not likely to succeed.¹⁵⁰ In order to bring a derivative suit, the complaining party must be a limited partner at the time of bringing action and must either have been a limited partner at the time of transaction of which he or she complains or have had his or her status as a limited partner devolved upon him or her by operation of law or by succession, pursuant to terms of partnership agreement, from a person who was a limited partner at the time of the transaction at issue.¹⁵¹ The complaining party also is required to plead with particularity the efforts he or she has made to secure initiation of action by general partner or reasons for not making the effort.¹⁵²

In an effort to discourage frivolous derivative suits, TRLPA grants a court discretion to require that the complaining party post security for the expense expected for the defense in a fashion similar to corporate statutes, and provides other disincentives to strike suits.¹⁵³ TRLPA also provides that a court may award attorneys' fees and expenses to a successful complaining party and may deprive a complaining party of any personal benefit the party may obtain from bringing the derivative suit.¹⁵⁴ Neither the TBCA nor the TULPA has a provision similar to this.

24. *Indemnification.* Prior to the enactment of TRLPA, there was no express statutory authority that permitted a limited partnership to indemnify its general partners against liability that the general partners might incur in connection with actions taken on behalf of the limited partnership.¹⁵⁵ Despite this lack of statutory authority, it was a common practice for partners to provide indemnification to each other pursuant to general indemnification agreements or simply by oral understandings.¹⁵⁶ Such being the case, it was the view of the drafters of TRLPA that a limited partnership should be able, by expressed statutory authority, to afford its general partners the same type of protection that a Texas corporation may afford its directors. Accordingly, TRLPA provides for standards of indemnification similar to those set forth

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¹⁴⁹. TEX. BUS. CORP. ACT ANN. art. 5.14 (Vernon 1980).
¹⁵⁰. TEX. REV. CIV. STAT. ANN. art. 6132a-1, §§ 10.01-10.05 (Vernon Supp. 1988).
¹⁵¹. Id. § 10.02.
¹⁵². Id. § 10.03.
¹⁵³. Id. § 10.04.
¹⁵⁴. Id. § 10.05. For example, sharing of a compromise settlement fee with the other limited partners. Id.
¹⁵⁵. Id. art. 11 comment.
¹⁵⁶. Id.
in TBCA section 2.02-1.\textsuperscript{157}

Although the indemnification standards under TRLPA and TBCA generally are the same, one should be aware that the TRLPA provisions are supplemented by the indemnification provisions of TUPA section 18(l)(b), which provides that a partnership must indemnify every partner in respect of payments made by and personal liabilities reasonably incurred by the partner in the ordinary and proper conduct of the partnership's business, or for the preservation of its business or property.\textsuperscript{158}

\textbf{B. Corporation Law}

The Texas Legislature during the 1987 regular session enacted legislation modernizing Texas corporation law regarding director liability limitations and indemnification and includes several significant changes to prior law.

1. \textit{Limitations on Director Liability}. In response to a recent crisis in obtaining director's liability insurance in both Texas and other states, and in an effort to encourage qualified persons to serve as directors by reducing their exposure to liability, the Texas Legislature passed a bill during the last regular session that permits a corporation to amend its articles of incorporation to provide for certain limitations on the monetary damages a director may be liable for to the corporation or its shareholders or members.\textsuperscript{159} In general, these limitations extend to monetary damages for an act or omission in a director's capacity as a director.\textsuperscript{160} The statute does not eliminate or limit the liability of a director for any of the following six matters: (i) a breach of the director's loyalty to the corporation or its shareholders or members, (ii) an act or omission not in good faith or involving intentional misconduct or a knowing violation of the law, (iii) a transaction from which a director received an improper benefit, whether or not the benefit resulted from an action taken within the scope of the director's office, (iv) an act or omission for which the liability of a director is expressly provided for by statute, (v) an act related to an unlawful stock repurchase or payment of a dividend, and (vi) an act or omission occurring prior to the later of (A) August 31, 1987,

\textsuperscript{157} TRLPA only "generally" provides for the same standards of indemnification as the TBCA because certain amendments to TBCA indemnification provisions were made at the same time as TRLPA and are intended to be reflected in TRLPA. \textit{Id.} Unfortunately, the amendments and TRLPA took different legislative paths and timing, which caused certain language differences between the two provisions. \textit{Id.} These differences in language are not intended to provide different substantive standards unless specifically noted on the comments to the specific provisions. \textit{Id.} The commentary to \textit{TEX. BUS. CORP. ACT ANN.} art. 2.02-1 (Vernon Supp. 1988) and the 1980 revision of the Model Business Corporation Act Section 5 contain explanations of the operation of and legal principles underlying these provisions. \textit{Id.; MOD. BUS. CORP. ACT § 5 (1980)}.

\textsuperscript{158} \textit{TEX. REV. CIV. STAT. ANN.} art. 6132b, § 18(1)(b) (Vernon 1970). TUPA's indemnification provisions continue to apply to limited partnerships by virtue of TRLPA § 13.03 and TUPA § 6(2). \textit{Id.} art. 6132a-1, art. 11 comment (Vernon Supp. 1988).

\textsuperscript{159} Tex. S.B. 260, 70th Leg. (1987).

\textsuperscript{160} Since the statute by its terms extends only to directors and does not expressly extend any relief to officers, the legislation may benefit persons who are both directors and officers of the same corporation regarding their actions as directors but not as officers.
the effective date of the law, or (B) the date the articles include the corporation’s liability limitation provision.\textsuperscript{161}

2. \textit{Indemnification}. The same insurance crisis also prompted the enactment of new indemnification provisions which allow a corporation to provide its directors with indemnification and assistance in three ways. First, a corporation may indemnify a director in limited instances against reasonable expenses in the event that the director is found liable to the corporation or on the basis that a personal benefit was received by the director.\textsuperscript{162} Second, a corporation also may advance expenses to a director based solely upon the corporation’s receipt of the director’s written affirmation that (i) the standards for indemnification have been met, and (ii) the director will repay the advance if it is ultimately determined that the director is not entitled to indemnification.\textsuperscript{163} Third, a corporation also may purchase insurance, or implement self-insurance arrangements, for liabilities for which indemnification is not permitted, provided that there is shareholder approval.\textsuperscript{164}

3. \textit{Distributions to Shareholders}. The amendments to the TBCA during the Survey period also included an overhaul of the financial provisions governing the payment of corporate dividends and redemptions and a recodification of all related provisions in one section of the TBCA. Under prior law, a corporation’s ability to pay a dividend or redeem stock was determined by reference to its “earned surplus,” “reduction surplus” and “capital surplus”.\textsuperscript{165} Because of the confusion and disagreement among practitioners regarding the application of these concepts to dividends and redemptions, the legislature eliminated each of these particular terms from the statute. In place of dividends and redemptions, the legislature substituted the concept of a “distribution,” which is defined as “a transfer of money or other property (except its own shares or rights to acquire its own shares), or issuance of indebtedness, by a corporation to its shareholders in the form of a dividend, a share repurchase or a liquidating distribution.”\textsuperscript{166} Because the concepts earned surplus, reduction surplus and capital surplus are no longer in the statute, the determination of a corporation’s ability to make a distribution, subject to any restrictions in its articles of incorporation, is determined by reference to (i) its “surplus”, which continues to be defined as the excess of the net assets of the corporation over its stated capital, and (ii) its solvency after giving effect to the distribution.\textsuperscript{167} As a result of this change in the statute, a corporation generally will be prohibited from making any distribu-

\textsuperscript{162} TEX. BUS. CORP. ACT. ANN. art. 2.02-1 (Vernon Supp. 1988). This indemnification, however, is available only if the director was not found liable for willful or intentional misconduct in performing his or her duties to the corporation. \textit{Id.}
\textsuperscript{163} \textit{Id.} Importantly, there is no longer any requirement of a prior determination by the disinterested directors that the facts known to them would not or would not preclude indemnification, or whether the director would have the ability to repay the advances.
\textsuperscript{164} \textit{Id.}
\textsuperscript{165} TEX. BUS. CORP. ACT. ANN. art. 1.02A (Vernon Supp. 1988).
\textsuperscript{166} \textit{Id.} art. 1.02A(18).
\textsuperscript{167} \textit{Id.} arts. 2.38B, 1.02(12).
tion if either (i) the corporation would be insolvent after giving effect to the
distribution, or (ii) the distribution would exceed the surplus of the corpora-
tion.168 The legislature also provided corporations with broad flexibility in
selecting the types of financial information upon which the corporations may
rely in determining their net assets, stated capital and surplus.169

4. Mergers and Reorganizations. The TBCA was amended to clarify that
no transfer or assignment occurs in connection with the vesting of rights,
privileges, immunities and franchises of a merged corporation in a surviving
corporation.170 Also, the Secretary of State's authority was expanded to per-
mit it to accept court ordered articles of merger, consolidation, or dissolu-
tion without shareholder action.171

5. Sales of Substantially All Assets. Prior law was ambiguous regarding
when shareholder approval was required for the sale of substantially all of
the assets of a corporation in the usual and regular course of business. New
TBCA article 5.09B addresses the ambiguity by defining the term "usual and
regular course of business," rather than trying to clarify "substantially all."
Under the new definition, assets are disposed of in the "usual and regular
course of business" when (i) the corporation, after the disposition, continues
to engage in one or more businesses or (ii) the corporation applies a portion
of the proceeds received from the transaction to a business it engages in after
the transaction. An important consequence of this change is that it is now
clear that a sale of assets by a corporation to a subsidiary or a master limited
partnership will not constitute an asset disposition that would require share-
holder approval. As a result, corporate asset dispositions in general will no
longer require shareholder approval except where the corporation, after the
disposition, liquidates and ceases to do business.

