

THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW

Val Ricks *

The following article was drafted and circulated informally before the 2011 Texas Legislative Session. Though the Legislature follows its own agenda, the author was pleased to see that changes made to the Texas Business Organizations Code in SB 748, signed by the Governor on May 27, 2011, correct the problems addressed in Parts I and II of this paper. Thus, though the statutes discussed in Parts I and II of the paper still apply to cases arising prior to the effective date of these new amendments, Parts I and II are now valuable primarily for their justifications of the amendments and the history of the prior provisions.

The Legislature also passed a bill purporting to address the third suggestion, described in Part III. SB 323, signed by the Governor on May 9, 2011, purports to impose on limited liability companies the restrictions on entity veil-piercing imposed on Texas corporations under Texas Business Organizations Code section 21.223. The passage of this bill moots this article's first two objections to importing section 21.223's rules against limited liability company members, though Parts III.A and III.B remain valuable generally as a warning against importing Business Organizations Code provisions from one Title to another. Part III.B also includes a helpful critique of section 21.223.

SB 323 fails, however, to address the third objection to application of section 21.223 to limited liability companies, namely, that section 101.113 of the Texas Limited Liability Companies Law forbids suing both the limited liability company and its members in a single suit. Because, as Part III.C explains, veil-piercing in Texas is merely a remedy and not a cause of action, section 101.113 presents a formidable obstacle to any limited liability company veil-piercing (an obstacle that courts to date seem entirely to have overlooked, though no one seems to have argued the section to them). Members cannot be joined to the suit against the limited liability company, and a second suit against the members lacks a cause of action.

SB 323, therefore, places Texas veil-piercing law for limited liability companies in a conundrum. Sections 101.113 and 101.114 (which states generally that members are not liable for the limited liability company's obligations) strongly suggest that no veil-piercing of limited liability companies is possible under Texas law. Cases holding otherwise thus far have clearly violated section 101.113. But SB 323 places in the Texas Limited Liability Company Law the limitations on veil-piercing that apply in the Texas Corporation Law. How can limitations on veil-piercing apply if veil-piercing is impossible? SB 323 is superfluous unless veil-

* Val Ricks is a Professor of Law at South Texas College of Law. The author wishes to thank Jennifer Q. Nguyen and Eric D'Olive for their research.

piercing against a limited liability company member is possible, but section 101.113 makes veil-piercing against a limited liability company member impossible. How to resolve this contradiction is a topic of another paper. In the meantime, if the issue comes up in litigation, one hopes the courts have a sense of humor. Because SB 323 does not address the topic of section 101.113, I believe that section 101.113 should continue to control, even if its application renders SB 323 superfluous.

I. CONFLICTING TRANSACTIONS INVOLVING GOVERNING PERSONS OR OFFICERS: A DRAFTING ERROR THAT GUTS THE STATUTE.....	32
II. TEXAS LLCs AND THE NEW THEORY OF AGENCY	35
A. The Common Law Applies to Texas LLCs, or Should Apply	36
B. How the Statute Changes the Common Law	40
i. Subsection (a): Delimiting Authority	40
ii. Subsection (b): A Third Theory of Authority (and NOT a Useful One)	44
iii. Subsection (c): The End of the Common Law of Agency for LLCs	46
C. If Agents Were Omitted.....	47
III. VEIL PIERCING	48
A. The Code Says So.....	51
B. Clarity	54
C. The Party Ends with the Corporation	58

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 31

A few years ago, I decided to teach business entity law primarily from the Texas Business Organizations Code (the "TBOC"). The Code draws heavily from the uniform acts with respect to corporations and partnerships,¹ especially for its operative language, so students would in substance be learning law applicable in most states.² But I wanted students to realize that no uniform act is ever passed as drafted. Local color enlivens local law, and all law is in a sense local.³

The TBOC provisions applicable to limited liability companies (LLC), however, were drafted without the benefit of a uniform act. The Texas LLC Act was passed before the Uniform Limited Liability Company Act existed. But the LLC code was not drafted "freehand."⁴ Many of the Texas provisions resemble code applicable to corporations or limited partnerships. Others have less precedent. What I discovered, however, is that the LLC code contains some provisions that are very difficult to explain to students (well, and also to myself). In some cases the borrowed corporate or partnership provision comes with defects that are replicated in the limited liability code, and in some cases the corporate or partnership provisions are applied without considering the LLC's different nature. Some provisions I am just at a loss to explain.

In this paper, I describe what I believe are the three most inexplicable Texas LLC laws. The first (described in Part I) is the provision purporting to address resolution of managers', managing members', and officers' conflicts of interest. This statute is drawn to mimic exactly a provision applicable to corporations. But the statute actually contains no language addressing conflicts of interest! The second statute (in Part II) addresses agency and the LLC. This provision was taken from the partnership code but adapted to the LLC in a manner I find befuddling. Read literally, it abolishes the common law of agency as applied to agents of LLCs. The third provision (Part III) is a bit of corporate code addressing veil-piercing that does not exist in the LLC code but is being applied to LLCs by the courts as if it did. It is difficult to explain why this provision should be imported, and the code forbids it.

¹ The corporate provisions obviously reflect the influence of the Revised Model Business Corporations Act (1984) and some amendments made since 1984. The general partnership and limited partnership provisions obviously reflect those of the Revised Uniform Partnership Act (1997) and Revised Uniform Limited Partnership Act (1976 & 1985), respectively, and some subsequent amendments to those acts.

² The Revised Model Business Corporations Act has been adopted in thirty or more states. 1 Model Bus. Corp. Act Ann. ix & nn.1-2 (2009); William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 U. Ill. L. Rev. 95, 97 N.11. The Uniform Partnership Act (1997) has been adopted in 37 states and the Virgin Islands. Uniform Laws Annotated, Unif. Partnership Act 1997 Refs & Annos (2010). The Uniform Limited Partnership Act (1976 and 1985 amendments) was adopted in at least 37 states and the Virgin Islands. Uniform Laws Annotated, Unif. Ltd. Part. Act 1976 Refs & Annos (2010). The 2001 Revised Uniform Partnership Act has been adopted in 15 states. See Uniform Laws Annotated, Unif. Ltd. Part. Act 2001 Refs & Annos (2010).

³ I bring Delaware and other law into the class as needed for a complete understanding.

⁴ The Texas Limited Liability Company Act was passed in 1991. Acts 1991, 72nd Leg., ch. 901, § 46, eff. August 26, 1991. The Uniform Limited Liability Company Act was passed in 1994. Uniform Laws Annotated, Unif. Ltd. Liability Co. Act 2006 Refs & Annos (2010). "By that time nearly every state had adopted an LLC statute." *Id.* at Prefatory Note.

Each section of this paper ends with a plea to the legislature to change the provisions discussed here. I suggest ways the legislature might fix the first two; the last I leave to our representatives. If the legislature will take me up on these suggestions, I will be able to spend more class time on other equally pressing legal issues and will spend less time trying to compensate with long explanations for what are probably primarily drafting failures.

I. CONFLICTING TRANSACTIONS INVOLVING GOVERNING PERSONS OR OFFICERS: A DRAFTING ERROR THAT GUTS THE STATUTE

A statute titled "Contracts or Transactions Involving Interested Governing Persons or Officers" appears at TBOC section 101.255. Despite its title, the statute's plain language actually does not address conflicted transactions at all. In fact, it addresses everything about conflicted transactions except the transactions themselves. The section should be amended as soon as possible. The full section reads as follows:

(a) This section applies only to a contract or transaction between a limited liability company and:

(1) one or more of the company's governing persons or officers; or

(2) an entity or other organization in which one or more of the company's governing persons or officers:

(A) is a managerial official; or

(B) has a financial interest.

(b) An otherwise valid contract or transaction described by Subsection (a) is valid notwithstanding that the governing person or officer having the relationship or interest described by Subsection (a) is present at or participates in the meeting of the governing authority, or of a committee of the governing authority, that authorizes the contract or transaction or votes or signs, in the person's capacity as a governing person or committee member, a written consent of governing persons or committee members to authorize the contract or transaction, if:

(1) the material facts as to the relationship or interest described by Subsection (a) and as to the contract or transaction are disclosed to or known by:

(A) the company's governing authority or a committee of the governing authority and the governing authority or committee in good faith authorizes the contract or transaction by the approval of the majority of the disinterested governing persons or committee members, regardless of whether the disinterested governing persons or committee members constitute a quorum; or

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 33

(B) the members of the company, and the members in good faith approve the contract or transaction by vote of the members; or

(2) the contract or transaction is fair to the company when the contract or transaction is authorized, approved, or ratified by the governing authority, a committee of the governing authority, or the members of the company.

(c) Common or interested governing persons of a limited liability company may be included in determining the presence of a quorum at a meeting of the company's governing authority or of a committee of the governing authority that authorizes the contract or transaction.⁵

This section has a long history. The LLC provision is modeled on a similar provision in the corporate code (that I have commented on elsewhere).⁶ Understanding it requires knowledge of the state of the common law prior to the statute's passage. Under the common law, a transaction involving a conflict of interest between a corporation and its director or officer was voidable by a shareholder.⁷ The interested director or officer was held unable to act for the corporation.⁸ The remainder of the board could act for the corporation,⁹ the court reasoned, but because the interested director and the rest of the board were so closely related, the courts would subject the transaction to review for "inherent fairness" to ensure that the interested director took no "undue advantage."¹⁰ The interested director or officer had the burden to show in court that the transaction was fair.¹¹ This remained the state of the law when the interested director statute was passed, in Texas, in 1985.¹²

When first passed, the corporate provision was written in the style of, and with language taken from, the Delaware corporate code.¹³ The substantive language provided, "No contract or transaction between a corporation and one or more of its directors or officers ... shall be void or voidable solely for this reason ... if" certain corporate procedures are followed and those procedures meet certain substantive standards.¹⁴

⁵ TEX. BUS. ORGS. CODE ANN. § 101.255 (Vernon 2010).

⁶ Val D. Ricks, *Texas' So-Called "Interested Directed" Statute*, 50 S. Tex. L. Rev. 129 (2008). The corporation provision is found at TEX. BUS. ORGS. CODE ANN. § 21.418 (Vernon 2010).

⁷ *Tenison v. Patton*, 67 S.W. 92 (Tex. 1902); see also Ricks, *supra* note 6, at 154-57 (reporting the state of the law up until the passage of the first interested director statute in 1985).

⁸ *Tenison*, 67 S.W. at 95.

⁹ *Id.*

¹⁰ *Id.* at 95-96.

¹¹ *Id.* at 96.

¹² See Ricks, *supra* note 6, at 137 n.33 & 154-57.

¹³ Ricks, *supra* note 6, at 136 (the original statute passed in Texas had language nearly identical to the Delaware statute).

¹⁴ Texas Business Corporations Act, 69th Leg., R.S., ch. 128, § 9, 1985 Tex. Gen. Laws 592, 597 (amended 1997) (current version at TEX. BUS. ORGS. CODE ANN. § 21.418 (Vernon 2010)). *Comp. id. with* Del. GEN. CORP. L. § 144.

Clearly, this statute aimed to define the effect of the conflict of interest itself. If the procedures and standards are met, then the conflict does not render the contract or transaction void or voidable. Delaware's statute still reads this way.¹⁵

After passage of the Delaware and Texas statutes, courts in Delaware construed this language so that, even if the procedures and standards were met, Delaware courts would still review the transaction in some limited respect.¹⁶ Thus, Delaware courts were reviewing not only whether the procedures and standards were met, but the transaction itself. The statute was not the litigation-stopper that some in Texas hoped it would be.

The response of the Texas legislature was to modify the statute. The hope was to strengthen it. Whereas the original statute said that "[n]o contract or transaction [with a conflict of interest] shall be void or voidable solely for this reason," the new statute said, "An otherwise valid contract or transaction [with a conflict of interest] shall be valid notwithstanding that"¹⁷ This sounds like a stronger approach if one stops reading there. But the statute fumbles and omits the most important part. Whereas the original statute said "void or voidable solely *for this reason*" (emphasis added), meaning by reason of the conflict, the new statute proclaims such a contract or transaction "valid notwithstanding that the director or officer ... is present at or participates in the meeting of the board of directors, ... or votes"¹⁸ Nowhere does the statute say that the contract or transaction is valid notwithstanding the conflict itself. In fact, the conflict is not mentioned in the operative language of the statute. So the plainly restrictive clause "valid notwithstanding that" inoculates the contract or transaction against the presence or participation of the conflicted director at a board meeting.¹⁹ And the clause saves the transaction from the actual voting of the conflicted director.²⁰ However, against the conflict itself, the statute does nothing. Because the statute no longer changes the effect of the common law on an interested transaction, the common law applicable to the transaction revives.²¹ Under the common law, such transactions are once again voidable, and the interested director has the burden of proving in court that they are fair.²²

¹⁵ DEL. GEN. CORP. L. § 144.

