# THE TWISTED VEIL OF TEXAS LLCS

by Val Ricks*

The Texas law of veil-piercing for limited liability companies is incoherent. It should be fixed. Section I tells what is wrong with the law. Section II proposes a fix.

## I. WHAT IS WRONG WITH THE TEXAS LAW OF LLC VEIL-PIERCING

### A. The Statute Prohibits Veil-Piercing.

Section 101.114 of the Texas Business Organizations Code (TBOC) contains a flat prohibition on imposing company liability on a member: "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 company . . . ."[1] Because limited liability is usually a primary objective of LLC members, under normal circumstances a company agreement will not provide otherwise. It is difficult to imagine a clearer statement of non-liability. Its clarity led a prominent commentator to suggest that veil-piercing principles "should not apply to LLCs in Texas."[2] Yet courts apply veil-piercing doctrine to LLCs.[3]

Commentators justify this as a common-law development.[4] But common law that disobeys

---

* Professor of Law, South Texas College of Law. The author wishes to thank John Bohannon for research assistance. The author also wishes to thank students in his Agency & Partnership classes for the last several years, who have diligently tried to learn the doctrine in this area notwithstanding its problems. Thank you for trying; our discussions clarified much.

[1] TEX. BUS. & ORG. CODE § 101.114 (West 2012).

[2] Byron F. Egan, *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, 42 TEX. J. BUS. L. 71, 173 (2007). In Egan's defense, note that the uniform LLC act differs by allowing common law development. *See* Larry E. Ribstein & Robert R. Keatinge, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES §§ 12.1-12.2 (2011). The uniform act says only that members are not liable "solely by reason of being . . . a member." *Id.* § 12.2. The Texas statute proclaims an absolute prohibition. *See* TEX. BUS. ORGS. CODE § 101.114 (West 2012).

[3] *E.g.*, Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427, 445 (5th Cir. 2013); *In re* Houst. Drywall, Inc., 2008 WL 2754526, *32 (Bankr. S.D. Tex., July 10, 2008) (mem. op.) (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, 2007 WL 4555943 (W.D. Tex., Dec. 18, 2007) (mem. op.) (allowing a reverse veil piercing action to continue against an LLC and its owners); DDH Aviation, L.L.C. v. Holly, 2005 WL 770595, **5-8 (N.D. Tex., Mar. 31, 2005) (mem. op.) (allowing an alter ego claim against a LLC); *In re* Moore, 379 B.R. 284, 284, 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); K-Solv, L.P. v. McDonald, No. 01-11-00341-CV, 2013 WL 1928798, *2 (Tex. App.—Houston [1st Dist.] May 9, 2013, no pet.) (mem. op.); Shook v. Walden, 368 S.W.3d 604 (Tex. App.—Austin 2012, pet. denied); Penhollow Custom Homes, L.L.C. v. Kim, 320 S.W.3d 366, 372-73 (Tex. App.—El Paso 2010, no pet.); Phillips v. B.R. Brick and Masonry, Inc., No. 01-09-00311-CV, 2010 WL 3564820, *7 (Tex. App—Houston [1st Dist.] Sept.10, 2010, no pet.) (mem. op.); Sanchez v. Mulvaney, 274 S.W.3d 708, 712 (Tex. App.—San Antonio 2008, no pet.); McCarthy v. Wani Venture, A.S., 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied) (dicta).

[4] *See* ELIZABETH S. MILLER & ROBERT A. RAGAZZO, 20 TEXAS PRACTICE SERIES: BUS. ORGS. § 20.7 (3d ed.

a statute is problematic. The legislature is supreme.[5] The commentators cite the corporate law of veil-piercing.[6] But the corporate code does not prohibit the imposition of corporate liability on shareholders. On the contrary, it explicitly provides for it.[7] Though section 21.223 limits shareholder liability, section 21.224 allows for the "liability of a holder . . . for an obligation that is limited by section 21.223."[8] The explicit blessing of veil-piercing in the corporate code reaffirms its place in corporate law. The explicit condemnation of it in the LLC code appears to intend the opposite.

Notwithstanding section 101.114, there is space in our jurisprudence for LLC veil-piercing. In fact, no statute could stop it because it would not be an exercise in common law-making. Equity sometimes interferes with the application of statutes.[9] When a statute reaches an absurd result, a court is free to depart from it to an extent. I am not referring to the statutory construction rule that requires courts to avoid absurd interpretations.[10] Equity allows courts more leeway. Equity allows courts to depart from absurd statutes. The Texas Government Code itself recognizes the possibility in the following provision, complete with dangling modifier: "In enacting a statute, it is presumed that . . . a just and reasonable result is intended."[11] When every construction of a statute is contrary to that presumption, what is a court to do? Many years ago, in *Witherspoon v. Jernigan*,[12] the Texas Supreme Court said,

> The purpose of the Legislature . . . must be preserved even though it should require the court to disregard some of the words, or to supply words necessary to make plain the meaning of the law. 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

---

2011); 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. 417.