6. Bylaw Amendments. Another important legislative change during this
Survey period has clarified who may amend bylaws. Under prior law, the
possibility existed that shareholders as a general rule could not amend or
repeal the bylaws of a corporation unless and until the board of directors had
approved such proposed amendment or repeal. New TBCA article 2.23
makes it clear that, unless provided otherwise in the articles of incorporation
or a bylaw adopted by the shareholders of the corporation, the shareholders
may always amend or repeal the corporation's bylaws or adopt new bylaws.

168. Id. art. 2.38B. There are specific instances, however, in which a corporation may
make a distribution regardless of whether it exceeds the corporation's surplus so long as the
corporation is still solvent after giving effect to the distribution. See id. art. 2.38C.

169. Id. art. 2.38-3A. The legislature also added several new articles to the TBCA as part of
the modernization and clarification of its financial provisions, including articles that
(i) clarify when share dividends may be made and the appropriate accounting for such transac-
tions, (ii) clarify that a split-up or division of issued shares without an increase in the corpora-
tion's stated capital does not constitute a share dividend or a distribution, and (iii) permit the
issuance of a special class of redeemable stock that does not have a liquidation preference. See
id. arts. 2.38-1, -2, 2.12B.

170. Id. art. 5.06A(4).

171. Id. art. 4.14.
7. Special Shareholders' Meetings. An amendment to the TBCA designed to assist corporations in their efforts to frustrate hostile suitors grants corporations the flexibility of specifying in their articles of incorporation percentage of shareholders necessary to call a special meeting. Under prior law, this percentage was 10%. Under the amendment, a corporation may establish this percentage at any level not in excess of 50%.172

8. Record Dates and Notices to the Shareholders. The maximum time periods for notice of shareholder meetings and fixing transfer dates or closing of books for transfer of stocks have been increased from fifty to sixty days. This change provides corporations with an additional ten days to comply with the various statutory and administrative requirements relating to notices of meetings and dividend dates as well as requirements relating to proxy solicitations.

9. Close Corporations. In order to remedy an apparent duplication of requirements for bylaws of close corporations in the TBCA, the legislature amended TBCA article 2.15 to provide that a corporation need not have separate bylaws if a shareholders' agreement embodies the corporation's bylaw provisions. Also, the legislature amended article 3.02(A)(9) to permit close corporation provisions to appear in both shareholder agreements and articles of incorporation.

10. Dismantling of the Title 32 Miscellaneous Corporate Statutes. The legislature dismantled the Miscellaneous Statutes located in title 32 of the Texas Revised Civil Statutes (TMCSA articles 1349, 1351, 1353, 1354, 1358a, and 1358b) by repealing them in total and selectively amending the TBCA or the Texas Nonprofit Corporation Act to incorporate those provisions having continuing validity. Articles 1358a and 1358b contained the most significant provisions of continuing validity. Article 1358a, which related to proper payees of corporate distributions of cash or property, was modified to resolve certain conflicts and moved to TBCA article 2.26B. Prior to this, the TBCA contained no provision that expressly permitted a corporation or its transfer agent to regard the record holder of the corporation's shares as "shareholders" for the purpose of receiving dividends and other distributions. Article 1358b, which provided that shares held in the name of two or more persons as joint owners with right of survivorship, may be treated by the issuing corporation as owned by the survivor or survivors until the corporation receives actual written notice that other persons claim an interest in such shares or in any dividends payable in respect of such shares, also was retained and moved to TBCA article 2.22G.

C. Securities Law

1. Refinement of the Commercial Paper Exemption. The Texas State Securities Board adopted a new regulation that further defines the kinds of

172. Id. art. 2.23.
negotiable promissory notes and commercial paper that are exempted from the registration requirements of the Texas Securities Act. The new regulation exempts "good faith issuances" of negotiable promissory notes and commercial paper. Such issuances are considered to be in good faith only if the issuer is financing current transactions with them and the issuer is not dependent on the continuing sale of notes and commercial paper to generate funds to retire the notes or paper at maturity. Abusive uses of the Texas Securities Act exemption under section 6.H prompted the rule, which is intended to restrict those uses.

2. Conforming Texas Private Offering Exemption. In November 1986, the Texas State Securities Board amended the Texas Uniform Limited Offering Exemption to conform with changes adopted earlier in the year to Regulation D and Form D under the Securities Act of 1933.

3. State Securities Board Proposal of Section 5 Exemption from Merit Review. The Texas State Securities Board proposed an amendment to the State Securities Regulations that would have liberalized the merit review applied to certain firm underwritten offerings of common stock. The proposal, however, was short lived because of a Texas Attorney General Opinion issued shortly thereafter that concluded that any attempt by the Board to promulgate such an amendment would be unconstitutional. The Board thereupon withdrew the proposal.

II. CASE LAW DEVELOPMENTS

A. Partnership Law

1. Interpretation of a Partnership Agreement. In Cunningham And Co. v. Consolidated Realty Management, Inc. the United States Court of Appeals for the Fifth Circuit considered whether certain provisions of a limited partnership's agreement permitted the general partner to dispose of the limited partnership's sole asset during the winding up and termination of the limited partnership without first obtaining the unanimous consent of the other partners. Cunningham was a limited partner in a limited partnership that was formed for the purpose of constructing, owning and operating an apartment building project. Under the terms of the partnership agreement, a simple majority in interest of the partners could dissolve the limited partnership by voting to do so. The partnership agreement, however, also provided that the general partner had no authority to perform any act that would make it impossible to carry on the business of the partnership, absent a unanimous vote by all the limited partners.

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175. Id.
177. 803 F.2d 840 (5th Cir. 1986).
178. This provision reads as follows:
In 1981 Cunningham and the other partners in the limited partnership began searching for a buyer for the project but they received no satisfactory offers for over two years. Finally, the partners found a third-party buyer and, at a meeting to which Cunningham was invited but which he did not attend, all of the other partners agreed to sell the project to the third-party buyer. On July 26, 1983 the general partner, Consolidated Realty Management, executed a sales contract concerning the sale and also signed a contract with the new owners to continue managing the project. Cunningham objected to the sale and sued the other partners for breach of the partnership agreement. The district court entered a take-nothing judgment against Cunningham and Cunningham appealed.179

The Fifth Circuit determined that an apparent conflict in the partnership agreement existed between the prohibited transactions provision, which required the unanimous consent of the partners, and the dissolution provision, which required the consent of simply a majority in interest of the partners.181 To resolve the matter the court applied a general rule of contract interpretation that courts will read apparently conflicting clauses of a contract so as to give effect to both.182 Applying this rule the court read the unanimous vote requirement as applying to the sale of all or a large portion of the partnership assets if the partnership intends to continue, but not where, as here, the sale is pursuant to a vote of a dissolution.183 While the unanimity requirement protects a minority partner from a variation in his investment while his money remains obligated to the partnership, the Fifth Circuit concluded that this requirement is not necessary in the event of termination of the partnership because each partner receives in connection therewith a distribution of his or her share of the equity of the partnership.184 Moreover, the court realized that the majority's right to agree to dissolve is useless if a minority can prevent the sale of assets that constitute a requisite part of dissolution.185 Accordingly, the court concluded that where there has been a vote to dissolve, that vote implies the power to take all necessary steps, including the sale of assets, to carry out the winding up and termination of the partnership after the dissolution.186

The court also looked to section 10(a) of TULPA and the legislative his-
tory thereunder to interpret the unanimous consent provision of the partnership agreement and concluded that section 10(a) permits the dissolution and winding up of a partnership provided a majority of the limited partners approves the dissolution as provided in the certificate.\textsuperscript{187}

2. \textit{Formation}. \textit{Austin v. Truly}\textsuperscript{188} involved the issue of whether a joint venturer breached a joint venture agreement (i) by failing to execute a promissory note necessary to finance the joint venture, and (ii) by repudiating personal liability on all joint venture debts. Jack Truly, James Austin and Gerald Clark each signed and approved the written document prepared by Truly's attorney, entitled "Agreement to Enter Into a Joint Venture Agreement." A transmittal letter that accompanied the execution drafts from Truly's attorney stated that time constraints prevented him from completing the joint venture agreement that Truly had requested, but that he had drafted a contract to enter into such an agreement that would enable the parties to legally bind themselves to the basic terms and conditions concerning the proposed joint venture to which they had already agreed.