¹⁶ These developments in Delaware corporate law are discussed in detail at Ricks, *supra*, note 6, at 136-40.

¹⁷ TEX. BUS. ORGS. CODE ANN. art. 2.35-1 (Vernon 2003).

¹⁸ TEX. BUS. ORGS. CODE ANN. § 21.418(b) (Vernon 2010).

¹⁹ *Id.*

²⁰ *Id.*

²¹ When a statute that supersedes the common law is repealed and not replaced, it is as if the statute never existed; the common law again applies. *Nat'l Carloading Corp. v. Phoenix-El Paso Exp.*, 176 S.W.2d 564, 570 (Tex. 1944); *Galveston, H. & H.R. Co. v. Anderson*, 229 S.W. 998, 1001-02 (Tex. Civ. App.—Galveston 1920, writ ref'd); *See Dickson v. Navarro County Levee Imp. Dist. No. 3*, 139 S.W.2d 257, 259 (Tex. 1940); *Phil H. Pierce Co. v. Watkins*, 263 S.W. 905, 907 (Tex. 1924); *Collins v. Warren*, 63 Tex. 311 (1885); *Goodrich v. Wallis*, 143 S.W. 285, 286 (Tex. Civ. App.—Fort Worth 1911, no writ). Or, as phrased in other states' decisions, repeal of the statute revives the common law that preceded it. *See Kelly v. Strange*, 14 F.Cas. 273 (D.N.C. 1869); *Wood v. Woods*, 184 Cal.Rptr. 471, 477 (Cal.App. 1982); *State v. Daley*, 29 Conn. 272 (1860); *Makin v. Mack*, 336 A.2d 230, 234 (Del.Ch. 1975); *Baum v. Thoms*, 50 N.E. 357, 360 (Ind. 1898) (holding so even though a repeal of a statute did not revive a prior statute); *State v. Buck*, 275 N.W.2d 194, 197 (Iowa 1979); *Harris v. State*, 509 A.2d 120, 124 (Md. 1986); *People v. Reeves*, 528 N.W.2d 160, 164 (Mich. 1995); *Hilton v. Thatcher*, 88 P. 20, 22 (Utah 1906) (quoting 1 Lewis' Sutherland Stat. Const. 294).

²² *Tenison v. Patton*, 67 S.W. 92 (Tex. 1902); *See Ricks, supra* note 6, at 137 n.33 & 154-57.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 35

In this respect, the Texas statute stands alone. The prior statute and the statutes of all 49 other states limit the effect of the conflict.²³ Only Texas omits a reference to the conflict. So while the statute protects against the interested director's comparatively trivial participation at a meeting at which the transaction is approved, or the interested director's voting for the transaction, these gnats are spit out while the camel of the conflict itself is swallowed whole. And no one wants to swallow a camel.²⁴

The corporate provision was copied into the LLC code, and changes made to the corporate provision over the years have likewise been copied into the LLC code.²⁵ But the problem has not been fixed in either, so as the code stands, a transaction involving a conflict between a LLC and its manager, officer, or a governing member is voidable unless proved fair, and the interested manager, officer, or member has the burden of proving fairness.

This problem is so easily fixed that letting it linger is inexcusable. The only change that needs to occur is that the phrase "the conflict described in subsection (a) or" be added after the word *notwithstanding* in subsection (b). Until then, the plain language of the statute renders the statute's title misleading and offers no help to business people seeking to avoid litigation over conflicted transactions. Delaware's statute would be more helpful.

II. TEXAS LLCs AND THE NEW THEORY OF AGENCY

Many years ago, the committee that drafts code for Texas business organizations provided the legislature with a statute that addressed the agents of limited liability companies.²⁶ This was a curious provision. No other business entity code addresses agents. In 2003, the committee that drafted the Texas Business Organizations Code provided the legislature with an updated statute.²⁷ The legislature passed the statute as written.²⁸ The code still contains this

²³ See Ricks, *supra* note 6, at 134 & 134 nn. 17-21.

²⁴ Interestingly, and oddly, the statute was amended in 2009 to refer back to subsection (a) without fixing the problem. Prior to 2009, the statute said, "An otherwise valid contract or transaction is valid notwithstanding that" TEX. BUS. ORGS. CODE ANN. § 21.418(b) (Vernon 2007). As amended, the statute says, "An otherwise valid contract or transaction described by Subsection (a) is valid notwithstanding that" Tex. Bus. Orgs. Code Ann. § 21.418 (Vernon 2009). The change was pointless. No one could have doubted that subsection (b) in 2007 referred to the contract described in subsection (a). But the change fixed nothing. The otherwise valid contract or transaction described in subsection (a) is still not made valid notwithstanding the conflict itself; rather, it is only made valid notwithstanding the comparatively trivial presence or participation or voting of the interested director or officer.

²⁵ Compare TEX. BUS. ORGS. CODE ANN. § 101.255 (Vernon 2007) and TEX. BUS. ORGS. CODE ANN. § 101.255 (Vernon 2009), with TEX. BUS. ORGS. CODE ANN. § 21.418 (Vernon 2007) and TEX. BUS. ORGS. CODE ANN. § 21.418 (Vernon 2009).

²⁶ See Charles Szalkowski, Chairman's Letter, 28-JUN Bull. Bus. L. Sec. St. B. Tex. 1 (1991) (explaining that H.B. 278, part of which became the Texas Limited Liability Company Act; See Acts 1991, 72nd Leg., ch. 901, § 46, eff. Aug. 26, 1991; was drafted by the Business Law Section's Corporation Law Committee); Bill Analysis of H.B. 278 of the 72nd Leg., § 46 (1991) ("This article ... states a member is not a proper party to a proceeding by or against Limited Liability Company").

²⁷ See Revisor's Report on the Business Organization's Code, Title 3, available at <http://www.texasbusinesslaw.org/committees/business-organizations-code/revisors-report-on-the-business-organizations-code/title-3.-limited-liability-companies/Title3.pdf/view>, page 15. Despite the quite different language of the amended statute, the Revisor's Report states, "No substantive change is intended." *Id.*

²⁸ TEX. BUS. ORGS. CODE ANN. § 101.113 (Vernon 2010), Acts 2003, 78th Leg., ch. 182, § 1, eff. Jan. 1,

provision.

I was surprised to find this provision. It is not needed, and courts seem to have ignored it. To date, the common law of agency has provided that LLCs could be either principal or agent, the same as every other business entity.²⁹ A simple statement in a statute saying this result should hold might have codified the common law. What was passed does not codify the common law, but instead injects into agency law otherwise applicable to LLCs new concepts and rules different than the rules applicable to agents of other business structures. The statute also injects uncertainty into the law.

Try as I might, I cannot think of a good reason for any of these provisions. I recommend that the legislature amend the statute to omit references to common law agents. The TBOC says in another provision that "the powers of a [LLC] include the power to: ... elect or appoint ... agents of the entity."³⁰ That provision is sufficient.

This Part II first describes the application of the common law of agency. Possible effects of the statute are then examined. In short, the statute provides the following: (1) the statute abrogates limitations on actual and apparent authority; under the code, all agents of LLCs have as much authority as managers;³¹ (2) a theory of liability, in addition to actual and apparent authority, is applied to LLCs, the contours of which are uncertain and potentially harmful;³² and (3) apparent authority is no longer applicable to agents of LLCs.³³ I conclude with arguments for the recommended amendment.

A. The Common Law Applies to Texas LLCs, or Should Apply

The Texas LLC is a principal or agent under the common law, just as is any other principal or agent, and just as any other business entity or individual person.³⁴ The common law of agency is universally applied and, with respect to its principles, uncontroversial. An agency relationship exists when one agrees with another that he will act for the other and subject to the other's control.³⁵

2006.

²⁹ See, e.g., *Aqueduct, L.L.C. v. McElhenie*, 116 S.W.3d 438, 441-42 (Tex. App.—Houston [14th Dist.] 2003, no pet.), and text *infra* Part II.A.

³⁰ TEX. BUS. ORGS. CODE ANN. § 2.101(14) (Vernon 2010); see also TEX. BUS. ORGS. CODE ANN. § 2.101(16) (Vernon 2010) (confirming a power to indemnify "agents of the entity").

³¹ See *infra* Part II.B.1.

³² See *infra* Part II.B.2.

³³ See *infra* Part II.B.3.

³⁴ See *Aqueduct*, 116 S.W.3d at 441-42 (holding on common law grounds that the LLC was the principle of an agent with implied actual authority), *Plantation Prod. Props., L.L.C. v. Meeks*, 10-02-00029-CV, 2004 WL 2005445 (Tex. App.—Waco Sept. 8, 2004, no pet.)(mem. op.) (employing common law agency principles to conclude that, though the purported agent lacked actual and apparent authority, the LLC had ratified the agency and was therefore bound by the contract). See also *Bion Const., Inc. v. Grande Valley Homes, LLC*, 2009 WL 4669844 (Tex. App.—San Antonio Dec. 9, 2009, no pet.)(mem. op.) (after passages of the TBOC but relying only on the common law of agency to resolve whether and LLC had conferred authority on an agent).

³⁵ See *Orozco v. Sander*, 824 S.W.2d 555, 556 (Tex. 1992); *SITQ E.U., Inc. v. Reata Restaurants, Inc.*, 111 S.W.3d 638, 652 (Tex. App.—Fort Worth 2003, pet. denied); *Royal Mortg. Corp. v. Montague*, 41 S.W.3d 721, 732 (Tex. App.—Fort Worth 2001, no pet.); *Commercial Escrow Co. v. Rockport Rebel, Inc.*, 778 S.W.2d 532, 539 (Tex.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 37

With respect to contractual liability, "[a]bsent actual or apparent authority, an agent cannot bind a principal."³⁶ Actual authority depends on a principal's communication to the agent.³⁷ Actual authority means authority "intentionally conferred by the principal upon the agent, or such as the principal either intentionally allows the agent to believe that he possessed, or by want of ordinary care on the part of the principal, allows the agent to so believe."³⁸

Apparent authority, on the other hand, is not actual authority but is a power to alter the legal relations of the principal. In Texas, apparent authority is related to estoppel.³⁹ It arises from a principal's manifestation of intent to a third party that another, the apparent agent, is authorized to represent the principal: "either from a principal knowingly permitting an agent to hold [himself] out as having authority or by a principal's actions which lack such ordinary care as to clothe an agent with the indicia of authority, thus leading a reasonably prudent person to believe that the agent has the authority [he] purports to exercise."⁴⁰ The third person must actually believe, reasonably, as a consequence of the principal's manifestation, that the "apparent agent" was authorized.⁴¹ Thus, evidence of the principal's conduct, not the agent's, establishes apparent authority.⁴² Declarations of the alleged agent, without more, do not establish apparent agency or the scope of the apparent agent's authority.⁴³ Finally, the principal must have

App.—Corpus Christi 1989, writ denied); *Tamburine v. Ctr. Sav. Ass'n*, 583 S.W.2d 942, 948 (Tex. Civ. App.—Tyler 1979, writ ref'd n.r.e.); *Tarver Steele & Co. v. Pendleton Gin Co.*, 25 S.W.2d 156, 158 (Tex. Civ. App.—Eastland 1930, no writ); *Bertrand v. Mut. Motor Co.*, 38 S.W.2d 417, 418 (Tex. Civ. App.—Eastland 1931, writ ref'd).

³⁶ *Suarez v. Jordan*, 35 S.W.3d 268, 272-73 (Tex. App.—Houston [14th Dist.] 2000, no pet.); *Currey v. Lone Star Steel Co.*, 676 S.W.2d 205, 209 (Tex. App.—Fort Worth 1984, no writ).

³⁷ *Gaines v. Kelly*, 235 S.W.3d 179, 182 (Tex. 2007); see *Thompson v. Schmitt*, 274 S.W. 554, 557 (Tex. 1925) ("One who acts in my behalf, for my advantage, by my authority, is my agent.").

³⁸ *Nat'l Cash Register Co. v. Wichita Frozen Food Lockers*, 172 S.W.2d 781, 787 (Tex. Civ. App.—Fort Worth 1943), aff'd, 176 S.W.2d 161 (Tex. 1944). This is an oft-quoted statement. See, e.g., *Sanders v. Total Heat & Air, Inc.*, 248 S.W.3d 907, 913 (Tex. App.—Dallas 2008, no pet.); *Lifshutz v. Lifshutz*, 199 S.W.3d 9, 22 (Tex. App.—San Antonio 2006, pet. denied); *Huynh v. Nguyen*, 180 S.W.3d 608, 623 (Tex. App.—Houston [14th Dist.] 2005, no pet.); *Park Cities Ltd. P'ship v. Transpo Funding Corp.*, 131 S.W.3d 654, 660 (Tex. App.—Dallas 2004, pet. denied); *Aqueduct, L.L.C. v. McElhenie*, 116 S.W.3d 438, 442 (Tex. App.—Houston [14th Dist.] 2003, no pet.); *Suarez*, 35 S.W.3d at 273; *Disney Enters., Inc. v. Esprit Fin., Inc.*, 981 S.W.2d 25, 30 (Tex. App.—San Antonio 1998, pet. dismissed w.o.j.); *Behring Intern., Inc. v. Greater Hous. Bank*, 662 S.W.2d 642, 649 (Tex. App.—Houston [1st Dist.] 1983, writ dismissed by agr.).