[5] State v. City of Austin, 331 S.W.2d 737, 743 (Tex. 1960) ("The judgment of the Legislature is supreme provided there is any reasonable basis for the action taken."); *see also* Gallagher Headquarters Ranch Dev., Ltd. v. City of San Antonio, 269 S.W.3d 628, 638 (Tex. App.—San Antonio 2008, pet. granted) ("If we determine that the statute directly conflicts with the common law, the statute controls."), *vacated on other grounds*, 303 S.W.3d 700 (Tex. 2010).

[6] *See, e.g.*, Miller & Ragazzo**,** *supra* note 4, at § 20.7 ("From a policy standpoint, there does not appear to be any reason for courts, when developing the Texas common law of LLC veil piercing, to adopt standards that explicitly provide less liability protection for an LLC member than that available to a corporate shareholder.").

[7] *Id*.

[8] *See* TEX. BUS. ORG. CODE §§ 21.223-.224 (West 2012).

[9] I imagine a retort at this point: "In a jurisdiction in which law and equity are merged, development of equitable jurisdiction is common law-making." No. There must be a distinction. Equity restricts itself in a manner the common law never has. If courts believe they have common law-making power in this area as they do in contracts or torts, then lawyers are doomed never to know the law, as the courts could simply pronounce it anew anytime they felt like creating legal authority contrary to a clear statute.

[10] *See* Del Indus., Inc. v. Texas Workers' Compensation Ins. Fund, 973 S.W.2d 743, 747 (Tex. App.—Austin 1998) ("A court … will not construe a statute in a manner that will lead to a foolish or absurd result when another alternative is available.") *aff'd* 35 S.W.3d 591 (Tex. 2000).

[11] TEX. GOV'T CODE § 311.021 (West 2012), made applicable to the TBOC by TEX. BUS. ORG. CODE § 1.051 (West 2013).

[12] 76 S.W. 445 (Tex. 1903).

general purposes and intent of the legislature.[13]

The *Witherspoon* court changed a statute to turn an "and" into an "or."[14] Alternately, the court read into the statute a long phrase that implied the same substance.[15]

This jurisdiction in equity to prevent absurdity applies when following a statute would require the court to countenance a fraud. The equitable exception to the Statute of Frauds is a good example. In *Hooks v. Bridgewater*,[16] the court described when equity would allow a court to depart from a statutory mandate: "to prevent the perpetration of a fraud. That is the only ground that can justify its interference. Otherwise, the exercise of its jurisdiction for the practical annulment of the statute would be but bare usurpation."[17]

Many cases confirm the equitable nature of the courts' power to make an exception to a statute when following the statute would allow fraud to occur.[18] Pursuant to these equitable powers, Texas courts have enforced oral agreements covered by the Statute of Frauds, notwithstanding the Statute's obvious applicability,[19] when equity dictated.[20] These are not broad exceptions. For instance, a sale of land does not have to be in writing if the consideration is paid, the vendee takes possession, and the vendee makes valuable and permanent improvements with the consent of the vendor.[21] But the elements are not the essential point. The *Hooks* court was quick to stress that the exception applied even without any improvements in "the presence of such facts as would make the transaction a fraud upon the purchaser if it were not enforced."[22] The central claim for relief from the statute is that following the statute would permit or allow the perpetration of a fraud. In those cases, equity intervenes.

Equitable intervention is not limited to oral sales of land. Equity allows exception to the

---

[13] *Id.* at 447.

[14] *Id.*

[15] *Id.*

[16] 229 S.W. 1114 (Tex. 1921).

[17] *Id.* at 1116.

[18] *See, e.g.*, Sharp v. Stacy, 535 S.W.2d 345, 347-48 (Tex. 1976); Cowden v. Bell, 300 S.W.2d 286, 289-90 (Tex. 1957); Texas Co. v. Burkett, 296 S.W. 273, 279-80 (Tex. 1927); Lovett v. Lovett, 283 S.W.3d 391, 394 (Tex. App.—Waco 2008, pet. denied).

[19] The Statute of Frauds reads, "A promise or agreement described in Subsection (b) of this section is not enforceable unless the promise or agreement, or a memorandum of it, is (1) in writing; and (2) signed by the person to be charged with the promise or agreement or by someone lawfully authorized to sign for him." TEX. BUS. & COM. CODE § 26.01(a) (West 2012).