The document provided that Truly, Austin, and Clark were to enter into a joint venture agreement for the purpose of financing the acquisition of a parcel of real estate and developing a shopping center thereon. Under the terms of the document, (i) Austin was to sell the real estate to the venture, (ii) Austin and Clark were to arrange financing of the venture, and (iii) Truly, an experienced developer of shopping centers, was to supervise the construction and development of the shopping center that the venture contemplated. Austin and Clark each were to receive a 30\% ownership and profits interest under the terms of the document and Truly was to receive a 40\% interest. The document also provided for Truly to receive a $2,000 per month draw from the venture during its first 12 months.

Shortly after the execution of the agreement, a dispute arose concerning whether Truly would have personal liability for the repayment of the development financing. Truly's position was that the development financing was to be nonrecourse as to him and, as a result, he refused to appear at the bank for the closing of the financing. Austin and Clark proceeded to close the financing without Truly and, thereafter, Truly terminated further association with the venture and the shopping center.

Truly later brought an action against Austin and Clark for breach of contract and, alternatively, quantum meruit for the value of his time, effort, and service in carrying out his obligations under the agreement. Austin and Clark counterclaimed alleging breach of contract and breach of fiduciary


\textsuperscript{188} 721 S.W.2d 913 (Tex. App.—Beaumont 1986, no writ).
duty. The trial court entered judgment based on a jury verdict in the amount of $215,480 against Austin and Clark and also awarded attorney’s fees to Truly. Austin and Clark appealed, claiming 52 points of error.

The appellate court, in a splintered decision, held that (i) Truly was personally liable for the debts of the venture on the grounds that he willingly became a partner in the venture based on the agreement, and (ii) Truly would be entitled to no recovery based on quantum meruit if the agreement was unambiguous and covered the compensation due him for the value of his time. On this basis the court reversed the judgment of the trial court and remanded the case solely for the determination of the amount of recovery due Truly with respect to his right to receive draws under the agreement.

Justice Burgess vigorously dissented to the majority’s holding that quantum meruit did not lie in the case. In Justice Burgess’s view, the agreement merely consisted of an agreement to form the relationship of the joint venturers at some future time, and it did not contractually place a dollar value on Truly’s services in obtaining leases for the shopping center; it constituted merely an agreement to form a future agreement. In addition, since Truly owned a 40% interest in the venture, performing fully entitled him to the reasonable value of his services anyway. Justice Burgess, therefore, preferred to hold as a matter of law that the agreement did not concern the subject matter of Truly’s claim, thereby allowing a recovery based on quantum merit. Justice Burgess also preferred to find no cap on the recovery. Since the parties did not intend the $24,000 to be Truly’s only remuneration for his services, Burgess did not consider this sum a limitation on the value of Truly’s services. Burgess concluded that the agreement entitled Truly to receive $24,000 for expenses, a 40% interest in the development, and the value of his services.

3. Relations of Partners to One Another. Reilly v. Rangers Management, Inc. involved the validity of certain amendments to a limited partnership agreement. Rangers Management, Inc. (Rangers Management) and CCK, Inc. (CCK), general partners in Texas Rangers, Ltd. proposed to amend the limited partnership agreement to change the price for which additional partnership units could be issued and to permit the partnership to issue an

189. Id.
190. Id. at 919. See Woodward v. Southwest States, Inc., 384 S.W.2d 674, 675 (Tex. 1964).
191. 721 S.W.2d at 919.
192. Id.
193. Id.
194. Id.
195. Id.
196. Id.
197. Id.
198. 727 S.W.2d 527 (Tex. 1987).
199. Texas Rangers, Ltd., a limited partnership, intended by buy and run an American League baseball franchise commonly known as the Texas Rangers. A second general partner, CCK, Inc., later jointed Rangers Management, Inc., the initial general partner.
unlimited number of units.\textsuperscript{200} Michael Reilly, one of Texas Rangers’ seventeen limited partners, opposed the validity of the proposed amendments, the issuance of additional units and the dilution of his investment. Reilly claimed that the proposed amendments could not be adopted consistent with the provisions of the limited partnership agreement without the unanimous consent of the limited partners.\textsuperscript{201}

Rangers Management and CCK sought a declaratory judgment finding the proposed amendments validly adopted and the limited partnership agreement, as amended, in full force and effect.\textsuperscript{202} The district court granted partial summary judgment in favor of Rangers Management and CCK.\textsuperscript{203} Reilly appealed on the grounds that the proposed amendments required the unanimous consent of the limited partners according to the terms of the limited partnership agreement.

The court of appeals overruled each of Reilly’s points of error and affirmed the district court’s judgment.\textsuperscript{204} With respect to the general liability argument, the court of appeals stated that for an amendment to adversely affect the general liability of limited partners, the amendment must make a limited partner liable beyond his partnership contribution.\textsuperscript{205} The court found that the proposed amendments did not require the limited partners to increase their partnership contributions.\textsuperscript{206} Accordingly, the court concluded that the proposed amendments did not unfavorably alter the general liabilities of the limited partners.\textsuperscript{207}

Concerning allocations of profits and losses, Reilly argued that the possibility of an unlimited number of partners to share in profits and losses according to their proportional interests changed the basic foundation of the partnership agreement’s profit and loss allocation provisions. The court of appeals agreed that the more partners there are, the smaller the percentage of profits each will receive.\textsuperscript{208} The court pointed out, however, that an increase in the number of partners did not actually change the method of allo-

\textsuperscript{200} The limited partnership agreement provided for the issuance of a maximum of 300 partnership units and set the price per unit at a minimum of $50,000 each.

\textsuperscript{201} The agreement required the unanimous consent of the limited partners for any amendment that would (i) impair the general liabilities of the limited partners, (ii) modify the system of allocation of the profits or losses of the partnership, or (iii) modify the mode of distribution of the partnership funds or assets. All other amendments to the partnership agreement required the approval of the holders of a two-thirds percentage interest in the partnership. At the time the general partners proposed the amendments for adoption, RMI and CCK owned an 83.78\% percentage interest in the partnership. RMI, CCK, and five limited partners voted in favor of the proposed amendments. One limited partner voted against the proposed amendments. Eleven partners, including Reilly, did not vote.


\textsuperscript{203} Id. at 844.


\textsuperscript{205} 717 S.W.2d at 447.

\textsuperscript{206} Id.

\textsuperscript{207} Id.

\textsuperscript{208} Id.
cation of profits and losses. The numerical increase merely changed the number of partners to whom the partnership distributed profits and losses. The court of appeals concluded that the method of allocation of profits and losses would not change as a result of the proposed amendments.

With respect to the distribution contention, Reilly asserted that the proposed amendments result in a dilution that could reduce or even totally eliminate a partner's share to which he or she was previously entitled, and that this diminution constituted a change in the "distribution of the partnership funds or assets." The appellate court acknowledged that the sale of additional partnership units could possibly reduce or eliminate the distribution of partnership funds and assets; however, the court refused to conclude that this constituted a change in the method of distribution.

Reilly's final contention was that TULPA section 10 barred the admission of additional limited partners absent a provision in the certificate to the contrary; therefore, the law required unanimous consent to adopt the proposed amendments. The court of appeals concluded that the proposed amendments did not give the general partner the authority to admit additional limited partners. Rather, the proposed amendments simply allowed for the issuance of partnership units in excess of the prior maximum of 300 units, while not specifying who the purchasers would be. Because the proposed amendments did not alter the general partner's power to admit additional limited partners, the court reasoned that the law did not require unanimous consent to adopt the proposed amendments.

Reilly applied for and received a writ of error from the Texas Supreme Court. At the supreme court level, Reilly asserted that the limited partnership agreement was ambiguous with respect to the unanimous consent provision and, therefore, that the district court had erred in granting sum-

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209. *Id.*
210. *Id.* at 448. The court stated that modification of the agreement resulting in the managing general partner receiving a different percentage constituted a change in the method of distribution. An amendment giving the general partners a fixed amount instead of distributing to them their proportional share based on individual interests in the partnership also constituted a change in the method of distribution. *Id.*
211. *Id.*
212. *Id.* at 449.
213. *Id.*
214. TEX. REV. CIV. STAT. ANN. art. 6132a, § 10 (Vernon 1970). In support of the same contention, Reilly asserted that sections 25(b)(3) and 26(a)(2) of the TULPA required the signatures and sworn oath of all limited partners prior to adoption of an amendment. *Id.* §§ 25(b)(3), 26(a)(2). The appellate court characterized this additional support as an accurate statement of the law, but noted that Reilly and the other limited partners had assigned the power of attorney found in the original agreement to the general partners, transferring to them the authority to sign any validly adopted amendment on behalf of the limited partners. *Reilly,* 717 S.W.2d at 430. The general partners therefore did not need the signature of each limited partner to adopt the proposed modification. See TEX. REV. CIV. STAT. ANN. art. 6132a, § 33 (Vernon Supp. 1988).
215. *Reilly,* 717 S.W.2d at 450.
216. *Id.*
217. *Id.*
mary judgment in favor of Rangers Management and CCK. The court agreed with Reilly and remanded the case to the district court for a trial on the grounds that a question of fact existed concerning the interpretation of the limited partnership agreement.\textsuperscript{219}