³⁹ *Gaines v. Kelly*, 235 S.W.3d 179, 182 (Tex. 2007). Despite repeated assertions of apparent authority's ties to estoppel, the standard formulations do not contain a requirement that the third party suffer a detriment. See, e.g., *Gaines*, 235 S.W.3d at 182. The omission of this element leaves the true theory in some doubt. Is it based on the principal's manifestation of consent to the third party, or is it based on the need to protect the third party from harm? The omission of detriment as an element points to consent as the true ground. Estoppel, on the other hand, traditionally requires a detriment, and is intended to prevent unfairness to the third party. See *David McDavid Nissan, Inc. v. Subaru of Am., Inc.*, 10 S.W.3d 56, 71 (Tex. App.—Dallas 1999) aff'd, 84 S.W.3d 212 (Tex. 2002). ("This doctrine applies where it would be unconscionable to allow a party to maintain a position inconsistent with one in which it acquiesced or from which it accepted a benefit."); *Hotel Longview v. Pittman*, 276 S.W.2d 915, 920 (Tex. Civ. App.—Texarkana 1955, writ ref'd n.r.e.) (requiring a showing of detriment to establish apparent agency based on estoppel).

⁴⁰ *Gaines*, 235 S.W.3d at 182; *Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 672 (Tex. 1998); *NationsBank, N.A. v. Dilling*, 922 S.W.2d 950, 952-53 (Tex. 1996).

⁴¹ See *Gaines*, 235 S.W.3d at 182.

⁴² See *Gaines*, 235 S.W.3d at 179, 182; *NationsBank, N.A.*, 922 S.W.2d at 952.

⁴³ *Gaines*, 235 S.W.3d at 182.



full knowledge of all material facts regarding its manifestation.⁴⁴

Both doctrines contain their own limitations. Both kinds of authority are limited by the content of the principal's manifestations. Actual authority is limited to that which is conferred on the agent by the principal.⁴⁵ Apparent authority is limited to "the scope of authority that is apparently authorized."⁴⁶

These principles have always been applied to Texas LLCs, which courts claim can serve as agents or principals. In *Aquaduct, L.L.C. v. McElhenie* (2003),⁴⁷ the McElhenies signed a note in favor of a vendor.⁴⁸ The vendor later transferred the note to Aquaduct, L.L.C. Aquaduct appointed Gibraltar Mortgage as its servicing agent for the note. Later, when the McElhenies refinanced, they sent Gibraltar a partial pay-off of the note.⁴⁹ Gibraltar registered the pay-off as a deposit to the LLC's account but never paid the LLC. Later, when Aquaduct sued on the note, the McElhenies claimed Aquaduct had been paid. The issue was whether Gibraltar as servicing agent was authorized to receive a pay-off of the loan.⁵⁰

The court treated the issue as a routine agency case. Citing the common law of agency, the court asked whether Gibraltar had actual or apparent authority to accept the partial pay-off on Aquaduct's behalf.⁵¹ After reviewing the evidence, the court affirmed that Gibraltar had implied actual authority to accept the payment.⁵² The court mentioned nothing unique about Aquaduct's status as a LLC. The court treated it as it would any other principal, whether business entity or natural person. No mention was made of the LLC's nature, and nothing appeared to depend on it.⁵³

In *Beckham Resources, Inc. v. Mantle Resources, L.L.C.* (2010),⁵⁴ Beckham claimed that Mantle was Beckham's agent and had breached fiduciary duties.⁵⁵ The court relied on the common law test for agency to determine that Mantle was not Beckham's agent: "[W]e fail to see how either of these facts prove that Mantle was transacting business for Beckham or that Beckham was exercising control over or directing the actions of Mantle, which is the fundamental test of agency."⁵⁶

⁴⁴ See *Gaines*, 235 S.W.3d at 183-84; *Sw. Title Ins. Co. v. Northland Bldg. Corp.*, 552 S.W.2d 425, 428 (Tex. 1977).

⁴⁵ See *Ins. Co. of N. Am.*, 981 S.W.2d at 672.

⁴⁶ *First Valley Bank of Los Fresnos v. Martin*, 144 S.W.3d 466, 471 (Tex. 2004); *Ins. Co. of N. Am.* at 672-73; *NationsBank, N.A.* 922 S.W.2d, at 952.

⁴⁷ *Aquaduct*, 116 S.W.3d 438.

⁴⁸ *Id.* at 440.

⁴⁹ *Id.* at 441.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Aquaduct*, 116 S.W.3d at 441-42.

⁵³ *Id.* at 440-43.

⁵⁴ *Beckham Res., Inc. v. Mantle Res., L.L.C.*, 13-09-00083-CV, 2010 WL 672880 (Tex. App.—Corpus Christi Feb. 25, 2010, pet. denied).

⁵⁵ *Id.* at *10.

⁵⁶ *Id.* at *12; see also *Id.* at *10-11.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 39

The same common law of agency that applies to corporations applies to LLCs.⁵⁷ In *In re Credit Suisse First Boston Mortgage Capital, L.L.C.* (2008),⁵⁸ the court had to decide whether a jury trial waiver extended to a nonsignatory "on the basis of agency principles."⁵⁹ Both the alleged principal and the alleged agent in the case were LLCs. Citing the practical reality that "corporations can act only through [their] agents and employees,"⁶⁰ the court examined only the most common of agency principles: actual and apparent authority.⁶¹ The court even referred to the two LLCs as "two corporations."⁶² Clearly the court understood that the two types of entities are treated identically for purposes of agency issues.

In *Preferred Fuel Distributors v. Amidhara, LLC, et al.* (2010),⁶³ the plaintiff complained that agents of Panamerican, LLC, had committed fraud.⁶⁴ The court found evidence of a false statement made by Panamerican, LLC's president with respect to a transaction later memorialized in a contract that Panamerican's president signed for the LLC. The court did not discuss at length whether the LLC was responsible for the president's statements. Instead, it cited a few cases involving corporations that indicated the common law of agency would apply.⁶⁵ More directly, the court included in a parenthetical after one of those cases that "a principal may be vicariously liable for the fraudulent conduct of its agent if the agent acted with actual or apparent authority."⁶⁶ Apparently on this citation alone, the court reversed a summary judgment for Panamerican, LLC, and held it subject to trial along with its agent.⁶⁷

The Texas common law of agency has thus been applied to LLCs as it has to other business entities and also to individuals. Nothing unique about the LLC has been recognized by Texas courts as calling for any special treatment. Yet, this is what the language of the statute demands.

⁵⁷ See, e.g., *Sanchez v. Mulvaney*, 274 S.W.3d 708, 712 (Tex. App.—San Antonio 2008, no pet.); *In re Credit Suisse First Boston Mortgage Capital, L.L.C.*, 273 S.W.3d 843 (Tex. App.—Houston [14th Dist.] 2008, no pet.).

⁵⁸ *In re Credit Suisse First Boston Mortgage Capital, L.L.C.*, 273 S.W.3d 843 (Tex. App.—Houston [14th Dist.] 2008, no pet.).

⁵⁹ *Id.* at 845.

⁶⁰ *Id.* at 849 (citing *GTE Sw., Inc. v. Bruce*, 998 S.W.2d 605, 618 (Tex. 1998)).

⁶¹ *In re Credit Suisse First Boston Mortgage Capital, L.L.C.*, 273 S.W.3d at 850.

⁶² *Id.*; see also *Sanchez*, 274 S.W.3d at 712 (opining in a case dealing only with an LLC that a "corporation's agent is personally liable for his own fraudulent or tortious conduct, even when acting within the course and scope of his employment").

⁶³ *Preferred Fuel Distribs., L.P. v. Amidhara, L.L.C.*, 10-08-00122-CV, 2010 WL 139308 (Tex. App.—Waco, Jan. 13, 2010, no pet.).

⁶⁴ *Id.* at *6.

⁶⁵ *Id.* at *7 (citing *NationsBank v. Dilling*, 922 S.W.2d 950 (Tex. 1996), and *Kingston v. Helm*, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2002, pet. denied)).

⁶⁶ *Id.* at *7 (citing *NationsBank*, 922 S.W.2d at 952-53).

⁶⁷ *Id.* at *9.

B. How the Statute Changes the Common Law

The statute now in the TBOC addressing agents of the LLC changes the common law. The statute reads as follows:

(a) Except as provided by this title and Title 1, each governing person of a limited liability company and each officer or agent of a limited liability company vested with actual or apparent authority by the governing authority of the company is an agent of the company for purposes of carrying out the company's business.

(b) An act committed by an agent of a limited liability company described by Subsection (a) for the purpose of apparently carrying out the ordinary course of business of the company, including the execution of an instrument, document, mortgage, or conveyance in the name of the company, binds the company unless:

(1) the agent does not have actual authority to act for the company; and

(2) the person with whom the agent is dealing has knowledge of the agent's lack of actual authority.

(c) An act committed by an agent of a limited liability company described by Subsection (a) that is not apparently for carrying out the ordinary course of business of the company binds the company only if the act is authorized in accordance with this title.⁶⁸

The difficulties the statute creates are catalogued in the sections that follow, which describe each subsection specifically.

1. Subsection (a): Delimiting Authority

The statute's message for agents in subsection (a) can be clarified if the language about only governing persons and officers of LLCs is discarded. Then section (a) of the statute reads as follows:

(a) ... [E]ach ... agent of a limited liability company vested with actual or apparent authority by the governing authority of the company is an agent of the company for purposes of carrying out the company's business.

⁶⁸ TEX. BUS. ORGS. CODE ANN. §101.254 (Vernon 2011).

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 41

What could be the purpose of such a provision? The language of the statute broadens the scope of each agent's authority. Under the common law, an agent vested with actual authority by an LLC's governing authority is an agent for purposes of carrying out that actual authority. The agent's authority is limited to what is authorized.⁶⁹ Thus, the LLC's real estate agent is empowered to look for property for the LLC, but not to sign a contract, execute a mortgage, or direct the employees. The LLC's lawyer is also supposed to have a limited role. So are the common employees. They may even drive the pizza delivery vehicle and be servants (which are a subset of agents⁷⁰) able to bind the LLC to tort liability. No one with common sense would suppose such persons to have broad authority within the business.

The statute describes their authority much more broadly. According to the statute's language, each such agent is "an agent of the company for purposes of carrying out the company's business." "[T]he company's business" is as broad as the business is broad. Agency limited only by that purpose includes everything the LLC does within the scope of its general powers⁷¹ and the purpose designated in its certificate of formation,⁷² which could include "any lawful purpose" for an LLC.⁷³ If this is the meaning of the clause, then appointing an agent is a dangerous act. Giving any agent actual authority makes them the LLC's agent for all of the company's business, just as any manager! Why else would the statute use the same language to describe both the authority of managers and the authority of all other agents? Creating apparent authority is even more hazardous. A person does not even need to be an agent to carry

⁶⁹ Ins. Co. of N. Am., 981 S.W.2d at 672.