[20] Hooks v. Bridgewater, 229 S.W. 1114, 1116 (Tex. 1921) ("Equity has no concern in such cases except to prevent the perpetration of a fraud."); Hunt v. Turner, 9 Tex. 385, 385 (1853) ("A contract may be void under the statute of frauds; yet if the conduct of the party setting up the invalidity of the contract has been such as to raise an equity outside of and independent of the contract, and nothing else will be adequate satisfaction of such equity, it will sustain the sale, though not valid under the statute of frauds."); Dugan's Heirs v. Colville's Heirs, 8 Tex. 126, 128 (Tex. 1852) ("such circumstances would raise an equity in favor of the vendee against his vendor, aside from and uncontrolled by the statute of frauds"); Lovett v. Lovett, 283 S.W.3d 391, 394 (Tex. App.—Waco 2008, pet. denied); Carmack v. Beltway Development Co., 701 S.W.2d 37, 40 (Tex. App.—Dallas 1985, no writ) ("may be enforced in equity if denial of enforcement would amount to a virtual fraud").

[21] *Hooks*, 229 S.W. at 1116.

[22] *Id.*; *see also Carmack*, 701 S.W.2d at 40.

Statute of Frauds also when a document meant to be a written lease for a period longer than a year has been prepared, the defendant promises to sign the document, and promissory estoppel applies to make that promise enforceable.[23] Here is a case in which the "enforcement of the statute of frauds 'would, itself, plainly amount to a fraud.'"[24] Occasionally, Texas courts have named the excusing doctrine "estoppel"[25] or "promissory estoppel"[26] instead of fraud, though the equitable principle is similar. Texas courts have rendered such holdings with regard to oral employment contracts for longer than one year,[27] contracts to make mutual wills,[28] easements by estoppel,[29] and contracts for real estate commissions.[30] The general principle was aptly stated by a Texas appellate court: "The statute of frauds was designed to prevent fraud and may not be employed to bring about the very thing it was designed to prevent."[31] Courts thus exercise their equitable power to depart from a statute when the application of the statute would be absurd. But this is a limited, extraordinary exception, not an exercise in common law-making. The courts are not free to make common law contrary to a constitutional statute.

A similar example is the equitable tolling of a statute of limitations. Most obviously, "the statute is tolled when by reason of fraud or concealment the defalcation or dereliction is kept hidden, until such time as knowledge is had of the defalcation, or in the exercise of reasonable diligence it might have become discovered."[32] The statute is likewise tolled in various circumstances that are equivalent to fraud.[33] This occurs when the wrong party is initially sued but the proper defendant knew of the suit, was not prejudiced, and did nothing to notify the plaintiff, and in which the plaintiff was diligent.[34] Tolling on the basis of equitable estoppel is a similar move, technically contrary to the statute but necessary to prevent the statute from

---

[23] Southmark Corp. v. Life Investors, Inc., 851 F.2d 763, 768-69 (5th Cir. 1988) (applying Texas law); Nagle v. Nagle, 633 S.W.2d 796, 800 (Tex. 1982); Moore Burger, Inc. v. Phillips Petroleum Co., 492 S.W.2d 934, 936-38, 940 (Tex. 1973).

[24] *Moore Burger*, 492 S.W.2d at 938.

[25] Murphy v. Long, 170 S.W.3d 621, 624-28 (Tex. App.—El Paso 2005, pet. denied).

[26] *See, e.g., Moore Burger*, 492 S.W.2d at 936-40.

[27] Welch v. Coca-Cola Enterprises, Inc., 36 S.W.3d 532, 539 (Tex. App.—Tyler 2000, pet. dism'd by agr.).

[28] Kilpatrick v. Estate of Harris, 848 S.W.2d 859, 855 (Tex. App.— Corpus Christi 1993, no writ.) (reasoning that the promisor "must comply with the agreement, or equity will step in to prevent a fraud or to estop the survivor from pleading the statute of frauds") (citing Kastrin v. Janke, 432 S.W.2d 539, 541 (Tex. Civ. App.— El Paso 1968, writ ref'd n.r.e.)).

[29] Murphy v. Long, 170 S.W.3d 621, 624-28 (Tex. App.—El Paso 2005, pet. denied); N. Clear Lake Development Corp. v. Blackstock, 450 S.W.2d 678 (Tex. Civ. App.—Houston 1970, writ ref'd n.r.e.).

[30] *Carmack*, 701 S.W.2d at 39-42.