In order to determine whether the intention of the parties as evidenced by the agreement was ambiguous, the supreme court looked at the limited partnership agreement as a whole in light of the circumstances existing at the time the parties entered into the agreement. Pertinent to the supreme court's inquiry was the rule of construction that "a court should construe contracts from a utilitarian standpoint bearing in mind the particular business activity sought to be served and need not embrace strained rules of interpretation which would avoid ambiguity at all cost."\textsuperscript{220} The supreme court also found relevant to its inquiry the rule that a court will avoid an unreasonable, inequitable, and oppressive construction of an agreement unless such avoidance is impossible or improper.\textsuperscript{221}

Reading the limited partnership agreement in a light most favorable to Reilly, the supreme court determined that (i) the limited partnership agreement evidenced the limited partners' intent to protect their limited partnership interests from dilution, and (ii) a reasonable and utilitarian construction of the unanimous consent provision was that the parties intended that the provision would protect against a nonconsensual dilution of a limited partner's interest.\textsuperscript{222} Elimination of such a protection without the unanimous consent of the limited partners, the court concluded, was potentially oppressive.\textsuperscript{223} Accordingly, the supreme court held that a fact issue existed as to whether the amendments required unanimous approval and remanded the case to the district court for trial.\textsuperscript{224} Three justices dissented from the opinion based on their view that the limited partnership agreement was clear and unambiguous.\textsuperscript{225}

4. Retirement or Withdrawal of a Partner. \textit{Perry v. Welch}\textsuperscript{226} involved the classic case of a young partner who bought into a professional services partnership shortly before the retirement of the partnership's rainmaker. R. J. Welch and several other persons were partners in Welch, White & Co., a Rio Grande Valley accounting firm. On July 1, 1980 Lester Perry and Noble Allen bought a one-seventh ownership and profits interest in the partnership by executing substantially identical installment promissory notes to each of the other partners in the firm. The notes provided in relevant part that the basis for determining the amount and payment date of each installment due under the notes was by reference to the date and amount of each cash with-

\textsuperscript{219} 727 S.W.2d at 530.  
\textsuperscript{220} Id.  
\textsuperscript{221} Id.  
\textsuperscript{222} Id.  
\textsuperscript{223} Id.  
\textsuperscript{224} Id. at 530-31.  
\textsuperscript{225} Id.  
\textsuperscript{226} 725 S.W.2d 347 (Tex. App.—Corpus Christi 1987, no writ).
dowal of partnership profits made "by the partners of Welch, White & Co." pursuant to their partnership agreement. Perry and Allen made note payments to Welch through June 1981, but stopped making payments upon Welch's retirement from the partnership on July 31, 1981. Welch brought a suit to collect on the notes and prevailed in the trial court.227

Perry and Allen appealed the trial court's judgment in favor of Welch, contending that a condition precedent to their obligation to make payments under the notes existed: namely, that Perry and Allen receive profits specifically from the partners of Welch, White & Co. Perry and Allen argued that this condition failed upon the retirement of Welch, because his retirement resulted in dissolution of the partnership. Perry and Allen asserted that, as a result of the dissolution and the accompanying change in the legal relationship of the partners, each of them ceased to receive profits from the partners of Welch, White & Co. as such and, therefore, they were also relieved from their liability to Welch under the notes. Perry and Allen also contended that Welch's retirement after the execution of the notes constituted a supervening cause that resulted in a failure of consideration, thus discharging their liability under the notes.

The court of appeals was unsympathetic to Perry and Allen and affirmed the decision of the trial court.228 The court based its decision on the general rule that a forfeiture of contractual duties because of a failure of a condition precedent must be avoided if other reasonable interpretations to the agreement exist.229 The court reasoned that Perry and Allen were not permitted to ignore a previous obligation to pay simply because a deal proved less profitable than anticipated. Furthermore, the court rejected Perry's and Allen's contention that the retirement of partners is a supervening cause, and found no reversible error in the lower court's conclusions of law or findings of fact.230

5. Power of a General Partner. Citizens State Bank v. Caney Investments231 involved a permanent injunction staying a bank's attempt to foreclose its lien on real property belonging to a limited partnership. The general partner of the limited partnership had deeded the property to the bank for other than partnership purposes without the consent of the limited partners. Relying on TULPA section 10(a)(4), the court of appeals affirmed the trial court's judgment that the deed was void, rather than merely voidable, because a general partner lacks the requisite authority to assign rights in such property if the assignment is for other than partnership purposes.232 Under the court of appeals holding, the bank's claim as a result of the void deed remained alive despite the four-year statute of limitations generally governing deeds. It

227. Id.
228. Id.
229. Id.
230. Id.
232. Id. at 586.
should be noted, however, that the Texas Supreme Court subsequently reversed the judgment of the court of appeals and vacated the permanent injunction on other grounds.233

6. Proper Party to Assert Claim. Thomasson v. Manufacturers Hanover Trust Co.234 involved a limited partnership, Republic Refining Limited (RRL), formed to build and operate a gas processing plant. A group of banks financed the construction of the project, but RRL defaulted on the construction loans and went into bankruptcy. The minority partners in RRL brought an action in the Federal District Court for the Northern District of Texas against the banks, alleging that the banks had committed a series of wrongs through a conspiracy with RRL's managing partner. The banks moved for dismissal on the grounds, inter alia, that the minority partners lacked standing because the partners were asserting partnership interests, rather than individual interests.

The Thomasson case presented a unique question heretofore unaddressed within the Fifth Circuit. The leading Fifth Circuit case regarding the issue of the ability of an individual partner to assert partnership-related interests is Cates v. International Telephone & Telegraph Co.235 In Cates the Fifth Circuit held that an individual partner generally has no standing to assert partnership claims in his or her individual capacity because such claims are subsumed within the causes of action of the partnership. The court, however, was careful to provide that in a proper case, Texas law would afford some remedy other than merely a damage or accounting suit against the controlling partners, at least where the latter would not be reasonably effective to protect the substantial rights of the minority. For example, where the controlling partners, for improper, ulterior motives and not because of what they believe to be the best interest of the partnership, decline to sue on a valid, valuable partnership cause of action which it is advantageous to the partnership to pursue, some remedy will be provided to the minority partner or partnership interest owner.236 Cates does not clarify, however, whether those claims become individual claims or remain partnership claims that minority partners may assert on behalf of the partnership.237

233. Under application of writ of error and without hearing oral argument, the Texas supreme court reversed the judgment of the court of appeals and vacated an order of the trial court that granted a permanent injunction. 746 S.W.2d at 479. The trial court erroneously permitted respondents, who were in fact third parties, to intervene following a final judgment. The supreme court stated that the trial court as well as the court of appeals erred in assuming jurisdiction and that the appeal required dismissal. Id. at 478. The more devastating aspect of the case occurred when the trial court refused to honor the bank's constitutional right to a jury trial. As a result of the foregoing, the court held that the judgment of the court of appeals conflicted with Texas Rule of Civil Procedure 216, reversed the judgment, and vacated the trial court's order. Id. at 479.
235. 756 F.2d 1161, 1173-74 (5th Cir. 1985).
237. The Thomasson court noted:

The Cates court outlined several possible remedies which might be available to such a partner/plaintiff. The court suggested that the individual partner might maintain suit "either derivatively in the name of the partnership, or for
The unresolved issue in Cates surfaced in Thomasson because RRL was involved in bankruptcy proceedings. The resolution of this issue was critical because if the claims did remain partnership claims, the claims would be property of the partnership's estate and the individual partners could not assert them. Only if the claims belong to the individual partners could the individual partners assert them.

Because the Cates opinion did not resolve the matter, the court looked to other jurisdictions for further guidance. The court concluded that to the extent that claims for conversion and damages for destruction of property, related to money or property contributed by the minority partners to RRL, those claims should be characterized as partnership claims. As such, the court dismissed them. By contrast, the allegations of aiding and abetting breach of fiduciary duty and tortious interference were claims alleging an interference with the relationships between their copartners and with the partnership. Thus, the minority partners could assert these claims as individual claims.

The court, however, had difficulty categorizing the minority partners' RICO claims and common law fraud claims. Therefore, it declined to dismiss the claims in their entirety, dismissing them only as they related to damage to the minority partners' contribution to the partnership.

B. Corporation Law

1. Incorporation of a Partnership. Holt v. Owen Electric Supply, Inc. exemplifies the problems that can arise when a partnership incorporates without changing its firm name or giving notice of its incorporation as article 1302-2.02 of the Texas Miscellaneous Corporation Laws Act requires.

his percentage of such claims, or alternatively [might] . . . have action on the case deferred until a receivership application could be acted on . . . or the partnerships' winding up could be completed.”