⁷⁰ See Am. Nat. Ins. Co. v. Denke, 95 S.W.2d 370, 372-73 (Tex. Comm'n 1936) (adopting as law the following language from the Comment (a) to Section 250 of the Restatement of the Law of Agency: "It is only when to the relationship of principal and agent there is added that right to control physical details as to the manner of performance which is characteristic of the relationship of master and servant, that the person in whose service the act is done becomes subject to liability for the physical conduct of the actor"); Stapp Drilling Co. v. Roberts, 471 S.W.2d 131, 134 (Tex. Civ. App.—Corpus Christi 1971, writ ref'd n.r.e.) (same as *Denke*); Graham v. McCord, 384 S.W.2d 897, 898-99 (Tex. Civ. App.—San Antonio 1964, no writ) (same as *Denke*); Sartain v. S. Nat. Life Ins. Co., 364 S.W.2d 245, 250 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.) (same as *Denke*); Walter Irvin, Inc. v. Vogel, 158 S.W.2d 93, 96-97 (Tex. Civ. App.—Amarillo 1942, writ ref'd w.o.m.) ("The true test in all of the cases on this question seems to be that in order to hold the principal liable it is not sufficient that he be interested only in the ultimate results to be accomplished by his representative, but he must also have the right to control the *physical details as to the manner of the performance* of the work."); Am. Nat. Ins. Co. v. Kennedy, 101 S.W.2d 825, 827-28 (Tex. Civ. App. 1937) *modified*, 107 S.W.2d 364 (Tex. 1937) (same as *Denke*). In other words, a servant is an agent subject also to the principal's control with regard to the physical details of the manner of performance. *But see* Ackley v. State, 592 S.W.2d 606, 608 (Tex. Crim. App. 1980) (stating in dicta that an agent is employed for contractual dealings but a servant is not, and generally treating them as different categories). *Ackley* cited as authority for this distinction Gibson v. Gillette Motor Transp., 138 S.W.2d 293, 294 (Tex. Civ. App.—Eastland 1940, writ ref'd). *Gibson* does not make an explicit distinction between agent and servant. *Ackley* was apparently trying to make sense of the following two sentences from *Gibson*: "There was no evidence to show that Miller was an agent. The evidence does show that Miller was an employee and that his duties were such as to make him a servant." *Id.* If a servant is an agent, the sentences must be incorrect. I suggest that the *Gibson* court meant to suggest that Miller had no actual authority. A servant needs no actual authority to bind its master to tort liability, however. There is also an old line of cases regarding workers' compensation that in defining *independent contractor* talks in dicta as if principal and agent and master and servant are separate categories. *Century Indem. Co. v. Carnes*, 138 S.W.2d 555, 556 (Tex. Civ. App.—Fort Worth 1940, writ dism'd judgm't cor.), is typical.

⁷¹ See TEX. BUS. ORGS. CODE ANN. § 2.101 (Vernon 2011).

⁷² See TEX. BUS. ORGS. CODE ANN. § 3.005(a)(3) (Vernon 2011).

⁷³ *Id.*



apparent authority.⁷⁴ Thus, the statute may have the effect of making someone who would otherwise not be an agent at all an agent for all of the LLC's business!

This would be an unfortunate effect, but that appears to be the language's meaning. The language is borrowed from the general partnership code, which has long provided that "[e]ach partner is an agent of the partnership for the purpose of its business."⁷⁵ With regard to a general partner, such a provision is justified in part because "[e]ach partner has equal rights in the management and conduct of the business of a partnership."⁷⁶ Each partner is thus a principal in the business—a manager. That is why each general partner is appropriately designated by the code as a "governing person."⁷⁷ A general partner is also an owner of the general partnership.⁷⁸ As owner, principal, and manager, a general partner is a general agent for purposes of the partnership's business—in fact, under agency principles, the general partner has power to designate herself as such. Thus, the language in the partnership code correctly designates each partner "an agent of the partnership for the purpose of its business."⁷⁹ This language means that, "[a]s a general rule, each partner ... is empowered to bind the partnership in the normal conduct of its business."⁸⁰ This conclusion follows from the partner's position as owner and manager of the general partnership. This result is consistent with the common law of agency.⁸¹

In the LLC context, the "purpose of its business" language has been construed to mean something similar to its meaning in the partnership code with respect to a manager of a LLC. In *EZ Auto, L.L.C. v. H.M. Jr. Auto Sales*,⁸² the initial manager of EZ Auto, Marks, bought four cars from H.M. Auto Sales (H.M.).⁸³ When the draft written to pay for the third car was returned unpaid, Marks explained that EZ was having trouble with its bank account and offered a personal check.⁸⁴ Marks also paid for the fourth vehicle with a personal check, essentially a loan by Marks to EZ.⁸⁵ The title to this fourth vehicle was transferred to EZ, and

⁷⁴ A person with apparent authority need not be an agent because nothing in the doctrine of apparent authority requires that the so-called "apparent agent" act on the principal's behalf and subject to its control.

⁷⁵ TEX. BUS. ORGS. CODE ANN. § 152.301 (Vernon 2011). TEX. BUS. ORGS. CODE ANN. § 152.301 (Vernon 2011); see, e.g., Vernon's Ann. Tex. Civ. St. Art. 6132b, § 9 (1962); see also Uniform Partnership Act § 9 (1914) ("Every partner is an agent of the partnership for the purpose of its business.").

⁷⁶ TEX. BUS. ORGS. CODE ANN. § 152.203(a) (Vernon 2011).

⁷⁷ See *id.* § 1.002(35)(A) & § 1.002(37).

⁷⁸ See *id.* § 152.051(b).

⁷⁹ See *id.* § 152.301.

⁸⁰ *Long v. Lopez*, 115 S.W.3d 221, 226 (Tex. App.—Fort Worth 2003, no pet.) (citing Texas Revised Uniform Partnership Act Art. 6132b-3.02(a)); see also *In re Hawthorne Townhomes, L.P.*, 282 S.W.3d 131, 139 (Tex. App.—Dallas 2009, no pet.) (finding on this same language that the general partner of a limited partnership was the agent of the partners).

⁸¹ *Cook v. Brundidge, Fountain, Elliott & Churchill*, 533 S.W.2d 751, 757-58 (Tex. 1976) (resting on both the statutory language and the common law to determine that "[t]he extent of authority of a partner is determined essentially by the same principles as those measuring the scope of the authority of an agent").

⁸² *EZ Auto, L.L.C. v. H.M. Jr. Auto Sales*, 2002 WL 1758315, Opinion (Tex. Civ. App.—San Antonio, July 31, 2002).

⁸³ *Id.* at *1.

⁸⁴ *Id.*

⁸⁵ *Id.* at *2.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 43

later EZ sold the vehicle to a third party.⁸⁶ After Marks's last check was returned unpaid for insufficient funds, H.M. sued EZ for the price of the car. At issue was whether Marks was the agent of EZ.

The court initially cited common law principles of actual and apparent authority.⁸⁷ The rule it followed, however, was the predecessor to TBOC § 101.254, which said that "each manager of a limited liability company whose management is vested in managers is an agent of the limited liability company for purposes of its business."⁸⁸ The court noted also that EZ's articles of organization provided that "any one manager may act on behalf of EZ."⁸⁹ On these grounds, the court concluded that Marks as manager had actual authority.⁹⁰ Either the statute, on the one hand, or the articles of organization and the common law of agency, on the other, support such a conclusion. The court seemed to see no difference resulting from applying either. Both independently show that Marks had actual authority to act for the LLC in the conduct of its business. The language in the code specifies the authority of a manager.

That is why using the same language to describe the authority of all agents or "apparent agents" of a LLC is such a serious problem. Should this language apply to a non-partner, non-manager agent? Should each real estate agent, lawyer, and pizza delivery driver hired by an LLC have the authority of a LLC manager? Surely not. Moreover, there is no reason in fact or law to deprive the LLC's management of the capacity to appoint an agent with limited authority, nor does a need exist to say that, if an agent is apparently authorized for a single purpose, it is authorized for all purposes. Yet the statute says flatly that an agent or apparent agent is an agent of the LLC "for purposes of carrying out the company's business,"⁹¹ just as if each such agent or apparent agent was a manager of the LLC.

Perhaps all is not lost. The TBOC recognizes that its default provisions might not be for everyone and allows them to be superseded by agreement of the LLC members.⁹² On the other hand, in the absence of agreement, the code provisions apply,⁹³ so agents' authority will have to be limited by affirmative agreement, a tedious chore that would be unnecessary if common law agents had not been included in this provision. Furthermore, it is not clear why (or whether) an agreement of the LLC members should be able to supersede the authority of an apparent agent. Allowing an agreement between LLC members to limit the authority of an apparent agent essentially allows principals of an LLC to mislead third parties with impunity. On the other hand, the authority named in subsection (a) is not apparent but actual authority, so perhaps this does not matter (the rest of section 101.254 probably abrogates apparent authority, anyway⁹⁴).

⁸⁶ *Id.* at *2

⁸⁷ EZ Auto, L.L.C., at *2-3.

⁸⁸ Texas Limited Liability Company Act, Art. 1528n, art. 2.21B (Vernon 1997).

⁸⁹ EZ Auto, L.L.C., at *3.

⁹⁰ *Id.*

⁹¹ TEX. BUS. ORGS. CODE ANN. § 101.254(a) (Vernon 2010).

⁹² *See id.* § 101.052.

⁹³ *See id.* § 101.052(b).

⁹⁴ *See infra* Parts II.B.2 & II.B.3.

If giving all agents the authority of a manager is not what the code drafters were trying to do, I confess to ignorance as to why they used language that appears to reach that result. I have only been able to think of one other possible reason for lumping all agents in with others such as managers who are clearly general agents of the LLC for its broad business purposes. Perhaps the drafters meant merely to define a term *agent* for purposes of subsections (b) and (c). Both subsections (b) and (c) begin with a reference to "an agent ... described in Subsection (a)."⁹⁵ Some definition was necessary. The difficulty with this rationale is that subsection (a) could perform this function without its final clause that empowers agents so broadly: "for purposes of carrying out the company's business." If that clause were omitted from (a), subsection (a) would then say, merely, "[E]ach ... agent of a limited liability company vested with actual or apparent authority ... is an agent of the company."⁹⁶ This would be tautological in the case of actual agents, but the definitional function of subsection (a) would be clear, as no language in subsection (a) would have any other substantive effect than to define the word *agent* as used technically in the rest of the statute. Unfortunately, this rationale therefore renders the final clause of subsection (a) superfluous, and is not a plausible construction of the statute. Subsection (a) appears to have the effect outlined above: all agents, including apparent agents, have authority equal to that of a manager.

ii. Subsection (b): A Third Theory of Authority (and NOT a Useful One)

Section (b) follows. Please consider while reading it that it applies to common agents of a LLC and also those who have only apparent authority.

(b) An act committed by an agent of a limited liability company described by Subsection (a) for the purpose of apparently carrying out the ordinary course of business of the company, including the execution of an instrument, document, mortgage, or conveyance in the name of the company, binds the company unless:

- (1) the agent does not have actual authority to act for the company; and
- (2) the person with whom the agent is dealing has knowledge of the agent's lack of actual authority.⁹⁷

Describing the meaning of this odd provision requires some explanation. First, it is clear that this provision is not a codification of, and in fact has nothing to do with, apparent authority. As stated earlier, apparent authority arises from the principal's manifestations of intent to a third party that a person is authorized as the principal's agent.⁹⁸ The third person must actually believe, reasonably, as a consequence of the principal's manifestation, that the "apparent agent" was authorized.⁹⁹

⁹⁵ TEX. BUS. ORGS. CODE ANN. § 101.254(b) & (c) (Vernon 2010).

⁹⁶ See *id.* § 101.254(a).

⁹⁷ See *id.* § 101.254(b).

⁹⁸ *Gaines*, 235 S.W.3d at 182; *Ins. Co. of N. Am.*, 981 S.W.2d at 672; *NationsBank, N.A.*, 922 S.W.2d at 952-53.

⁹⁹ *Gaines*, 235 S.W.3d at 182.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 45

This section is inconsistent with apparent authority in several ways. Authority under the statute is established without a showing that anyone—governing person, manager, member—made a manifestation. Nor does the statute require that the third party form a reasonable belief. In fact, the third party's belief is not relevant at all under the statute. It is possible, in fact, that the third party unreasonably believe that the agent is authorized, and the section might still apply to give that agent authority, as long as the requisite act occurred. All that need be shown is that a person named in subsection (a) did an act that fits the description in (b). As long as the third party did not know—not merely believe, reasonably or unreasonably—that the agent was not authorized, the agent will still have authority under the statute even if it lacked actual authority. Clearly what the statute describes is not apparent authority.

If that were not clear enough, the mere presence of element (2) in the exception to subsection (b) also proves that what the section describes is not apparent authority. For apparent authority to exist, the third person must actually believe that the "apparent agent" is authorized, so no apparent authority could exist if (b)(2) applied. The language of (b)(2) negates apparent authority. Thus, if what section (2) described was apparent authority, no one could ever get to (b)(2). Section (b)(2) would be superfluous. Section (b) would only apply if that kind of knowledge were absent. The presence of (b)(2) thus proves that subsection (b) does not describe apparent authority.

Stated another way, an exception cannot entirely negate that to which it is an exception. If it did, then it would not be an exception but a part of the general rule. If the theory of subsection (b) is apparent authority, then that theory is fully stated in the words "for the purposes of apparently carrying out the ordinary course of business of the company." Nothing more could be needed to say it, as those are all the relevant words available in the subsection. Clause (b)(2) is phrased as an exception, but in fact the knowledge of the third person that an "apparent agent" is not authorized would mean that no apparent authority existed. If the third person knew such a thing, there would be no apparent authority left for which clause (b)(2) could be an exception. It follows that section (b) is not talking about apparent authority.