[31] Twelve Oaks Tower I, Ltd. v. Premier Allergy, Inc., 938 S.W.2d 102, 112 (Tex. App.— Houston [14th Dist.] 1996, no writ); *see also* Morris v. Gaines, 17 S.W. 538, 539 (Tex. 1891) ("The doctrine is well established that where either party, in reliance upon the verbal promise of the other, has been induced to do or to forbear to do any act, and thereby his position has been so changed for the worse that he would be defrauded by a failure to carry out the contract, equity will enforce a performance.").

[32] Franklin Cty. v. Tittle, 189 S.W.2d 773, 774-75 (Tex. Civ. App.—Texarkana 1945, writ ref'd).

[33] *See* Leonard v. Askew, 731 S.W.2d 124, 128-29 (Tex. App.—Austin 1987, writ ref'd n.r.e.).

[34] *E.g.*, Continental Southern Lines, Inc. v. Hilland, 528 S.W.2d 828 (Tex. 1975); Torres v. Johnson, 91 S.W.3d 905, 909-10 (Tex. App.—Fort Worth 2002, no pet.); Palmer v. Enserch Corp., 728 S.W.2d 431 (Tex. App.—Austin 1987, writ ref'd n.r.e.).

countenancing fraud or what is in effect its equivalent.[35]

Unlike the corporate code, the LLC law prohibits veil-piercing, so courts are not free to amend in veil-piercing without establishing the equitable basis of the exception. I anticipate a counter-argument: "The corporate veil-piercing doctrine is itself based in equity. The corporation is a separate entity, so equitable jurisdiction was necessary." No. It is possible to conceive corporate veil-piercing that way, and in the past, some of it may have arisen on that basis. But now there is no need for equitable jurisdiction because the corporate code directly allows veil-piercing. Section 21.223(b),[36] which allows veil-piercing for contractual debt when actual fraud is shown, preserves for contractual liability what equitable jurisdiction seems to demand, so even if the point would have been true, it is now moot. As the corporate statutes codify the courts' equitable jurisdiction, the case law is not an assertion of it. Moreover, section 21.223[37] of the corporate code throttled corporate veil-piercing for contractual liability back to actual fraud, and all veil-piercing with respect to formalities, with nary a suggestion that the equitable jurisdiction of the courts was infringed. The lack of judicial assertion is proof there was no need.

But the courts' lawlessness in the LLC veil-piercing area perhaps prompted the legislature in 2011 to address veil-piercing of LLCs. Unfortunately—

## B. The LLC Code Was Amended in 2011 to Contradict Itself.

The "common law" that the courts applied to LLCs took its content from the statute that applied only to corporations.[38] The TBOC forbid this as well.[39] But if judges were going to act contrary to the prohibition in the LLC code, they could certainly borrow from corporate law contrary to the dictates of the corporate code. If the courts are not going to follow code, then they can depart from a little more code.

The legislature seemed to notice the issue and took it up in 2011. (How legislation resolves a conflict between the legislature and the courts is anyone's guess. If the courts are not following statutes, passing another statute to stop them seems an ironic gesture.) In what looks at first glance like an attempt to cure the courts' lawlessness, the legislature passed section 101.002 of the TBOC.[40] Section 101.002's declarative provisions apply to limited liability companies the statutes that place limits on the veil-piercing of corporations.[41] The idea was to justify application of corporate statutes to LLCs—a sort of after-the-fact authorization of what the courts were already doing.

Oddly, though, the whole section 101.002 is made "[s]ubject to Section 101.114." Section

---

[35] *See* Kamat v. Prakash, 420 S.W.3d 890, 899-903 (Tex. App.—Houston [14th Dist.] 2014, no pet. h.).

[36] TEX. BUS. ORGS. CODE § 21.223 (West 2012).

[37] *Id.* § 21.223.

[38] Val Ricks, *Three Suggestions for the Texas Limited Liability Company Law*, 44 TEX. J. BUS. L. 29, 51-54 (2011); *see also* TEX. BUS. ORGS. CODE §§ 21.223-21.224 (West 2012).

[39] Ricks, *supra* note 38, at 51-54.

[40] TEX. BUS. ORGS. CODE § 101.002 (West 2012).

[41] *Id.* § 101.002.

101.114 is the LLC code provision stating flatly that "a member . . . is not liable for a debt, obligation, or liability of a limited liability company." Put substantively, section 101.002 means that courts are to apply to limited liability companies the limitations on veil-piercing found in section 21.223 of the corporate code, subject to the more general notion that there will be no veil-piercing at all. What does it mean to say that the limits on veil-piercing that apply to corporations also apply to veil-piercing of limited liability companies, subject to a flat prohibition on any veil-piercing? While the substantive provisions of section 101.002 seem to suggest that veil-piercing will occur, and when it does it should be subject to the same limitations to which corporate veil-piercing is subject, the proviso to section 101.002 affirms a flat prohibition on the veil-piercing of LLCs. The statute contradicts itself.