[W]here one partner and a third person by fraud or breach of fiduciary duty cause a disposition, waste, or diminution of partnership property under circumstances rendering the third person liable therefore, the act of the third party at least must be regarded . . . as an individual wrong to each other partner for which each may recover his own damages.

Thomasson, 657 F. Supp. at 453, quoting Mannaberg, 45 N.Y.S. at 201 (emphasis by Thomasson court).

239. 657 F. Supp. at 453.

240. Id. at 453-54.


242. TEX. REV. CIV. STAT. ANN. art. 1302-2.02A (Vernon 1980), provides as follows:

Whenever any banking, mercantile or other business firm desires to become incorporated without a change of firm name, such firm shall, in addition to the notice of dissolution required at common law, give notice of such intention to become incorporated for at least four (4) consecutive weeks in some newspaper published in the county in which such firm has its principal business office, if there be a newspaper in such county; and, if not, then in some newspaper pub-
Mike Rose and Viola Holt were partners in Holt Electric. In June 1980 Holt Electric incorporated as Holt Electric Co., Inc. but failed to comply with the notice provisions of article 1302-2.02. In December 1981 Holt retired from the corporation. Rose continued the business after Holt's retirement and, approximately one and one half years later, ordered and received goods from Owen Electric Supply, Inc., but failed to pay for them.

Owen brought a suit on a sworn account against the corporation, Rose and Holt to recover the price of the goods. The trial court entered judgment against the corporation, Rose and Holt. The trial court held that Holt was legally obligated to pay for the goods, despite the fact that she did not buy or receive the goods, because of her failure to properly notify creditors of the partnership's incorporation as required by article 1302-2.02. Holt appealed the judgment of the trial court.

The appellate court identified the issue on appeal as being whether evidence existed that Owen sold the particular goods on credit to the company based on the belief that the company believed it was dealing with Holt individually and not with the corporate entity. The evidence at trial showed the debt at issue to be a corporate debt, incurred approximately three years subsequent to the partnership's incorporation and after Holt's departure. The evidence also showed that once it incorporated, the corporation made all of its regular payments to Owen on checks in the name of the corporation, and that Holt never signed any form of individual guaranty. The appellate court relied on precedent interpreting article 1302-2.02 as having no basis upon which to impose personal liability where the complaining creditor did not act in justifiable reliance upon the debtor's individual responsibility for the corporate debt. The message of the Holt decision is that technical noncompliance with article 1302-2.02 probably will be insufficient to sustain the imposition of individual liability upon a shareholder and former partner, and that a creditor who does desire to continue a relationship with recourse to the individual shareholders is advised to obtain an individual guaranty from them.

2. Duties of Officers of Corporation. Grierson v. Parker Energy Partners 1984-1 involved the duties that a corporation's officers owe to a limited partnership where the corporation acts as a general partner. William Grierson served as president of Parker Energy Technology Corporation, the general partner of Parker Energy Partners 1984-1, a California Limited

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243. Id.
244. Id.
245. Id.
246. Id.
247. 737 S.W.2d 375 (Tex. App.—Houston [14th Dist.] 1987, no writ).
As general partner, the corporation wrongfully charged $346,308.34 of expenses to the limited partnership. The partnership sued the corporation and Grierson for breach of the partnership agreement and breach of fiduciary duties to the limited partnership. In its suit, the partnership sought an accounting, removal of the corporation as general partner, return of the limited partnership's books and records, and actual and exemplary damages.

Grierson and the corporation never answered the limited partnership's petition and the trial court entered an interlocutory judgment that prohibited the corporation from serving as general partner and ordered an accounting. After the accounting, the trial court awarded approximately $350,000 in actual damages, $500,000 in exemplary damages, and $45,000 in attorney's fees against Grierson and the corporation.

Grierson appealed the trial court's judgment, claiming that (i) the pleadings and evidence lacked sufficient allegations to establish that he owed a duty to the limited partnership, (ii) the evidence did not support the damage award, and (iii) the evidence did not support a finding of exemplary damages. The appellate court agreed and reversed the judgment of the trial court with respect to Grierson. The court held that the petition was insufficient to give fair notice to Grierson of the relief sought because it simply alleged that Grierson failed to force the corporation to resign as general partner and neglected to transfer the books and records to the newly elected general partner. To give Grierson fair notice the petition should have alleged that Grierson, as president of the corporation, knowingly participated in the conversion and misapplication of partnership property. Since the petition failed to allege this, the appellate court sustained Grierson's points of error.

The court of appeals affirmed as to the corporation and severed the judgment as to Grierson, affirming in part and reversing and remanding in part on the issue of damages only.

In its opinion, the appellate court questioned the circumstances in which an officer of a corporation would be personally liable without piercing the corporate veil, noting that a corporate officer owes a fiduciary duty to the corporation and its shareholders, but generally owes no duty to third persons. The officer may not, however, knowingly direct or participate in a tortious or fraudulent act. A corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to a third party without meeting the requirement of piercing the corporate veil. Since the
breach of a fiduciary duty is a tort under Texas law, the appellate court concluded that if Grierson knowingly participated in the breach of the corporation's fiduciary duty to the partnership, he may be liable without piercing the corporate veil.

3. Restrictions on Transfer of Shares. The Texas Business Corporation Act permits the shareholders of a corporation to impose restrictions upon the sale or other transfers of stock of the corporation. Consolidated Bearing & Supply Co. v. First National Bank involved the effectiveness of a certain bylaw restriction in the face of a pledge of the stock and a foreclosure and sale of the stock by the pledgee. In 1976, Consolidated, a closely held corporation, issued 7500 shares of stock to one of its directors. A restrictive bylaw provision appeared on the face of the stock certificate. This provision required a shareholder to give other shareholders or the corporation the right of first refusal in the event the shareholder wished to sell any stock.

In March 1979 the director borrowed $300,000 from First National Bank at Lubbock and pledged the Consolidated stock as security for the loan. Shortly thereafter the director died without fully satisfying his obligation with the bank. The bank unsuccessfully attempted to collect the unpaid balance of the loan and, thereafter, acquired the 7500 pledged shares of consolidated stock by a sheriff's sale.

In 1983 Consolidated and two of its shareholders filed suit seeking a declaratory judgment that the pledge of the restricted stock by the director, and the resulting foreclosure and sale, were null and void, and that title to the stock remained in Consolidated. In the alternative Consolidated alleged that the shares remained subject to the restrictions on the face of the stock certificates in that the shares belonged in a constructive trust. The trial court entered judgment in favor of the bank. Consolidated and its shareholders appealed.

On appeal Consolidated claimed (i) that the bank had or should have had knowledge of the director's pledge of the stock and (ii) that the bank's subsequent purchase of the stock at the sheriff's sale violated the bylaw restriction that gave the other shareholders a right of first refusal. The appellate court looked to precedent and concluded that stock restrictions are not looked upon with favor and generally are construed narrowly, noting that restrictions of this type generally do not apply to a transfer that occurs through an involuntary sale or by operation of law unless a special provision in the restriction states otherwise. The court also took notice of the general recog-

such a situation the officer will not incur personal liability. Barclay v. Johnson, 686 S.W.2d 334, 336-37 (Tex. App.—Houston [1st Dist.] 1985, no writ).

Douglas v. Aztec Petroleum Corp., 695 S.W.2d 312, 318 (Tex. App.—Tyler 1985, no writ).

737 S.W.2d at 377.

TEX. BUS. CORP. ACT ANN. art. 2-22, § D(4) (Vernon Supp. 1988).

720 S.W.2d 647 (Tex. App.—Amarillo 1986, no writ).

726 S.W.2d 192 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ), where the court did not permit a
nition that transfer restrictions ordinarily apply only to bona fide sales and not to transfers pursuant to foreclosure proceedings. The appellate court concluded that the pledge of stock to the bank and the bank’s subsequent purchase of the stock at the sheriff’s sale did not violate the bylaw restriction.

4. Piercing the Corporate Veil. As in previous Surveys, piercing the corporate veil has continued to be a fruitful ground for litigation during the Survey period. In Valdes v. Leisure Resource Group, Inc. the United States Court of Appeals for the Fifth Circuit addressed a creditor’s attempt to hold a parent company and a lender individually liable for the debts of a subsidiary company based on the corporate alter ego theory. In 1978 United Service Corporation (USC), a wholly owned subsidiary of Capitol Savings & Loan (Capitol), sold condominium units located in Texas to Leisure Resource Group (LRG) of Austin, Texas who wanted the units to use in its vacation time-share business. USC retained deeds of trust pertaining to the units and agreed to purchase the credit contracts that resulted from the sale of time-share intervals in the units. This purchase provided LRG enough cash to meet its current operating expenses.

In 1980 LRG experienced cash flow problems. In March 1981 LRG employed two consultants to aid in the organization of its business undertakings. The consultants reported the LRG needed a cash infusion in order to maintain business as usual. USC, although hesitant to advance LRG additional funds, agreed to loan $700,000 to LRG in an effort to prevent loss of USC’s collateral in the event of bankruptcy. USC knew that the cash from this loan would be used for necessary business expenditures, but it did not know that LRG secretly had earmarked $210,000 as a fee for the consultants.