If subsection (b)'s theory is not apparent authority, then what is it? Section (b) actually extends to the agents of LLCs a theory of agency found in the general partnership code, which is (as it was for subsection (a)) the source of this language. The partnership code provides,

Unless a partner does not have authority to act for the partnership in a particular matter and the person with whom the partner is dealing knows that the partner lacks authority, an act of a partner, including the execution of an instrument in the partnership name, binds the partnership if the act is apparently for carrying on in the ordinary course: (1) the partnership business; or (2) business of the kind carried on by the partnership.¹⁰⁰

Here as well, and for the same reasons, this clause cannot logically purport to bind partnerships under the common law doctrine of apparent authority. Instead, this language is, like the lan-

¹⁰⁰ TEX. BUS. ORGS. CODE ANN. § 152.302(a) (Vernon 2010).



guage similar to that in subsection (a), meant to take account of a general partner's particular status as owner, manager, and principal of a partnership. Such a manager and general agent of a partnership has power herself to determine the scope of the partnership's business and to appoint agents to carry it forward. Such an agent's power need not be tied to the reasonable belief of the third party. Thus, when a Texas Court of Appeals looked at this corresponding partnership code provision, in *Burns v. Gonzalez*,¹⁰¹ though the court talked a bit about apparent authority, the court concluded that the "apparently for carrying on" language required a look not at what the principal had done, or what the other party to the transaction reasonably or unreasonably thought, but at what was apparent to the court, or a disinterested onlooker.¹⁰² That is a reasonable construction of a statute that is not simply a codification of the doctrine of apparent authority.¹⁰³

The theory described in section 101.254(b), like the one espoused in *Burns*, does not mention the principal at all, nor does it depend on the principal holding out the agent as having authority. Nor does it require the reasonable belief of a third party. Instead, liability appears to depend on the circumstances of the business and the transaction, something quite beyond the governing authority's control and beyond the needs of the third party. It is not actual authority, and it is not apparent authority. It threatens to reach beyond what the LLC can control. It also applies even when an ignorant third party unreasonably believes that an agent is authorized, thus rewarding ignorance. Whatever reasons may support its existence for partners, or perhaps for LLC managers and officers, it should not be allowed to displace the common law of agency that the courts, quite rightly as a matter of policy, believe apply to LLCs.

iii. Subsection (c): The End of the Common Law of Agency for LLCs

Whereas subsection (b) attempts to promulgate an additional theory of liability for businesses, in addition to the common law of agency, subsection (c) attempts to limit the law of agency to only two theories: that found in (b) and a theory of actual authority named in the statute. Subsection (c) states:

¹⁰¹ *Burns v. Gonzalez*, 439 S.W.2d 128 (Tex. Civ. App.—San Antonio 1969, writ ref'd n.r.e.).

¹⁰² *Id.* at 132-34. In *Burns*, a partnership had signed a contract conveying to a third party a right to broadcast time on a radio station. The partnership's sole business was selling broadcast time on that single radio station. *Id.* at 129. When the station went off the air for several months, the partners tried to settle with disgruntled advertisers. *Id.* at 130. Burns was a disgruntled advertiser. One of the partners, Bosquez, signed a note to Burns for \$20,000 to compensate Burns for the deprivation of broadcast time. *Id.* Settling with disgruntled advertisers seems like just the thing a partnership devoted to selling advertising on a radio station would do if the station went off the air. But the court never asked whether Burns reasonably thought Bosquez by virtue of his position as a partner was apparently authorized to sign the note. *Id.* at 132-34. Instead, it asked whether partnerships generally engaged in selling ad time on the radio regularly signed notes, like "trading partnerships." *Id.* Of course, they did not, and Burns was unable to recover. I am indebted to Professor Gary Rosin for calling *Burns* to my attention.

¹⁰³ The Texas Supreme Court looked at this provision later, in *Cook*, 533 S.W.2d at 758, and said, after citing *Burns*, "The extent of authority of a partner is determined essentially by the same principles as those measuring the scope of the authority of an agent." *Id.* at 758 (reciting section 9 of the Uniform Partnership Act (1914), which was Texas law at the time and was the pattern for TBOC § 152.302(a)). The court never noted the illogic of that statement as a construction of the statute, which it had just cited. To make matters worse, the *Cook* court found that the partner at issue had no authority under either theory, *id.* at 758-59, so the statement is essentially dicta. This area of the law is not fully consistent with applicable statutes.

(c) An act committed by an agent of a limited liability company described by Subsection (a) that is not apparently for carrying out the ordinary course of business of the company binds the company only if the act is authorized in accordance with this title.¹⁰⁴

The obvious effect of this section is to limit liability to subsection (b) and the theory of actual authority set out in subsection (c). The language "that is not apparently for carrying out the ordinary course of business of the company" is an obvious reference to subsection (b). The section sets out only two alternatives. An act not binding under subsection (b) is binding "only if" it is authorized in accordance with Title 3, which contains provisions addressing only limited liability companies. Thus, subsection (c) limits liability to two theories: that in subsection (b) and actual authority. Because the theory set forth in subsection (b) is not apparent authority, subsection (c) requires that the theory of apparent authority be abandoned in the LLC context. LLCs are not bound by apparent authority.

This seems at first a very odd result, especially since subsection (a) refers to agents "vested with ... apparent authority."¹⁰⁵ However, at least the statute is consistent. Subsection (a) in fact says of agents vested with apparent authority that each is in fact "an agent of the company for purposes of carrying out the company's business."¹⁰⁶ Subsection (a) thus also discards the doctrine of apparent authority, with its limitations, and instead empowers "apparent agents" with actual authority broadly to carry out the company's business, as discussed previously.¹⁰⁷ Since subsection (a) replaces the apparent authority of "apparent agents" with a broader grant of actual authority, the doctrine of apparent authority is unnecessary to bind a LLC.

Subsection (c) on its face has other, broader consequences, however. As discussed previously, servants are agents.¹⁰⁸ If subsection (c) limits the liability of the LLC to the theory in subsection (b) and actual authority, liability under respondeat superior is also abrogated. I think that would be a ludicrous result, and I seriously doubt any Texas court would reach that conclusion, but when the language of the statute plainly reaches it, and a court in order to reach a sensible result has to depart from the statute's plain language, it is evidence that the statute needs to be reworked.

C. If Agents Were Omitted

To resolve the foregoing difficulties, I recommend omitting agents from section 101.254. Merely removing the phrase "or agent" from section 101.254(a) would have the desired effect. The statute would no longer displace agency law, and agents of LLCs would go back to being treated like agents of other business entities.

The section would still not be perfect. One would have to explain why managers and

¹⁰⁴ TEX. BUS. ORGS. CODE ANN. § 101.254(c) (Vernon 2010).

¹⁰⁵ See *id.* § 101.254(a).

¹⁰⁶ *Id.*

¹⁰⁷ See *supra* Part II.A.

¹⁰⁸ See *supra* note 70.



officers of LLCs could not be liable under apparent authority, but the statute would cause no more potential confusion in that regard than the statute applicable to partners, section 152.302, as explained above, which also adopts liability for "apparently ... carrying on," a theory that appears to depart from the common law's doctrine of apparent authority.¹⁰⁹ Resolving that confusion further in the LLC and partnership codes might require more amending. But at least agents should be cut out and sent back to the common law of agency.

III. VEIL PIERCING

The LLC code seems quite clear on the issue of members' liability for the obligations of the LLC:

Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability of a limited liability company¹¹⁰

This section does not protect individuals acting within or for a LLC from their own individual liability.¹¹¹ Rather, this sentence holds merely that the liability of the LLC will not be placed on a member or manager. This seemingly simple sentence does not tell the whole story, though. The corporate code has long provided that shareholders also are not liable for the debts and obligations of corporations, and that has not stopped courts from "piercing the corporate veil" and imposing corporate liability on shareholders notwithstanding.¹¹² Courts have held that an LLC's veil can also be pierced.¹¹³

A variety of rationales support imposing, in appropriate circumstances, entity liability on those who control the entity. I have two favorite rationales, for which I have never heard good counter-arguments. First of all, a rule should not be construed to reach absurd results.¹¹⁴ When a person controlling a limited liability entity places liability exclusively in the entity in order to enable the controller to commit a fraud, the rule shielding the controller from that liability is absurd and should be discarded. The Texas Supreme Court recently affirmed this rationale for veil piercing when it listed the "kinds of abuse ... that the corporate structure should

¹⁰⁹ See *supra* Part II.B.

¹¹⁰ TEX. BUS. ORGS. CODE ANN. § 101.114 (Vernon 2010).

¹¹¹ Sanchez, 274 S.W.3d at 712 ("The issue of a defendant's liability in his individual capacity is distinct from that of his liability under an alter ego theory."); see also Miller v. Keyser, 90 S.W.3d 712, 717 (Tex. 2002) ("[A] corporate agent is personally liable for his own fraudulent or tortious acts.").

¹¹² See, e.g., Robert W. Hamilton, Elizabeth S. Miller & Robert A. Ragazzo, 20 Texas Practice Series § 26.11 et seq. (2004).

¹¹³ See, e.g., *id.* at § 20.7; *infra* note 119.

¹¹⁴ See Witherspoon v. Jernigan, 76 S.W. 445, 447 (Tex. 1903) ("When a literal interpretation of the language used would produce an absurdity, the court will restrict or enlarge the text so as to conform to the general purposes and intent of the Legislature."); Korndorffer v. Baker, 976 S.W.2d 696, 700 (Tex. App.—Houston [1st Dist.] 1997, pet. dismissed w.o.j.) ("[W]here the application of the statute's plain language would lead to absurd consequences that the legislature could not have possibly intended, we will not apply the statutory language literally."); see also, e.g., Sharp v. House of Lloyd, Inc., 815 S.W.2d 245, 249 (Tex. 1991); see also, e.g., V.T.C.A., Government Code § 311.021 (2010) ("In enacting a statute, it is presumed that ... a just and reasonable result is intended."), made applicable to TBOC § 101.113 by TBOC § 1.051 (2010).

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 49

not shield."¹¹⁵ The first item on the list was "fraud."¹¹⁶

Second, business entities may convey away assets in exchange for less than reasonably equivalent value. This is the kind of activity that fraudulent transfer laws¹¹⁷ are supposed to stop, but those laws may not work very well against certain business entities. These entities cannot be put on the stand and cross-examined. They are only what their controllers make of them. Their controllers keep records, or they do not. If no or inadequate records exist, then proving that a conveyance occurred at all could be difficult, and the details of numerous fraudulent conveyances may be lost. Assets may be moved, business opportunities shifted to new entities with the same or similar owners, taxes paid or not, costs and employees paid by one entity or the other, and so on—and all potential evidence of wrongdoing is in the hands of the person controlling the entity, and that person has caused no documentation to be made. At some point, it is fair to hold that person liable for the entity's liability because the alternative would be that the person's sloppiness and negligence (or perhaps intent to hide wrongdoing) would place the entities themselves entirely beyond the law. Small wonder that the Texas Supreme Court listed next after fraud, in its list of abuses that the corporate veil should not shield, "evasion of existing obligations."¹¹⁸

The chapter of the TBOC that contains provisions that apply to LLCs does not itself mention veil piercing doctrines, or anything other than the shield law cited at the beginning of this section. However, Texas courts have agreed that veil piercing doctrine applies against LLC members.¹¹⁹ Inasmuch as any rule could have absurd applications and actually shield fraudulent conduct, and inasmuch as the LLC form could be abused as much as the corporate form, application of some veil piercing doctrine against certain LLC members and managers makes sense.

¹¹⁵ *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 455 (Tex. 2008).

¹¹⁶ *Id.* at 455; *id.* at 451 ("Examples are when the corporate structure has been abused to perpetrate a fraud").

¹¹⁷ *See, e.g., V.T.C.A., Bus. & C. T. 3, Ch. 24* (2010) (Uniform Fraudulent Transfer Act).

¹¹⁸ *SSP Partners*, 275 S.W. 3d at 455; *id.* at 451 ("Examples are when the corporate structure has been abused to ... evade an existing obligation"). Potential other abuses that the Texas Supreme Court cited to justify imposing liability on shareholders involve shareholders more directly: "circumvention of statutes, monopolization, criminal conduct." *Id.* at 455; *id.* at 451 ("achieve or perpetrate a monopoly, circumvent a statute, protect a crime, or justify wrong").