Unfortunately, section 101.002's suggestion that veil-piercing will occur also conflicts with another part of the LLC code—

### C. A Veil-Piercing Suit Against a LLC Member Is Procedurally Forbidden, by Statute.

The procedural posture of a veil-piercing case is also forbidden by the TBOC.[42] The statute, section 101.113, reads, "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."[43]

A veil-piercing suit is by definition brought to impose a LLC liability on a LLC member. Normally, veil-piercing suits name both the LLC and the member as defendants.[44] The plaintiff proves a cause of action against the LLC itself; this liability is then imposed on the member. However, section 101.113 forbids suing a LLC and its member in a single suit.[45] This rule prohibits the veil-piercing suit in its normal form. Other states whose statutes contain similar provisions[46] have so held.[47] The liability of a LLC can be established in one suit, but a

---

[42] Ricks, *supra* note 38, at 58-60.

[43] TEX. BUS. ORGS. CODE § 101.113 (West 2012).

[44] *See, e.g.,* Spring Street Partners-IV. L.P. v. Lam, 730 F.3d 427, 445 (5th Cir. 2013); Shook v. Walden, 368 S.W.3d 604 (Tex. App.—Austin 2012, pet. denied); Phillips v. B.R. Brick And Masonry, Inc., No. 01-09-00311-CV, 2010 WL 3564820 (Tex. App.— Houston [1st Dist.] Sept. 10, 2010, no pet.) (mem. op.); Sanchez v. Mulvaney, 274 S.W.3d 708, 712 (Tex. App.— San Antonio 2008, no pet.); McCarthy v. Wani Venture, A.S., 251 S.W.3d 573, 589 (Tex. App.— Houston [1st Dist.] 2007, pet. denied). This has also been true in the federal cases, where this procedural rule may or may not apply. *See, e.g.*, *In re* Hous. Drywall, Inc., No. 05-95161-H4-7, 2008 WL 2754526, *32, (Bankr. S.D. Tex. July 10, 2008) (mem. op.); Bramante v. McClain, No. SA-06-CA-00102007, 2007 WL 4555943, *6 (W.D. Tex. Dec. 18, 2007) (mem. op.); DDH Aviation, L.L.C. v. Holly, No. 3:02-CV-2598-P, 2005 WL 770595, *5-8, (N.D. Tex. Mar. 31, 2005) (mem. op.); *In re* Moore, 379 B.R. 284, 284 *et seq.* & 289 n.4 (Bankr. N.D. Tex. 2007); *In re* JNS Aviation, LLC, 376 B.R. 500, 525-31 (Bankr. N.D. Tex. 2007).

[45] TEX. BUS. ORGS. CODE § 101.113 (West 2012) ("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.").

[46] Bishop and Kleinberger list five other states. Carter G. Bishop & Daniel S. Kleinberger, *Limited Liability Companies: Tax & Business Law* ¶ 6.01[3] n.48 (2014).

[47] *See* Eastern Elec. Corp. of New Jersey v. Shoemaker Constr. Co., Order, No. 08-3825, 2009 WL 3397989 (E.D. Pa. Sept. 26, 2009) (applying Pennsylvania law); *In re* Gillespie Opinion, No. 2012 WL 102417, *3 (W.D.N.C. Bankr., Mar. 26, 2012) (applying North Carolina law); Dougle-Eight Oil and Gas, L.L.C. v. Caruthers Producing Co.,

LLC member cannot be a party to that suit, so the lawsuit that establishes the LLC's liability cannot result directly in veil-piercing.

Can a second suit, brought after the LLC is successfully sued, be brought against a member? "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."[48] Because veil-piercing is not a cause of action under Texas law, a second suit against the member for that liability is subject to summary judgment for no cause of action or failure to state a claim.[49] The limited liability company is, of course, an entity separate from its member, and a cause of action against a LLC is not a cause of action against a member. Moreover, section 101.114, which forbids the imposition of any kind of limited liability company liability on a member, appears to have anticipated a "second suit" approach: it forbids imposing LLC liability on a member for "a debt, obligation, or liability under a judgment, decree, or order of a court."[50] A second suit based on liability established against a LLC in a first suit would be "a debt, obligation, or liability under a judgment, decree, or order of a court," the very thing section 101.114 forbids.[51]

Perhaps section 101.113's purpose is narrower than prohibiting veil-piercing suits? Discerning such an other purpose is difficult at best. Miller and Ragazzo claim the section "reflects the principle that an LLC is an entity separate from its members."[52] Obviously it does so, but that much is explicit in the code's very definition of *limited liability company* ("means an entity").[53] Surely section 101.113 did not mean merely to restate this obvious point. That a person and an entity are separate does not mean they cannot be "named as a party in an action . . . against" the other. Section 101.113 goes well beyond parroting the separateness of LLCs and members.