In July 1981 the president of LRG contractually agreed to purchase from Valdes and his company, IKK, a hotel in Cancun, Mexico, that he intended to convert into 55 condominium units. LRG gave Valdes and IKK promissory notes totalling approximately $8,000,000 as payment for the hotel. Shortly thereafter Capitol and USC discovered that LRG’s president fraudulently pledged unenforceable credit contracts to USC as security for additional loans. In October 1981, Capitol and USC called in all of LRG’s loans and proceeded to foreclose on the president’s LRG stock that served as security for the loans. Despite several attempts to work things out, problems continued to worsen. Shortly thereafter LRG terminated its contract with IKK.

corporation to buy stock that a divorce action had awarded to a shareholder’s wife, despite the fact that such a transfer restriction appeared in its articles of incorporation. Earthman’s, 526 S.W.2d at 202, cited in Consolidated, 720 S.W.2d at 650-51.

261. Consolidated, 720 S.W.2d at 651, citing Annotation, Construction and Application of Provisions of Articles, Bylaws, Statutes or Agreements Restricting Alienation or Transfer of Corporate Stock, 2 A.L.R.2d 745, 754-56 (1948).

262. Id.

263. 810 F.2d 1345 (5th Cir. 1987).
IKK filed an action in federal district court against Capitol, USC, and LRG seeking recovery for breach of contract and several other causes of action including a claim that Capitol, USC, and LRG fraudulently induced IKK to surrender valuable rights in the promissory notes owed to it by LRG. One day prior to the date of the trial the district court granted Capitol, USC, and LRG's motion for summary judgment on the breach of contract issue based on its conclusion that the November contract was illegal and unenforceable under Mexican law.264

The district court submitted two issues to the jury: (i) whether Capitol, USC or LRG fraudulently induced IKK to surrender its rights in the promissory notes, and (ii) whether IKK was the corporate alter ego of Capitol or USC. The jury found in favor of IKK on both issues and awarded IKK $6,600,000 in actual damages. The jury also assessed $100,000 in exemplary damages against Capitol, USC, and LRG, found each lender to be the alter ego of LRG, and found Capitol and USC jointly liable for LRG's fraudulent conduct.265

On appeal the Fifth Circuit addressed, among other things, the issue of alter ego status and applied the test set forth by the Texas Supreme Court in Castleberry v. Branscum.266 In Castleberry the supreme court held that the proper test to be applied in alter ego cases is whether there is such unity between a corporation and another person or entity that the separateness of the corporation has ceased and holding only the corporation liable would be unfair. The court held that the unfairness test in alter ego cases is based on the fact that the dominant shareholder or parent company is the party that should be held legally responsible for creating the subservient company's debts because it controls the subservient company.267 After analyzing applicable precedent, the Fifth Circuit predicted that Texas courts would not always require full and unfettered ownership of the corporation whose veil the complainant seeks to pierce based on the alter ego theory. In the absence of such a conclusion, however, the court would require especially persuasive evidence of control.268 Absent full ownership or ownership of the allegedly controlled entity, the court required other indicia of the supplantation of the autonomy of the subservient corporation by the actions of the allegedly dominant company before imposing alter ego liability.269

The court held that the Interim Operating Agreement did not evidence that Capitol and USG possessed ownership of LRG.270 The appellate court also found no evidence indicating that LRG had failed to comport with corporate formalities; hold shareholder or director meetings; keep separate corporate and financial records from its lenders; commingle the property of LRG and the lenders; have identical corporate officers, business transactions

264. Id. at 1348.
265. Id. at 1349.
266. 721 S.W.2d 270 (Tex. 1986).
267. Castleberry, 721 S.W.2d at 272.
268. Valdes, 810 F.2d at 1354.
269. Id.
270. Id.
or offices with its lenders; or generate confusion among creditors with respect to with whom they were dealing.\textsuperscript{271} Finally, the court concluded that objective criteria displaying control and alter ego status were absent.\textsuperscript{272} The appellate court also noted that in \textit{Lucas v. Texas Industries}\textsuperscript{273} these characteristics did not exist and therefore the Texas Supreme Court did not find the parent company to be the alter ego of its subsidiary.\textsuperscript{274} Accordingly, the \textit{Valdes} court held that the alter ego theory was inapplicable.

Another example of an attempt to impose the alter ego theory is \textit{Robbins v. Robbins}.\textsuperscript{275} \textit{Robbins} arose from a suit that a widow brought against her husband's six children from a prior marriage in order to determine the status of 153,150 shares of stock owned by the husband as separate property before his death. Ernestlene and Harvey Robbins became husband and wife on June 10, 1964. At this time Mr. Robbins owned the majority of the stock of Lakeside Telephone Company (Lakeside). In January 1983 Mr. Robbins traded his shares of Lakeside stock for 153,150 common shares of Continental Telecom, Inc. (Contel). Mr. Robbins died in December 1983.

Ms. Robbins initiated a suit pursuant to the Texas Uniform Declaratory Judgments Act\textsuperscript{276} presenting an alter ego theory of liability characterizing Lakeside as the alter ego of Mr. Robbins; thus, the Lakeside stock would be community property. The trial court ruled in favor of Ms. Robbins and awarded her 75,449.73 shares of the Contel stock, which represented her community interest in the originally acquired, now traded Lakeside stock.\textsuperscript{277} The estate appealed the trial court's judgment, contending that there was no evidence or insufficient evidence to support the trial court's alter ego finding.

The appellate court reviewed the teaching of \textit{Castleberry} and concluded that alter ego applies when there is such unity between a corporation and an individual that the separateness of the corporation has ceased and holding only the dominant corporation liable would be unfair.\textsuperscript{278} Although the court could not point to any case using the alter ego theory to determine the status of a decedent's property, it concluded that the rules of law concerning the alter ego theory apply in such situations.\textsuperscript{279}

The court applied the rule that it will not use the alter ego theory to disregard the corporation unless: (i) it appears that the unity outweighs the corporation's individuality; and (ii) due to the facts of the case, adherence to the fictitious separate existence would promote injustice.\textsuperscript{280} The court also noted that in the past Texas courts have been reluctant to pierce the corpo-

\begin{footnotesize}
\textsuperscript{271} \textit{Id.}
\textsuperscript{272} \textit{Id.}
\textsuperscript{273} 696 S.W.2d 372 (Tex. 1984).
\textsuperscript{274} \textit{Valdes}, 810 F.2d at 1354.
\textsuperscript{275} 727 S.W.2d 743 (Tex. App.—Eastland 1987, no writ).
\textsuperscript{276} TEX. CIV. PRAC. & REM. CODE ANN. §§ 37.001-.004, .006-.011 (Vernon 1986), § 37.005 (Vernon Supp. 1988).
\textsuperscript{277} \textit{Robbins}, 727 S.W.2d at 744.
\textsuperscript{278} \textit{Id.} at 745.
\textsuperscript{279} \textit{Id.}
\textsuperscript{280} \textit{Id.} at 746.
\end{footnotesize}
rate veil and find the individual personally liable. The court stated that compelling circumstances generally were necessary before a Texas court would hold a chief executive officer or controlling stockholder personally liable. Mere domination of the business of the corporation by a stockholder will not, standing alone, require personal liability, nor will the mere unification of financial interests require a disregard of the corporation as an entity.

The appellate court next considered the factual sufficiency of the evidence upon which the trial court based its finding of alter ego liability. Regarding the no evidence point, the appellate court reviewed the trial court's findings of fact and concluded that same evidence did in fact serve to support the trial court's findings that Lakeside was the alter ego of Mr. Robbins. The majority of the evidence, however, supported the proposition that Lakeside and Mr. Robbins maintained separate existences. The appellate court found the evidence as reported in the record factually insufficient to establish a unity between Lakeside and Mr. Robbins and a resulting cessation of separate corporate existence. The appellate court thus reversed the judgment of the trial court and remanded the cause for a new trial.