¹¹⁹ *In re Hous. Drywall, Inc.*, 05-95161-H4-7, 2008 WL 2754526, *32 (Bankr. S.D. Tex., July 10, 2008) (holding that a limited partnership and its general partner, an LLC, were a "sham corporation" and unable to shield the individual controlling them from personal liability); *Bramante v. McClain, Sr.*, CIVA SA-06-CA-0010 O, 2007 WL 4555943 (W.D. Tex. Dec. 18, 2007) (allowing a reverse veil piercing action to continue against an LLC and its owners); *DDH Aviation, L.L.C. v. Holly*, CIV .A3:02-CV-2598-P, 2005 WL 770595, **5-8, (N.D. Tex. Mar. 31, 2005) (allowing an alter ego claim against a LLC); *In re Moore*, 379 B.R. 284, 284 et seq. & 289 n.4 (Bankr. N.D. Tex. 2007) ("The court believes that whether a business enterprise is an LLC or a corporation is a distinction without a difference in this context."); *In re JNS Aviation, LLC*, 376 B.R. 500, 525-31 (Bankr.N.D.Tex. 2007); *Watkins v. Basurto*, 2011 WL 1414135 (Tex. App.—Houston [14th Dist.] Apr. 14, 2011); *Genssler v. Harris Cty.*, ___ S.W.3d ___, 2010 WL 3928550 ((Tex. App.—Houston [1st Dist.] Oct. 7, 2010); *Phillips v. B.R. Brick and Masonry, Inc.*, 01-09-00311-CV, 2010 WL 3564820 (Tex. App.—Houston [1st Dist.] Sept. 10, 2010, no pet.); *Sanchez*, 274 S.W.3d at 712; *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); *Pinebrook Props., Ltd. v. Brookhaven Lake Prop. Owners Ass'n*, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied) (dicta).

Just what veil piercing doctrine to apply is another matter.¹²⁰ Thus far, courts have imposed on LLC managers and members the same doctrines applicable to corporations.¹²¹ This is somewhat problematic in Texas, however. In Texas, the legislature in response to some loose language in a decision by the Texas Supreme Court in 1986, *Castleberry v. Branscum*,¹²² changed the common law's doctrine of veil piercing.¹²³ The statute passed in 1989 and amended in 1993 has a long and well-told history.¹²⁴ The statute was in fact poorly drafted and has been the source of controversy in judicial decisions since its passage,¹²⁵ as I discuss *infra*. My purpose is not to ask that it be re-drafted (though that is surely a good idea), but to ask whether it should be imposed on LLCs, too.

The answer to that question, thus far, appears to have been ... why not? The law has not progressed beyond asking that question. One thing the statute requires, in order to impose a contractual liability on shareholders, is a finding of actual fraud.¹²⁶ In the leading case, *McCarthy v. Wani Venture, A.S.*,¹²⁷ the trial court assumed the statute applied and presented the case to the jury on that assumption.¹²⁸ The jury found what the statute requires—actual fraud—and this was supported by the evidence.¹²⁹ The existence of actual fraud obviated the need to say whether application of the statute was really necessary. In *Sanchez v. Mulvaney*,¹³⁰ the court turned liability aside for failure to prove actual fraud, but this is because the entity was, the court said, a "limited liability corporation to which state law principles for piercing the corporate veil apply."¹³¹ The court failed to explain why a limited liability company is a corporation.

The courts are not alone. Professor Miller claims, speaking of the developments in *McCarthy* and *Sanchez*, "there is nothing to preclude a court from defining the standards in the LLC context consistently with the corporate statutes in Texas when defining how veil piercing should apply to LLCs as a matter of Texas common law."¹³² On policy, she reaches the same conclusion: "there does not appear to be any reason for the courts, when developing the Texas common law of LLC veil piercing, to adopt standards that explicitly provide less liability pro-

¹²⁰ The difficulty I describe here was also named in Elizabeth S. Miller, *Are There Limits on Limited Liability? Owner Liability Protection and Piercing the Veil of Texas Business Entities*, 43 Tex. J. Bus. L. 405, 416-26 (2009); Natalie Smeltzer, *Piercing the Veil of a Texas Limited Liability Company: How Limited Is Member Liability?*, 61 SMU L. Rev. 1663 (2008).

¹²¹ See *supra* cases cited note 119. To its credit, *Watkins*, 2011 WL 1414135, *8 n.15, reserves the question.

¹²² *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), *superseded in part by statute*, TEX. BUS. ORGS. CODE ANN. § 21.223 (Vernon 2010) (formerly Texas Business Corporations Act Art. 2.21).

¹²³ See Hamilton, Miller & Ragazzo, *supra* note 112, at § 26.16 et seq.

¹²⁴ See *id.* at § 26.11 et seq.

¹²⁵ See, e.g., *id.* at § 26.16 to 26.23.

¹²⁶ TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2) & (b) (Vernon 2010).

¹²⁷ *McCarthy*, 251 S.W.3d 573.

¹²⁸ *Id.* at 591.

¹²⁹ *Id.*

¹³⁰ *Sanchez*, 274 S.W.3d 708.

¹³¹ *Id.* at 712.

¹³² Miller, *supra* note 120, at 417; see also Hamilton, Miller & Ragazzo, *supra* note 112, at § 20.7 ("there is no apparent policy reason not to apply consistent standards"; "the standard set by [the corporate provision] ... would be appropriate in the context of LLCs").

tection for an LLC member than that available to a corporate shareholder."¹³³ But she provides no reasons why the statute should be imposed on LLCs and their members. For my part, I wish to suggest three reasons why not to impose this statute outside of its stated boundaries. These seem sufficient to me, and it is difficult to explain to students why no one has taken account of them.

A. The Code Says So

First, the Texas Business Organizations Code itself says that the statute's reach is limited. The reorganization of business entity statutes that became the Texas Business Organizations Code was conducted on a well-known principle: Those statutes that apply to all "domestic entities" (defined to include any entity "formed under" the code or "the internal affairs of which are governed by" the code¹³⁴) and foreign entities (formed under or governed in their internal affairs by the laws of other states¹³⁵) are included under the General Provisions, comprising Title 1.¹³⁶ Those provisions governing only specific kinds of domestic entities are set forth in other titles, one title each for each kind of entity. So Title 2 governs corporations. Title 3 governs LLCs. Lest there be any confusion, the TBOC specifically authorizes the citation of Title 2 and those provisions of Title 1 applicable to corporations as "the Texas Corporation Law."¹³⁷ The provisions of Title 3 and the provisions of Title 1 applicable to LLCs may be cited as "the Texas Limited Liability Company Law."¹³⁸

The code really does assert that its organization means something. Thus, it provides, "Each title of this code, other than this title [Title 1], applies to a different type of entity to the extent provided by that title." Thus, when Title 2's Chapter 21, which contains the limitation on veil piercing, provides, "This chapter applies only to a: (1) domestic for-profit corporation formed under this code, and (2) foreign for-profit corporation that is transacting business in this state," we should take that at face value. Title 2 thus applies only to for-profit corporations.

What does this provision of the statute mean if courts can, as Professor Miller says, develop the common law by applying statutes wherever they see no reason not to? To say, as Professor Miller does, that in applying the corporate veil-piercing limitation to LLCs the courts are only developing the common law reads these limiting provisions right out of the code. When the courts want to apply the Texas Limited Liability Company Law to a Texas LLC, they are applying the statute; when they want to apply the Texas Corporation Law to a Texas LLC, they are simply developing the common law? It's all too convenient, and it ignores the plain language of the code.

In fact, it also ignores changes to Texas limited liability company law that have occurred over time. A provision of the Texas Limited Liability Company Act as passed in 1991

¹³³ Miller, *supra* note 120, at 418.

¹³⁴ TEX. BUS. ORGS. CODE ANN. § 1.002(17) & (18) (Vernon 2010).

¹³⁵ See *id.* § 1.002(27).

¹³⁶ See *id.* § 1.106(a).

¹³⁷ See *id.* § 1.008(b).

¹³⁸ See *id.* § 1.008(e).

provided,

To the extent this Act contains no provision with respect to one of the matters provided for in the TBCA or the Texas Miscellaneous Corporation Laws Act as such acts shall be amended from time to time, the provisions of the TBCA and the Texas Miscellaneous Corporation Laws Act shall supplement the provisions of this Act to the extent they are not inconsistent with the provisions of this Act.¹³⁹

This statute might well have mandated that the Texas Business Corporation Act's veil-piercing statute¹⁴⁰ be applied to LLCs. However, two years later, this provision of the Texas LLC Act was amended to name specifically only certain provisions of the TBCA that would apply to LLCs.¹⁴¹ The corporate veil-piercing statute, which was amended in *the same bill*,¹⁴² was omitted from the list.¹⁴³ This legislative move is a clear rejection of the general application of corporate statutes to LLCs, and a specific rejection of the application of the corporate veil-piercing statute to LLCs. Later, when the TBOC was passed, the legislature again omitted the veil-piercing statute from the Texas Limited Liability Company Law.¹⁴⁴

Not only is the export of corporate provisions to other entities forbidden by the code, it not a good idea, generally. Each entity is designed specifically by the legislature with attributes that enhance its function and value. For example, it is not uncommon to set up an LLC with something like a corporate structure. The managers or members who are to manage might in the company agreement be called a board. Under the LLC statutes, if the LLC has managers, those managers—the board—are the LLC's governing authority.¹⁴⁵ The code directs that the governing authority "shall manage the business and affairs of the company."¹⁴⁶ A majority of this board constitute a quorum.¹⁴⁷ The affirmative vote a majority of the board pre-

¹³⁹ Texas Limited Liability Company Act Art. 1528n, Art. 8.12; Acts 1991, 72nd Leg., ch. 901, § 46, eff. Aug. 26, 1991.

¹⁴⁰ The provision was then codified at Texas Business Corporation Act Art. 2.21 (1990); Acts 1989, 71st Leg., ch. 801, § 7, eff. Aug. 28, 1989.

¹⁴¹ See Texas Business Corporation Act Art. 8.12 (1992); Acts 1993, 73rd Leg., ch. 215, § 1.25, eff. Sept. 1, 1993.

¹⁴² See Acts 1993, 73rd Leg., ch. 215, § 2.05, eff. Sept. 1, 1993.

¹⁴³ See *id.* The Bill Analysis for Acts 1993, 73rd Leg., ch. 215, § 1.25, states that the amendment "[p]rovides specificity as to the incorporation of certain provisions of the TBCA and Texas Miscellaneous Corporation Laws Act." Bill Analysis, HB 1239, *codified at* Acts 1993, 73rd Leg., ch. 215, *available at* <http://www.lrl.state.tx.us/legis/billsearch/text.cfm?legSession=73-0&billtypeDetail=HB&billNumberDetail=1239&billSuffix=&startRow=1&IDlist=&unClicklist=&number=100>. This change was noted at Hamilton, Mill, & Ragazzo, *supra* note 112, at § 20.7 n.4.

¹⁴⁴ The TBOC drafters omitted from the Texas Limited Liability Company Law a provision similar to TLLCA § 8.04, which incorporated explicitly named provisions of the TBCA. Instead, the TBOC made those provisions of the TBCA applicable to LLCs by placing the substantive elements of those TBCA provisions in Title 1 of the TBCA. See, e.g., Texas Corporation and Partnership Laws XXXIX (West 2010) (a disposition table showing where the substantive provisions former located in 8.04 can now be located: all but those pertaining to derivative actions can be found in Title 1).

¹⁴⁵ TEX. BUS. ORGS. CODE ANN. § 101.251 (Vernon 2010).

¹⁴⁶ See *id.* § 101.252.

¹⁴⁷ See *id.* § 101.353.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 53

sent at a meeting at which a quorum is present constitutes an act of the governing authority.¹⁴⁸ These provisions all have corporate analogs. The board is the corporation's governing authority.¹⁴⁹ A majority of the board constitutes a quorum.¹⁵⁰ The affirmative vote of a majority of the board present at a meeting at which a quorum is present constitutes an act of the board.¹⁵¹

To some extent, both LLC provisions and corporate provisions are variable by contract.¹⁵² The corporate code provisions allowing different percentages of attending board members to form a quorum is limited, however; it may be no less than one-third of the number of board members.¹⁵³ Likewise, the minimum number of directors of a quorum who must vote for something may also be varied, but only by increasing it.¹⁵⁴ The number cannot be lowered. Surely these are wise limitations. Requiring that at least a third of board members meet in order to do business ensures that some deliberation takes place. Requiring at least a majority of a quorum to sign onto decisions makes it more probable that decisions are rational. But the LLC code contains no such limitations. No statute I have found limits the percentage of governing persons that can make up a quorum.¹⁵⁵ It could be a single manager. Aside from some particular instances named by the code, the number of votes necessary for an action to take place appears to be equally malleable. It apparently could be less than a majority: perhaps a plurality, or perhaps a single manager.¹⁵⁶

Should the common law of LLCs be developed by adopting in the limitations of the corporate code, in order to protect the non-managing members? Why not? It seems to me the best reason why not is that, if the code wanted LLCs to be governed like corporations, it would have said so. Instead, it appears to say differently. Surely this reason is applicable to the veil piercing "common law," too. Business entities are fictions, or, alternately, are perhaps better thought of as a shorthand reference to a number of legal conclusions that are always or usually true of an entity of a certain type. Legislatures define business entities deliberately, or at least that is what a court is supposed to assume. The Texas legislature has defined corporations and LLCs the way it wants them, and it has directed that the veil piercing statute should apply to corporations, not to LLCs. Allowing common law development of entity law would turn the design of entities over to the courts, who can change the attributes of entities at best in piecemeal fashion over many years, and never with complete coherence over the short term. Business needs more certainty than that.