---

13 So.3d 754, 757-58 (La. Ct. App. 2009); Page v. Roscoe, LLC, 497 S.E.2d 422, 428 (N.C. App. 1998) (imposing Rule 11 sanctions for including the member as a party defendant); *see also, e.g.*, Primary Investments, LLC v. Wee Tender Care III, Inc., 746 S.E.2d 823, 827-28 (Ga. Ct. App. 2013). The statute has also been used to forbid standing of a member to sue for an obligation to the LLC. Crozier v. Gattoni, 28 Conn. L. Rptr. 320 (Conn. Superior Ct. 2000).

[48] Gallagher v. McClure Bintliff, 740 S.W.2d 118, 119-20 (Tex. App.—Austin 1987, writ denied); *see, e.g.,* Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427, 443 (5th Cir. 2013) (applying Texas law); 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. Civ. App.—Fort Worth 1970, no writ). Unpublished authority also exists. *See* Rio Grande H2O Guardian v. Robert Juller Family Partnership Ltd., No. 04-13-00441, 2014 WL 309776, *4 (Tex. App.—San Antonio 2014, no pet.).

[49] *See* MT Falkin Investments, L.L.C. v. Chisholm Trail Elks Lodge No. 2659, 400 S.W.3d 658 (Tex. App.—Austin 2013, pet. denied) (granting summary judgment to an association member named as a defendant because the association was a separate legal entity); Sewell v. Smith, 819 S.W.2d 565 (Tex. App.—Dallas 1991, no writ) *aff'd* 858 S.W.2d 350 (Tex. 1993); Weibel v. Martin Indus., Inc., 806 S.W.2d 345 (Tex. App.—Fort Worth 1991, writ denied).

[50] TEX. BUS. ORGS. CODE § 101.114 (West 2012).

[51] *See* Dougle-Eight Oil and Gas, L.L.C. v. Caruthers Producing Co., 13 So.3d 754, 757-58 (La. Ct. App. 2009).

[52] Miller & Ragazzo**,** *supra* note 4, at § 20.45; *accord* Bishop & Kleinberger, *supra* note 46, ¶ 6.01[3].

[53] TEX. BUS. ORGS. CODE ANN. § 1.002(46) (West 2012).

The statute's purpose is more obviously shown by its location. Its placement next to section 101.114 suggests its relevance to veil-piercing and is a holdover from the prior limited liability company code, where the two provisions were together in the same article.[54] The procedural provision is most reasonably read as an additional protection against the imposition of entity liability on company members.

Section 101.113 has no corporate analog. In Texas law, it is unique to the LLC. It is thus an impediment to veil-piercing that is shared by no other entity.

Evidence in the case law suggests that, until very lately, both courts and lawyers have ignored section 101.113.[55] When the statute was finally raised before a court in May 2013, the plaintiff bringing the veil-piercing suit audaciously suggested that, as the statute had been ignored previously, it could be ignored now![56] The case law allowing suits forbidden by the code is part of the incoherence of the law's current approach to LLC veil-piercing.

## D. Incorporation of the Corporate Statute, Itself Muddled, Is Not Such a Great Idea.

When courts decided to apply veil-piercing principles to LLCs, they adopted the same principles applicable to corporations. At least part of section 101.002 now appears to authorize the use of those principles to LLCs. Is that such a good idea? I have discussed some objections to these doctrines before in greater detail[57] and will recapitulate here.

---

[54] In the prior instantiation of the limited liability company code, the provision was grouped with the predecessor to section 101.114 in article 4.03. TEXAS LIMITED LIABILITY COMPANY ACT art. 4.03 (expired Jan. 1, 2010). The predecessor statute was followed in *Video Ocean Group LLC v. Balaji Management, Inc*., 2006 WL 964565, *11 (S.D. Tex. Apr. 12, 2006) (mem. op.), to prohibit a LLC member from suing as a co-plaintiff with the LCC which the member owned.