Francis v. Beaudry presented the issue of piercing the corporate veil in another unusual context. In that case, a deceased stockholder's estate brought an action against the other stockholders as well as the directors of the corporation to recoup the value of the deceased shareholder's holdings in the corporation as of the date of his death. In September 1981 Reeves, Francis, and Edwards incorporated Columbia Oilfield Equipment, Inc. The three parties were to be shareholders in the corporation in equal proportions. The parties drafted and executed the requisite documents of incorporation and the corporation issued equal shares of stock to Reeves, Francis, and Edwards as shareholders. None of these shareholders, however, contributed any funds to the corporation as consideration for the shares of stock as required under Texas law prior to the corporation's commencement of busi-

281. Id. citing, Aztec Management & Inv. Co. v. McKenzie, 709 S.W.2d 237, 239 (Tex. App.—Corpus Christi 1986, no writ); Torregrossa v. Szlecz, 603 S.W.2d 803, 804 (Tex. 1980); Bell Oil & Gas Co. v. Allied Chem. Corp., 431 S.W.2d 336, 340 (Tex. 1968); Place Corp. v. Jackson, 155 Tex. 179, 284 S.W.2d 340, 351 (1955).
282. Robbins, 727 S.W.2d at 746.
283. Id.
284. Id.
285. Id. at 747.
286. Id. The court recited the following evidence that Lakeside and Harvey were distinct and separate entities: (1) Lakeside was operated as a corporation and the directors observed corporate formalities; (2) Lakeside's assets were never intermingled with Harvey's individual assets; (3) the only item of personal services or goods furnished to Harvey by Lakeside was an automobile used at least partly for business purposes; (4) all of the assets used in the business were owned by Lakeside; (5) Harvey's individual bank accounts and Lakeside's corporate bank accounts were kept separately and were never intermixed; (6) the corporation paid its own taxes and had a tax number separate from Harvey's social security number; and (7) Lakeside employees were corporate employees, not employees of Harvey. Id.
287. Id.
288. Id.
289. 733 S.W.2d 331 (Tex. App.—Dallas 1987, no writ).
 Nevertheless, the parties undertook operation of the business in the name of the corporation. Reeves served as president of the corporation from the date of incorporation until his death in May 1982 and managed the majority of the corporation's activities.

The problems started after Reeves' death, when Francis and Edwards attempted to "wind up" the business. This winding up process basically involved Francis and Edwards settling the corporation's affairs and paying the corporation's creditors. During this process the two men also managed to buy themselves cars in their individual names out of business funds and each personally received payments from the sale of certain assets of the business. In early 1984 Edwards and Francis sold and distributed the remaining company assets to themselves in the sum of approximately $44,000 to Francis and $47,000 to Edwards, but they never formally dissolved the corporate shell.

Beaudry, the administrator of Reeves' estate, brought an action against Francis and Edwards to recover Reeves' one-third interest in the corporation valued as of the date of Reeves death. Beaudry alleged that following Reeves' death Francis and Edwards ran the business for their own personal benefit. Beaudry's pleadings also stated that Francis' and Edwards' identities and the corporation's identities were united and that the corporation was their alter ego. Beaudry based his alter ego allegation on the grounds that Francis and Beaudry utilized the corporation only as a conduit for their personal businesses and as a means to injure those who dealt with it.

Beaudry raised the following facts in support of his allegations: (i) Francis and Edwards owned two-thirds of the corporation's outstanding stock, (ii) they were the sole directors of the corporation and served as its officers, and (iii) they ignored the corporation's separate existence by failing to hold regular directors and shareholders meetings, failing to acquire written consents to corporate actions, and by failing to keep corporate records other than the corporate formation documents. Through their control of the corporation, Beaudry asserted, Francis and Edwards obtained possession of the whole of the assets of the business and appropriated these assets for their own personal use, thereby depriving the estate of its undivided one-third interest in the corporation.

The trial court found the value of Reeves' interest on the date of his death to be approximately $50,000 and that, after that date, Francis and Edwards (i) continuously operated the corporation for their own personal benefit, (ii) wound up the affairs of the business and distributed the assets to themselves, and (iii) used the form of a corporation to serve solely their individual interests. The trial court also termed the corporation as the alter ego of Francis and Edwards and awarded the estate its $50,000 of damages, together with attorneys' fees and costs. Francis alone appealed the judgment of the trial court.

290. TEX. BUS. CORP. ACT. ANN. art. 3.05 (Vernon 1980).
291. Francis, 733 S.W.2d at 334.
292. Id.
In the appellate court Francis raised five related points of error. First, Francis characterized Beaudry's claim as a stockholder's derivative action and argued that Beaudry did not comply with the Texas statutory requirements for such suits. Second, Francis argued that Beaudry was not legally entitled to recover one-third of the value of the corporation at the time of Reeves' death as an asset of the estate. Third, Francis argued that the alter ego theory did not apply to his type of case.

The appellate court interpreted the essence of Francis' points of errors to be that the trial court erred in permitting Beaudry to pierce the corporate veil and recover directly against Francis and Edwards since the case involved assets of a corporation. This argument had superficial appeal because of the presumed existence of a corporate veil that generally prevents a stockholder from suing a director or officer for breach of a duty to the corporation. Generally the right to bring suit for such a breach belongs to the corporation since the corporation sustains the primary injury.

The appellate court, while agreeing in principle with Francis' argument, diligently applied the teaching of *Castleberry* stating that courts will not adhere to the corporate fiction and will find shareholders, officers, and directors personally liable when these parties take advantage of the corporate privilege. The appellate court held that Beaudry did not need to bring the suit in the form of a shareholder's derivative suit where the evidence sufficiently supported piercing the corporate veil. The court held Francis to be personally liable. The appellate court applied the rationale behind the alter ego theory, namely, that if the shareholders themselves ignore the separate existence of the corporation, the law will ignore it as well in order to prevent injury to individual and corporate creditors.

The court noted that a second theory, known as "denuding the corporation," also supported Beaudry's right to bring his claim directly against Francis and Edwards, as well as the piercing the corporate veil theory, that would permit Beaudry to recover the value of one-third of the corporate assets belonging to Reeves' estate. The appellate court also rejected Francis' argument that the estate may not obtain the corporation's assets due to the failure of the corporation to formally dissolve. The court held that the estate could trace the assets of the denuded corporation to the two other owners, notwithstanding the absence of a formal dissolution.

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293. *Id.*
294. *Id.* at 334-35.
295. *Id.*
296. *Id.*
297. *Id.*
298. *Id.* The "denuding the corporation" theory had its roots in Texas in *World Broadcasting System, Inc. v. Bass*, 160 Tex. 1261, 328 S.W.2d 863, 864 (1959) and, the Texas Supreme Court recently approved the theory in *Castleberry*, 721 S.W.2d at 271 n.1. In *World Broadcasting System* shareholders sold the entire assets of a corporation and kept the resulting income for their own personal benefit. The Texas Supreme Court found the corporation was denuded of its assets and held the shareholders personally liable to the corporation's creditors up to the sum of the funds they obtained. 328 S.W.2d at 864.
299. *Francis*, 733 S.W.2d at 335.
300. *Id.*
Francis' final argument stated that the alter ego theory did not apply to his case because Beaudry did not allege that the shareholders used the corporation as a sham. The court followed Castleberry and did not agree with this argument because of the separate and distinct nature of the causes of action for the alter ego theory and the theory based on a sham to perpetuate a fraud. 301

A case of first impression regarding whether the right to assert an alter ego theory belongs to the corporation or merely to its shareholders and third parties arose in S.I. Acquisitions, Inc. v. Eastway Delivery Service, Inc. 302 S.I. Acquisitions involved a shipper (S.I.A.) that entered into a service contract in 1984 with Eastway, a delivery service company. Shortly thereafter in March 1985 S.I.A. became a delinquent debtor failing to pay Eastway as stated in their contract. S.I.A. eventually sent two partial payments to Eastway from an account that Abel Furniture & Equipment Co., Inc. (Abel) possessed. 303 Eastway subsequently continued to serve S.I.A. but did not receive any additional payments.

In August 1985 Eastway filed a state court action against S.I.A., Abel, and TPO, Inc. demanding the remaining payments contractually due as well as damages. The action also named Thomas P. O'Donnell, the registered agent for all of the above-mentioned corporations, as a defendant. Eastway claimed liability from S.I.A. based on their contract and in turn from Abel, TPO, and O'Donnell because, Eastway argued, they completely controlled S.I.A. 304 Shortly thereafter S.I.A. filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code. 305 Eastway countered S.I.A.'s petition for bankruptcy by severing S.I.A. from its state court action due to the fact that section 362(a)(1) of title 11 served as an automatic stay with respect to the claim against S.I.A. 306

Subsequently, Eastway delivered written interrogatories to Abel, TPO,
and O'Donnell, the non-bankrupt defendants in the state court action, that questioned the financial and control connections between the three corporations and O'Donnell. S.I.A. then filed a motion to show cause in the bankruptcy court claiming that it would be improper to hold Eastway in contempt based on an alleged violation of the automatic stay provisions. The bankruptcy court considered whether the automatic stay provision prevented further actions being taken against the non-bankrupt defendants while in state court based on piercing the corporate veil of S.I.A., the debtor. The bankruptcy court denied S.I.A.'s motion, concluding that (i) Eastway's alter ego claim did not constitute a claim that S.I.A. or a trustee in bankruptcy under 11 U.S.C. § 544 could assert and (ii) the alter ego cause of action did not constitute property for purposes of determining S.I.A.'s bankruptcy estate since neither S.I.A. nor the trustee could bring an alter ego cause of action. The court concluded that the automatic stay provisions of section 362 did not apply to Eastway's claim against Abel, TPO, and O'Donnell. S.I.A. appealed the judgment to the district court, which affirmed the decision of the bankruptcy court without issuing an opinion. S.I.A. then filed an appeal to the United States Court of Appeals for the Fifth Circuit.