Last September, the First District Court of Appeals in Houston decided a case involv-

¹⁴⁸ See *id.* § 101.355.

¹⁴⁹ See *id.* § 21.401.

¹⁵⁰ See *id.* § 21.413(a).

¹⁵¹ See *id.* § 21.415(a).

¹⁵² See *id.* §§ 21.101, 21.106, 21.109, 21.413(a) (allowing different quorum requirements in the bylaws or certificate of formation); 21.415(a) (allowing different voting percentages in the bylaws of the certificate of formation); TBOC 101.054.

¹⁵³ See *id.* § 21.413(b).

¹⁵⁴ See *id.* § 21.415(a).

¹⁵⁵ See *id.* §§ 101.054, 101.353.

¹⁵⁶ See *id.* §§ 101.054, 101.355.



ing whether to pierce the veil of an LLC.¹⁵⁷ In the trial court, no one, it appears, knew that they were to apply corporate law to LLCs. Neither party argued that section 21.223 of the Texas Corporation Law or its predecessor should apply.¹⁵⁸ The trial court issued the jury charge without mentioning it.¹⁵⁹ Perhaps the lawyers and the court should have noticed the case law in this area,¹⁶⁰ but there is no evidence that they they did not look in the right place in the code, is there? Please, let us have some guidance, here.

B. Clarity

A second reason not to apply the statute to LLCs is that its meaning is uncertain. Applying this poorly drafted statute to a new set of entities would only magnify the interpretive problems created by the statute.

The language of the 1989 statute, at first and as amended in 1993, is unclear for two reasons. First, in order that a shareholder be held liable for a contractual obligation of the corporation, the court must find "actual fraud" by the shareholder.

The statute specifies this in a convoluted manner. It first provides that no shareholder will be liable for any contractual obligation of the corporation on the basis that the shareholder "is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory."¹⁶¹ Whence this long list? It is evidence of the legislature's antipathy to the loose language of the 1986 Supreme Court decision, *Castleberry*.¹⁶² *Castleberry* went out of its way to state its own long list of general categories of conduct that would justify veil-piercing. The breadth of the categories appeared to leave courts a great deal of discretion: fraud, sham to perpetrate a fraud, alter ego, means of evading an existing legal obligation, mere tool or business conduit of another corporation, inadequate capitalization—in short, whenever "the corporate form has been used as part of a basically unfair device to achieve an inequitable result."¹⁶³ Lest "sham to perpetrate a fraud" be confused with mere fraud, the *Castleberry* court distinguished the two:

To prove there has been a sham to perpetrate a fraud, tort claimants and contract creditors must show only constructive fraud. We distinguished constructive from actual fraud in *Archer v. Griffith*:

Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive

¹⁵⁷ Phillips v. B.R. Brick & Masonry, Inc., 01-09-00311-CV, 2010 WL 3564820 (Tex. App.—Houston [1st Dist.], September 10, 2010).

¹⁵⁸ *Id.* at *7 n.6.

¹⁵⁹ *Id.*

¹⁶⁰ McCarthy, 251 S.W.3d at 589 (applying § 21.223 to the issue of whether a LLC's veil could be pierced).

¹⁶¹ TEX. BUS. ORGS. CODE ANN. § 2.21(a)(2) (Vernon 2010).

¹⁶² *Castleberry*, 721 S.W.2d 270.

¹⁶³ *Id.* at 271-72.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 55

others, to violate confidence, or to injure public interests.¹⁶⁴

The statute's purpose in naming the theories appears to be to oppose *Castleberry's* long list. Note that *Castleberry* included actual fraud in its long list, and so does the statute include actual fraud in the list of prohibited theories.

But, after taking away liability based on actual fraud with one hand, the code provides it with the other: That provision "does not ... limit the liability of a [share]holder ... if ... the [share]holder ... caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the [share]holder."¹⁶⁵ That take-and-give-back drafting method combined with the natural ambiguity of the phrase "actual fraud" leave us wondering what "actual fraud" is supposed to mean. The phrase was used in *Castleberry* itself, in the passage quoted above. It might mean nothing more than conduct "involv[ing] dishonesty of purpose or intent to deceive."

Or, on the other hand, it might mean something else, like the tort of fraud. One might quite logically assume that, the legislature having said "actual fraud," the tort of actual fraud was what was wanted. That is the way my students sometimes read it.

The elements of fraud are: (1) that a material representation was made; (2) the representation was false; (3) when the representation was made, the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion; (4) the speaker made the representation with the intent that the other party should act upon it; (5) the party acted in reliance on the representation; and (6) the party thereby suffered injury.¹⁶⁶

The statute appears to demand that this be the new test for imposing corporate liability on a shareholder. The irony of that construction of the statute would be that if these elements are proved, the shareholder committed a tort and is liable in tort. No veil piercing is necessary to hold a defrauder liable for fraud, as the courts have recognized.¹⁶⁷ And the damage rule for the tort of fraud is in fact broad enough itself to cover the corporate liability. Damages from fraud include either money paid out of pocket in reliance on the fraud, or the benefit of the promised, fraudulent bargain.¹⁶⁸ "When properly pleaded and proved, consequential damages that are foreseeable and directly traceable to the fraud and result from it might be recoverable."¹⁶⁹ If the fraud consisted in tricking the obligee into accepting an obligation of the corporation (as most often would be true for a case involving contractual liability of a corporation), then that obligation would be the benefit of the bargain, and money paid out by the plaintiff for it would be out of pocket. These would be the contract damages due from the corporation, and these

¹⁶⁴ *Castleberry*, 721 S.W.2d at 273 (quoting *Archer v. Griffith*, 390 S.W.2d 735, 740 (Tex. 1964)).

¹⁶⁵ TEX. BUS. ORGS. CODE ANN. § 2.21(b) (Vernon 2010).

¹⁶⁶ *Aquaplex, Inc. v. Rancho La Valencia, Inc.*, 297 S.W.3d 768, 774 (Tex. 2009).

¹⁶⁷ *Sanchez*, 274 S.W.3d at 712.

¹⁶⁸ *Baylor Univ. v. Sonnichsen*, 221 S.W.3d 632, 636 (Tex.2007); *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 (Tex.1998); *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex.1997).

¹⁶⁹ *Formosa Plastics Corp. USA*, 960 S.W.2d at 49.



would also be the damages due the plaintiff under the common law tort of fraud in an action against the defrauding shareholder. But, of course, we did not need a statute for that. We had the common law tort of fraud already. It appears that the statute reserves liability that defendants already had under the common law, making a reservation of liability for actual fraud pointless.

There is another possibility. It is possible that the statute means to require that the tort of fraud be proved in order to make the shareholder liable for some corporate liability *even if unrelated to the fraud*. Perhaps the tort resulted in no or little damages, or some measure of damages not coinciding with the damages owed by the corporation in contract. The statute does not require that the "actual fraud" result in the corporate liability. In fact, it does not require any relation between the fraud and the contractual obligation at all: "Subsection (a)(2) does not prevent or limit the liability of a [share]holder ... if ... the holder ... did perpetrate an actual fraud," but not necessarily a fraud related to the corporate contractual liability. The statute does not require that the shareholder be liable "to the extent" of the fraud, for instance. This would be a remarkable statute if it actually means fraud whether or not related to the corporate liability, but it would not be without precedent.¹⁷⁰ However, the use of the phrase "actual fraud" in both (a)(2) and (b) suggests that the corporate debt should be related in some way to the fraud, as if that debt is the actual fraud for which the shareholder would be liable. Moreover, the suggestion that committing the tort of fraud should subject a person under this section of the Texas Corporation Laws to greater or different damages than could be had under the common law for the tort of fraud would be an enlargement of tort law that one should expect to be announced more clearly than this, if, that is, the statute by naming "actual fraud" means to refer to the tort of fraud.

Yet, the statute's language does not clearly call for this interpretation. The statute describes "actual fraud" without any limitations, and without clearly referring to the tort. Moreover, it uses the term "actual fraud" rather than "the tort of fraud" or merely "fraud." The phrase "actual fraud" comes (apparently) from *Castleberry* itself (it being the closest relevant authority), and it is doubtful, given *Castleberry*'s broad dicta, whether it meant the tort. It defined "actual fraud" as including a mental state: "usually involves dishonesty of purpose or intent to deceive."¹⁷¹ Beyond that, the case distinguished a sham to perpetrate a fraud from "common-law fraud or deceit," as if the tort were required.¹⁷² But the court also distinguished a sham to perpetrate a fraud, or constructive fraud, from "intentional fraud" by saying that "[n]either fraud nor an intent to defraud" was required, and this language suggests that an intent to defraud could have been the "something more than constructive fraud" that the court was considering. That the statute's phrase "actual fraud" appears to be lifted from this confusing *Castleberry* dicta leaves the phrase open to interpretation as a mental state, or the tort of fraud, or perhaps something else.

Perhaps because of this ambiguity and because the statute's reservation clause, read to refer to the tort, might well be superfluous, courts have generally not taken it literally. Sorting this out has taken some time. The statute was passed in 1989 and the courts of appeals are on-

¹⁷⁰ For a similar move under Rule 10b-5 of the federal securities law, see *U.S. v. O'Hagan*, 521 U.S. 642 (1997).

¹⁷¹ *Castleberry*, 721 S.W.2d at 273 (quoting *Archer*, 390 S.W.2d at 740).

¹⁷² *Castleberry*, 721 S.W.2d at 273.

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 57

ly now clarifying what "actual fraud" means.¹⁷³ Rather than require that the tort of fraud be proved, courts, especially lately, have required merely that the shareholder have had some dishonesty of purpose or intent to deceive, which of course is something less than the tort of actual fraud.¹⁷⁴ This comes with controversy, as commentators now assert that the tort was what was intended.¹⁷⁵ The commentators do not address the ambiguity in the phrase "actual fraud," however, or what the point of the statute was if the tort is required, since shareholders who commit fraud were already liable without the statute in tort to corporate obligees.

As if the phrase "actual fraud" were not uncertainty enough, an equally ambiguous clause is the statute's list of theories. The statute prohibits veil piercing for contractual liabilities "on the basis that the [share]holder ... is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or *other similar theory*."¹⁷⁶ Commentators have been clocking the evolution of the "other similar theory" clause over the years.¹⁷⁷ Only repeated visits to the courts of appeals have begun to settle its meaning. The "ratification" theory was included as an "other similar theory" only in 2006.¹⁷⁸ The single business enterprise theory was classed as one in 2003.¹⁷⁹ Will other theories arise to test the clause? Surely, and surely given the differences in form between a corporation and a LLC, litigants will seek a hearing on each theory for each entity, especially if development of LLC veil-piercing law is considered to be only common law development, as Professor Miller suggests.¹⁸⁰

But why should the law multiply this ambiguity by applying the statute to an additional entity? In light of such ambiguity, LLCs would be better served if the legislature were

¹⁷³ See *Latham v. Burgher*, 320 S.W.3d 602 (Tex. App.—Dallas 2010, no pet.) (discussing the issue at length and resolving it); *Dick's Last Resort of W. End, Inc. v. Mkt./Ross, Ltd.*, 273 S.W.3d 905, 908-09 (Tex. App.—Dallas 2008, pet. denied) (discussing the issue at length and resolving it); *Solutioneers Consulting, Ltd. v. Gulf Greyhound Partners, Ltd.*, 237 S.W.3d 379, 387-89 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (referring to a brief passage in *Castleberry v. Branscum* that "usually involves dishonesty of purpose or intent to deceive" in order to define the meaning of the statute meant to supersede the language of *Castleberry*).

¹⁷⁴ *Latham*, 320 S.W.3d 602 ("[I]n the context of piercing the corporate veil, actual fraud is not equivalent to the tort of fraud. Instead, in that context, actual fraud involves 'dishonesty of purpose or intent to deceive.'"); see *Dick's Last Resort of W. End, Inc.*, 273 S.W.3d at 908-09; *Solutioneers Consulting, Ltd.*, 237 S.W.3d at 387-89.

¹⁷⁵ See Glenn D. West & Stacie L. Cargill, *Corporations*, 62 SMU L. Rev. 1057, 1066-1073 (2009).

¹⁷⁶ TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2) (Vernon 2010) (italics added). The phrase in italics was added to the statute in 1993.