[55] The statute is cited only a few times in Texas case law, once by a court that appears to have ignored it completely, Shook v. Walden, 368 S.W.3d 604, 613 (Tex. App. –Austin 2012, pet. denied), and thrice by courts who sidestepped the issue to affirm a judgment for LLC members on another ground, Fin & Feather Club v. Leander, 415 S.W.3d 548, 556 (Tex. App.—Dallas 2013, no pet.); Metroplex Mailing Services, LLC v. RR Donnelley & Sons Co., 410 S.W.3d 889, 897-98 (Tex. App.—Dallas 2013, no pet.); K-Solv, L.P. v. McDonald, No. 01-11-00341-CV, 2013 WL 1928798 (Tex. App.—Houston [1st Dist.] May 9, 2013, no pet.) (mem. op.). *See also* note 54, *supra.* All other courts granting veil-piercing relief to plaintiffs in LLC veil-piercing cases appear to have been ignorant of the statute; surely the LLC-member defendants failed to argue it. Interestingly, the argument against section 101.113 in *K-Solv* was that "despite these statutory provisions, Texas courts have nevertheless applied common-law veil-piercing theories in the LLC context." *K-Solv*, 2013 WL 1928798 at *2. In other words, if everyone else ignores the legislature, what's the harm? The statute was referred to as supportive reasoning on facts that did not require its application, in *Barrera v. Cherer*. No. 04-13-00612-CV, 2014 WL 1713522, *2 (Tex. App.—San Antonio Apr. 30, 2014, no pet.) (mem. op.). Of course, the courts have allowed numerous suits to continue against both a LLC and its member notwithstanding the statute, and without ever mentioning it. *See* cases cited footnote 44.

[56] The *K-Solv, LP* decision was the first to ask in print whether section 101.113 had any effect. *See* No. 01-11-00341-CV, 2013 WL 1928798, *2 (Tex. App.—Houston [1st Dist.] May 9, 2013, no pet.) (mem. op.). The argument against section 101.113 in *K-Solv* was that "despite these statutory provisions, Texas courts have nevertheless applied common-law veil-piercing theories in the LLC context." *Id.* at *2. Restated, this argument is merely that courts have acted inconsistently with the law before and therefore can again.

[57] *See* Ricks, *supra* note 38, at 54-58.

### *1. Actual Fraud*

The most glaring incoherence in the statute limiting veil-piercing of corporations is the use of the phrase "actual fraud" to describe both a limit on veil-piercing for contractual liability and an exception to that limit. The corporate statute now perhaps applicable to LLCs reads as follows:

> (a) A holder of shares . . . may not be held liable to the corporation or its obligees with respect to: . . . (2) any contractual obligation of the corporation . . . on the basis of actual or constructive fraud . . . .[58]

This limitation is itself limited in the same statute:

> (b) Subsection (a)(2) does not prevent or limit the liability of a holder . . . if the obligee demonstrates that the 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 holder . . . .[59]

The use of "actual fraud" this way, in this statute, creates incoherence for a number of reasons, even besides the obvious circularity.

First, "actual fraud" has several potential meanings in the law. The most obvious meaning—the tort of actual fraud (as opposed to constructive fraud)—does not fit here at all.[60] That cannot logically be the meaning of the statute. If a person commits the tort of fraud, then that person is individually liable for resulting damages.[61] No veil-piercing is necessary to hold such a person liable; that person is liable independently of any corporate liability.[62]

---

[58] TEX. BUS. ORGS. CODE § 21.223(a)(2) (West 2012).

[59] *Id.* § 21.223(b).

[60] *See* In re Ritz, 513 B.R. 510, 538 (S.D. Tex. 2014); Latham v. Burgher, 320 S.W.3d 602, 607 (Tex. App.—Dallas 2010); *e.g.*, Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427 (5th Cir. 2013) (finding actual fraud for purpose of veil-piercing on facts lacking a misrepresentation); Tryco Enterprises, Inc. v. Robinson, 390 S.W.3d 508, 510 (Tex. App.—Houston [1st Dist.] 2012, pet. dism'd) (same).

[61] Ricks, *supra* note 38, at 55; *see* 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). The defendant LLC member in *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App.—Houston [1st Dist.] 2007, pet. denied), was probably liable for the tort of fraud. Compare *McCarthy*'s jury instruction elements for fraud (taken from the Texas pattern jury charge), 251 S.W.3d at 584, with the elements of fraud set forth in *Aquaplex, Inc. v. Rancho La Valencia, Inc.*, 297 S.W.3d 768, 774 (Tex. 2009). In *McCarthy*, a finding of veil-piercing was probably unnecessary.

[62] *See, e.g.,* Weitzel v. Barnes, 691 S.W.2d 598, 601 (Tex. 1985) (affirming individual liability for DTPA violations perpetrated while serving as agents of a corporation); Nwokedi v. Unlimited Restoration Specialists, Inc., 428 S.W.3d 191, 201 n.1 (Tex. App.—Houston [1st Dist.] 2014, pet. denied) (affirming a controlling shareholder's individual liability for fraud, without veil-piercing); Walker v. Anderson, 232 S.W.3d 899, 918-20 (Tex. App.—Dallas 2007, no pet.) (affirming a corporate shareholder's individual liability for fraud, without veil-piercing, and stating, "[A] corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though he performed the act as an agent of the corporation."); Kingston v. Helm, 82 S.W.3d 755, 758-59 (Tex. App.—Corpus Christi 2002, pet. denied).