In analyzing the issue, the Fifth Circuit noted that a section 362(a)(1) stay generally applies solely to prevent claims against a debtor, but that some courts have permitted such a stay to prohibit claims against non-bankrupt codefendants where the two parties involved are found in reality to be one entity or to have a solitary interest. Relying on precedent in the circuit, the Fifth Circuit stated the guiding principles to be that (i) a section 362(a)(3) stay pertains to a state or federal claim that belongs to the debtor, (ii) such a stay pertains to a claim that attempts to recover estate property where this property is under the control of a person or entity other than the debtor himself, and (iii) when employing this rule, courts should remember the Bankruptcy Code's general guidelines of obtaining and preserving the debtor's assets and of guaranteeing equal distribution of these assets to creditors who are in similar situations.

The issue on appeal concerned whether once a debtor files his bankruptcy petition, section 362 automatically stays a state court suit based solely on the theory that the named defendants actually control the bankrupt debtor and are thereby responsible for the debtor's debts. The Fifth Circuit reviewed

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310. 817 F.2d at 1145.
312. *S.I. Acquisition*, 817 F.2d at 1150 (citing *In re Mortgage America*, 714 F.2d 1266 (5th Cir. 1983)).
313. *S.I. Acquisition*, 817 F.2d at 1150.
Texas law regarding the alter ego remedy and concluded that the remedy appeared to be available to all creditors of a corporation provided the creditors establish the unification of the corporation and its controller. The court stated that the alter ego theory did not depend upon a certain creditor's transactions with or dependence upon the person in actual control, nor did it depend upon the plaintiff's ability to show fraud on the part of a particular creditor.

The court characterized the issue of whether a corporation could bring an alter ego cause of action against itself as very important to its decision. Although the court found no controlling precedent on point, it stated that the generally accepted policy of Texas alter ego law is that the person in control who abused the corporate form will be responsible for the corporation's debts. The court believed the corporation had a separate existence, and that therefore inconsistency did not prevent the corporation from piercing its own corporate veil and holding responsible those people who abused the corporation in order to meet its corporate debts. The court found support for this conclusion in Castleberry, to the effect that a remedy based on the alter ego theory, the doctrine of trust fund, and the theory of denuding the corporation (the latter two being stayable) are like theories of recovery that seek to cure the problems of abuse of the corporate form.

The Fifth Circuit also concluded that, while the debtor corporation's creditors usually assert a claim founded on the alter ego theory, this did not impair the conclusion that "nothing in Texas law prohibits a corporation from asserting on its own an action based on alter ego. . ." Furthermore, the court determined the rationale for the remedy also supports this conclusion. The court concluded that Eastway's cause of action based on the alter ego theory belonged to S.I.A. and, therefore, this claim constituted estate property within the meaning of section 541(a)(1). The court held that the automatic stay applied to Eastway's state claim and the decisions of the bankruptcy court and district court denying the motion to show cause filed by S.I.A. Thus, the court remanded the case for further proceedings.

314. Id. at 1152, citing Valdes v. Leisure Resource Group, Inc., 810 F.2d 1345, 1352-54 (5th Cir. 1987).
315. S.I. Acquisition, 817 F.2d at 1152 (citing Castleberry, 721 S.W.2d at 272-73 and Edwards Co. v. Monogram Indus., Inc., 730 F.2d 977, 982-84 (5th Cir. 1984)).
316. S.I. Acquisition, 817 F.2d at 1152.
317. Id. (citing Castleberry, 721 S.W.2d at 272, and Valdes v. Leisure Resource Group, Inc., 810 F.2d 1345, 1352-54 (5th Cir. 1987) (discussing Texas law on alter ego and holding that this doctrine applies to find controlling entity accountable for subservient company's obligations since controlling entity created debts)).
318. S.I. Acquisition, 817 F.2d at 1152. The court noted that another court reached the identical conclusion when interpreting Nevada alter ego law, which is the same as Texas alter ego law, on the grounds that the corporation possesses a separate legal interest of its own in assuring that it can meet its obligations to its creditors. Id. at 1152-53. See In re Western World Funding, Inc., 52 B.R. 743, 783 (Bankr. D. Nev. 1985).
319. S.I. Acquisition, 817 F.2d at 1153 (citing Castleberry, 721 S.W.2d at 271 n.1).
320. S.I. Acquisition, 817 F.2d at 1153.
321. Id.
323. S.I. Acquisition, 817 F.2d at 1153.
C. Securities Law Development

1. Contract in Violation of Securities Laws. Texas courts aroused national attention by upholding the largest civil damages award in history, $8.53 billion, in *Texaco, Inc. v. Pennzoil, Co.*\(^{324}\) *Texaco* involved a claim against *Texaco* for tortious interference with a stock purchase-merger agreement between *Pennzoil* and Getty Oil Company, Sarah C. Getty Trust, and the J. Paul Getty Museum (the " Getty Entities"), resulting in a jury award of $7.53 billion of actual damages and $3 billion of punitive damages to *Pennzoil*. *Texaco* appealed the jury award to the First District Court of Appeals characterizing the stock purchase-merger agreement as void because it violated SEC Rule 10b-13,\(^{325}\) which states that upon public announcement of a tender offer, the offeror may not acquire stock of the target company, unless the acquisition is made by means of the tender offer, for the duration of the open offer.\(^{326}\) *Texaco* claimed that any contractual agreement violating the SEC rule had no effect.

*Texaco* argued that *Pennzoil* contracted (i) to buy at once the J. Paul Getty Museum's shares of Getty Oil Company stock and (ii) at a later date to buy the public shares at a higher price than that offered in the tender offer while the tender offer remained open. *Texaco* argued this resulted in a per se violation of the SEC rule, regardless of whether any shareholders received a windfall from the outside purchase. While the purpose of the SEC rule is not to protect a party such as *Texaco*; nonetheless, *Texaco* claimed that since *Pennzoil*’s agreement violated the SEC rule, it became void and therefore could not support a cause of action for tortious interference. The appellate court concluded, however, that the SEC rule's express exemption provision argues against the implication that all violations of the rule unquestionably render the transaction void.\(^{327}\) Assuming the transaction at best then would be voidable, *Texaco* had no standing to argue the violation of the rule.\(^{328}\) The appellate court upheld the trial court's judgment, but required a $2 billion dollar remittitur.\(^{329}\) The United States Supreme Court granted certiorari to hear the case but the parties settled out of court for $3 billion.

2. Texas Deceptive Trade Practices Act Not Applicable to the Sale of Securities. In a case of first impression, the Texas Supreme Court ruled in *E.F. Hutton & Co. v. Youngblood*\(^{330}\) that the Texas Deceptive Trade Practices Act ("DTPA")\(^{331}\) does not apply to the sale of securities.\(^{332}\) *Youngblood*

\(^{324}\) 729 S.W.2d 768, 866 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

\(^{325}\) 17 C.F.R. § 240.10b-13 (1985).

\(^{326}\) Id.; see *Texaco*, 729 S.W.2d at 806.

\(^{327}\) Id.

\(^{328}\) Id. The court declined to speculate on whether a party with standing could have successfully asserted a violation of the SEC rule. Id. at 806-07.

\(^{329}\) Id.


\(^{331}\) TEX. BUS. & COM. CODE ANN. § 17.41-.826 (Vernon 1987).

\(^{332}\) 30 Tex. Sup. Ct. J. at 509.
involved a brokerage firm that advised a customer regarding the tax consequences of withdrawing money from a retirement fund and reinvesting the money in one of the brokerage firm's bond funds. The brokerage firm's advice was erroneous and the customer incurred a substantial tax liability. The customer brought an action under both the DTPA, the Texas Securities Act (the TSA) and common law fraud to recover his liability. The trial court and the appellate court held in favor of the customer on the DTPA issue. The brokerage firm appealed to the Texas Supreme Court.

The court analyzed the legislative intent as evidence by the differences between the DTPA and the TSA and concluded that it would be inconsistent to hold the brokerage firm liable under both. The key to the court's analysis was its determination that the DTPA essentially is a strict liability statute, while the TSA permits a due diligence defense. Concluding that the due diligence defense would be illusory if the same conduct was actionable under a strict liability theory, the supreme court reversed the lower courts and remanded the case for consideration of the TSA and common law theories of liability. It is interesting to note that eight of nine jurisdictions that have addressed the issue have concluded that securities transactions are outside of the scope of their DTPA analogues. Only Arizona has reached the opposite result.

3. Enforcement of 1934 Act Arbitration Agreements. In Shearson/American Express, Inc. v. McMahon, the United States Supreme court held that the Federal Arbitration Act requires the enforcement of agreements to arbitrate claims brought under the Securities Exchange Act of 1934 and that its holding was to be applied retroactively.

335. Id. at 509.
336. Id.
337. Id.
342. McMahon, 107 S. Ct. at 2343, 96 L. Ed. 2d at 201.