¹⁷⁷ See, e.g., Hamilton, Miller & Ragazzo, *supra* note 112, at §§ 26.22-26.23; Miller, *supra* note 120, at 406-14; West & Cargill, *supra* note 175, at 1059-74; Glenn D. West & W. Benton Lewis, Jr., *Corporations*, 61 SMU L. Rev. 743, 746-54 (2008); Glenn D. West & Emmanuel U. Obi, *Corporations*, 60 SMU L. Rev. 885, 886-95 (2007); Glenn D. West & Benton B. Bodamer, *Corporations*, 59 SMU L. Rev. 1143, 1145-53 (2006); Marc I. Steinberg, *Alter Ego and Single Business Enterprise in the Texas Contractual Debt Context*, 41 Tex. J. Bus. L. 1 (2005); Glenn D. West & Susan Y. Chao, *Corporations*, 56 S.M.U. L. Rev. 1395, 1403-08 (2003); Glenn D. West & Brandy L. Treadway, *Corporations*, 55 SMU L. Rev. 803, 810-11, 815 (2002); Alan W. Tompkins & Theodore S. O'Neal, *Corporations*, 52 SMU L. Rev. 873, 874-80 (1999). Mr. West's felt need at least since 2005 constantly to interpret this statute for the courts, and criticize at length every court decision on this issue with which he disagrees, is itself evidence of the statute's lack of clarity.

¹⁷⁸ *Willis v. Donnelly*, 199 S.W.3d 262, 273 (Tex. 2006).

¹⁷⁹ *S. Union Co. v. City of Edinburg*, 129 S.W.3d 74, 85-90 (Tex. 2003).

¹⁸⁰ See *supra* notes 132 & 133 and accompanying text.

to take another try at drafting something clearer. Or perhaps the Texas Supreme Court, which seems itself to favor common law more friendly to businesses on this issue,¹⁸¹ should develop the law in this area. I for one believe they would do a better job than the drafters of this statute.

C. The Party Ends with the Corporation

Finally, another statute that is part of the Texas Limited Liability Company Law weighs in on the propriety of collecting a LLC debt from a member: "A member of a limited liability company may be named as a party in an action by or against the limited liability company only if the action is brought to enforce the member's right against or liability to the company."¹⁸² This provision, which appears only in the Texas Limited Liability Company Law and not in the Texas Corporation Law, has not been construed by the state's courts.¹⁸³ The provision's plain language throws a wrench in a veil-piercing claim involving a LLC, however.

Veil-piercing is itself not an independent claim. "An attempt to pierce the corporate veil, in and of itself, is not a cause of action but rather is a means of imposing liability on an underlying cause of action such as a tort or breach of contract."¹⁸⁴ Veil-piercing "is merely a ground upon which the individual may be held liable upon a cause of action which otherwise would have existed only against the corporation."¹⁸⁵ Commonly, shareholders are named party defendants in actions seeking veil-piercing as a remedy for corporate liability.¹⁸⁶ Once the corporation is held liable, and veil-piercing prerequisites met, shareholders are adjudged liable for the corporate liability.

This would not be possible in a suit against an LLC. A suit seeking veil-piercing must allege some cause of action against the LLC other than veil-piercing, such as tort (through the agency doctrine of *respondeat superior*) or contract. If the suit is successful on such a cause of action against the LLC, then under veil-piercing law a member might be held liable. But in order for the member to be held liable, the member must be a party to the suit, the very thing prohibited by the statute. The exceptions to the statute, for member derivative

¹⁸¹ SSP Partners, 275 S.W.3d at 450-56.

¹⁸² TEX. BUS. ORGS. CODE ANN. § 101.113 (Vernon 2010).

¹⁸³ *Harris v. Guetersloh*, 07-99-0046-CV, 2000 WL 12523 (Tex.App.—Amarillo, Jan. 6, 2000, no pet.), suggested that, under the statute's predecessor, the defense provided by the statute must be raised by a defendant affirmatively or was waived. Other than this case, I have found no mention of the provision.

¹⁸⁴ *Gallagher v. McClure Bintliff*, 740 S.W.2d 118, 119-20 (Tex. App.—Austin 1987, writ denied); *see, e.g., Phillips v. United Heritage Corp.*, 319 S.W.3d 156, 158 (Tex. App.—Waco 2010, no pet.) ("[T]hese theories and the attempts to utilize them are not substantive causes of action."); *Wilson v. Davis*, 305 S.W.3d 57, 68 (Tex. App.—Houston [1st Dist.] 2009, no pet.); *Cox v. S. Garrett, L.L.C.*, 245 S.W.3d 574, 582 (Tex. App.—Houston [1st Dist.] 2007, no pet.); *Specialty Retailers, Inc. v. Fuqua*, 29 S.W.3d 140, 147 (Tex. App.—Houston [14th Dist.] 2000, pet. denied); *Farr v. Sun World Sav. Ass'n*, 810 S.W.2d 294, 297 (Tex. App.—El Paso 1991, no writ); *Gulf Reduction Corp. v. Boyles Galvanizing & Plating Co.*, 456 S.W.2d 476, 479 (Tex. App. 1970).

¹⁸⁵ *Gulf Reduction Corp. v. Boyles Galvanizing & Plating Co.*, 456 S.W.2d 476, 479 (Tex. App.—Fort Worth 1970, no writ).

¹⁸⁶ *See, e.g., Seidler v. Morgan*, 277 S.W.3d 549, 557 (Tex. App.—Texarkana 2009, pet. denied) ("Seidler also argues that there is some evidence to suggest that it would be appropriate to pierce the corporate veil, and thereby show that Morgan[, a shareholder,] was a proper party.").

2011] THREE SUGGESTIONS FOR THE TEXAS LIMITED LIABILITY COMPANY LAW 59

suits¹⁸⁷ and suits brought by the company against the member, obviously do not apply.

Could a second, separate suit be brought against the member? That would seem an odd result. Most likely the member would not be bound by the earlier suit, to which it was not a party.¹⁸⁸ The underlying LLC liability would have to be litigated a second time. Moreover, one would have to ask whether, in the second suit against the member for veil-piercing liability, the complaint would withstand a motion to dismiss for failure to state a claim. Veil-piercing is not a cause of action, and the claim in the veil-piercing suit would be a claim only against the LLC, not a member. For this last reason, third party claimants would also not be able to bring a claim against a LLC member without first suing the entity.

The no-member-party rule is not hindered by Rule 39(a)(1) of the Texas Rules of Civil Procedure. That rule provides, "A person who is subject to service of process shall be joined as a party in the action if ... in his absence complete relief cannot be accorded among those already parties."¹⁸⁹ First of all, if a rule of civil procedure conflicts with a statute, the statute controls unless the rule is passed last.¹⁹⁰ Rule 39 was last amended in 1971, however.¹⁹¹ The no-member-party rule first came into being in 1991¹⁹² and was placed in its present form by legislative act in 2003.¹⁹³ Second, the no-member-party rule is also far more specific than Rule 39, and therefore should control if a conflict exists.¹⁹⁴ Finally, no conflict exists. Rule 39(a)(1) is satisfied even without the LLC member's participation in a suit because the LLC is a party; a judgment for the full amount of damages can be rendered against the LLC. Rule 39's

¹⁸⁷ See TEX. BUS. ORGS. CODE ANN. § 101.451 et seq. (Vernon 2010).

¹⁸⁸ Generally, a person is not bound by a judgment in a suit to which she was not a party. *Amstadt v. U.S. Brass Corp.*, 919 S.W.2d 644, 652 (Tex. 1996). An exception exists for those "in privity with the parties to the original suit." *Id.* at 652-53. "People can be in privity in at least three ways: (1) they can control an action even if they are not parties to it; (2) their interests can be represented by a party to the action; or (3) they can be successors in interest, deriving their claims through a party to the prior action." *Id.* at 653. However, "a party's mere status as shareholder does not create privity [with the corporation] absent further evidence." *Tex. Capital Sec. Mgmt., Inc. v. Sandefer*, 80 S.W.3d 260, 265-67 (Tex. App.—Texarkana 2002, pet. struck); see also *Dudley v. Smith*, 504 F.2d 979, 982 (5th Cir.1974); *Am. Range Lines, Inc. v. C.I.R.*, 200 F.2d 844, 845 (2d Cir.1952). In *Sandefer*, the court held that not even the shareholders' additional status as officers of the corporation conferred privity. *Sandefer*, 80 S.W.3d at 266 ("This status alone, without more evidence, does not, as a matter of law, establish privity."); accord *T.L. Dallas (Special Risks), Ltd. v. Elton Porter Marine Ins. Agency*, CIV 3:07-CV-0419, 2008 WL 7627806, *6, (S.D.Tex. Dec. 22, 2008); *Brown v. Zimmerman*, 160 S.W.3d 695, 703 (Tex. App.—Dallas 2005, no pet.). Moreover, "mere participation in a prior trial does not suffice to bar the participant on principles of res judicata, nor does knowledge of an ongoing trial." *Brown*, 160 S.W.2d at 703. The upshot is that well-counseled shareholders or LLC members will not participate in the corporate or LLC litigation, nor control it, and hence will be less likely to be bound.

¹⁸⁹ Tex. R. Civ. Pro. 39(a)(1).

¹⁹⁰ V.T.C.A., Government Code § 22.004(c); *Johnstone v. State*, 22 S.W.3d 408, 409 (Tex. 2000); *Villasan v. O'Rourke*, 166 S.W.3d 752, 762 (Tex. App.—Beaumont 2005, pet. denied).

¹⁹¹ V.T.R. Ann. Rule 39 Credits.

¹⁹² Acts 1991, 72nd Leg., ch. 901, § 46, eff. Aug. 26, 1991.

¹⁹³ Acts 2003, 78th Leg., ch. 182, § 1, eff. Jan. 1, 2006.

¹⁹⁴ TEX. BUS. ORGS. CODE ANN. § 1.051 (Vernon 2010) (mandating that Chapter 311 of the Government Code apply to construction of each provision of the TBOC); V.T.C.A., Government Code § 311.026(b) ("If the conflict between the general provision and the special or local provision is irreconcilable, the special or local provision prevails as an exception to the general provision, unless the general provision is the later enactment and the manifest intent is that the general provision prevail.")

purpose is to allow complete adjudication of disputes, not ensure the existence of a defendant with the means to pay a judgment.¹⁹⁵

Whatever section 101.113's purposes and effects are, it is not friendly to veil-piercing suits. The application of the corporate veil-piercing statute to LLCs assumes that the law of veil piercing applies to LLCs just as it does to corporations. But the no-member-party statute prohibits the normal corporate veil-piercing suit against an LLC member and raises questions as to whether such a suit could proceed at all. The result is that the analogy is dissimilar, and the "why not?" attitude of courts and commentators unjustified.

Incidentally, every Texas case in which LLC veil-piercing succeeded or was approved as a theory appears to have violated this statute.¹⁹⁶ The lawyers appear to have had no idea of the violation. Clearly it is time to begin paying attention to the language of the code. Pretending that an LLC is just like a corporation is not the way to encourage the bar to follow the TBOC.

Because the code expressly indicates that the corporate veil-piercing statute, TBOC section 21.223, should apply only to corporations; because the provision is awkwardly drafted and not one wisely adopted elsewhere by the common law; and because LLC members cannot be party defendants in actions against LLCs, anyway, I conclude that TBOC section 21.223 would best not be applied to LLCs. The legislature should, if it wishes such a thing to occur, write a statute for LLCs and place it in the Texas Limited Liability Company Law. That would resolve the first objection named here, and it would clarify that the legislature really did want such a poorly drafted statute to apply to LLCs as well as corporations. Better yet, the legislature should re-draft the statute and place a much clearer one in the Texas Limited Liability Company Law. I will leave its contents to them and hope they avoid the clear inadequacies of the corporate rule.

¹⁹⁵ Hall v. Dorsey, 596 S.W.2d 565, 570 (Tex. Civ. App.—Houston [1st Dist.] 1980) ("Rule 39(a) is designed to avoid subjecting a person to the risk of paying the same claim more than once. ")

¹⁹⁶ Members are, inexplicably, with no reference to the no-member-party statute, party defendants with LLCs of which they are members in *Watkins*, 2011 WL 1414135, at *1; *Genssler*, 2010 WL 3928550, at *1-3; *Phillips*, 2010 WL 3564820; *Sanchez*, 274 S.W.3d at 712; *McCarthy*, 251 S.W.3d at 589; and in all the federal cases: In re *Houston Drywall, Inc.*, 05-95161-H4-7, 2008 WL 2754526, *32 (Bankr. S.D. Tex. July 10, 2008); *Bramante*, 2007 WL 4555943; *DDH Aviation, L.L.C. v. Holly*, 2005 WL 770595, **5-8 (N.D. Tex. Mar. 31, 2005); In re *Moore*, 379 B.R. 284, 284 et seq. & 289 n.4 (Bankr. N.D. Tex. 2007); and In re *JNS Aviation, LLC*, 376 B.R. 500, 525-31 (Bankr. N.D. Tex. 2007).