Consequently, the abolition of an actual fraud veil-piercing theory in (a)(2) of the statute had no effect on the common law tort of fraud. If (a)(2) and (b) referred to the tort of fraud, subsection (b) would be completely unnecessary as an exception to (a)(2).

The next most obvious meaning, and the one I believe was probably intended by the statute, is at best ambiguous. The Texas Supreme Court case that the corporate statute meant to correct, *Castleberry v. Branscum*,[63] employed the phrase "actual fraud" to describe a ground for veil-piercing liability.[64] I have omitted theories other than "actual fraud" from the quoted statute above, but subsection (a)(2) of the statute named several others that the *Castleberry* court also listed.[65] Because "actual fraud" comes from *Castleberry*, one should turn to *Castleberry* for its meaning. On this, the case provides some limited guidance:

> 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 others, to violate confidence, or to injure public interests.[66]

Logically, then, the statute's reference to actual fraud means some action done with "dishonesty of purpose or intent to deceive." The problem with that definition is that it refers only to intent. A mental state is not something one can perpetrate, as subsection (b) seems to require: "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud."[67]

I do not doubt that the law can construct a meaning around the phrase "actual fraud," and case law is finally now defining it (usually to mean what it meant in *Castleberry*, despite the difficulty).[68] But the statute in its present form does not dictate to the courts, because the

---

[63] 721 S.W.2d 270 (Tex. 1986).

[64] *Id.* at 273. Brent Lee cites this as a reason for presuming the legislature intended *Castleberry*'s meaning. Brent Lee, *Veil Piercing and Actual Fraud Under Article 2.21 of the Texas Business Corporation Act*, 54 BAYLOR L. REV. 427, 438-39 (2002).

[65] *Compare* TEX. BUS. ORGS. CODE § 21.223(a)(2) (West 2012) ("alter ego . . . [,] actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory"), *with Castleberry*, 721 S.W.2d at 271-73 (listing alter ego, actual fraud, constructive fraud, and sham to perpetrate a fraud as viable theories).

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

[67] TEX. BUS. ORGS. CODE § 21.223(b) (West 2012).

[68] Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427, 442-43 (5th Cir. 2013); In re Ritz, 513 B.R. 510, 536 (S.D. Tex. 2014) ("Within the meaning of the Business Organizations Code for piercing the corporate veil regarding a contractual obligation, 'actual fraud' . . . 'involves dishonesty of purpose or intent to deceive.'"); Ogbonna v. USPLabs, LLC, 2014 WL 2592097, *8-12 (W.D. Tex., June 10, 2014) ("Actual fraud, in this context, involves dishonesty of purpose or intent to deceive, and is not equivalent to the tort of fraud."); Maxwell v. Neri North America, No. 4:13-cv-269, 2014 WL 2441200 ** 4-5 (S.D. Tex., May 30, 2014) (mem. op.); Weston Group, Inc. v.

statute has no clear meaning.

### *2. "Other Theories"*

This is not the only ambiguity in the corporate statute. The statute as noted does not list all of the theories of veil-piercing that it disallows for contractual liability; it instead gives examples and tags on "or other similar theory."[69] The result is that the similarity of every other theory must be litigated to the Texas Supreme Court to see if it is "similar." This has happened over and over again in the courts of appeal until the Texas Supreme Court finally took up each theory and settled the matter.[70] That ambiguity is now spread to LLCs, where it may or may not generate more litigation.

### *3. Formalities*

The corporate statute also limits the use of a "formality" in veil piercing:

> A holder of shares . . . may not be held liable to the corporation or its obligees with respect to . . . (3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to: (A) comply with this code or the certificate of formation or bylaws of the corporation; or (B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.[71]

On the one hand, the point of this clause seems clear: a shareholder should not be liable because, for example, the board of directors did not meet, or not every accounting rule was followed. Commentators have pointed out the irrelevance of certain formal, corporate acts to

---

Sw. Home Health Care, LP, No. 3:12-CV-1964-G, 2014 WL 940329, * 4-5 (N.D. Tex., Mar. 11, 2014) (mem. op.); *In re* Arnette, 454 B.R. 663, 694-95 (Bankr. N.D. Tex. 2011) ("In the context of piercing the corporate veil, the concept of 'actual fraud' contained in section 21.223 is not the same as the common law tort of fraud . . . ."); Weaver & Tidwell, L.L.P. v. Guarantee Co. of North America USA, 427 S.W.3d 559, 574 (Tex. App.—Dallas 2014, no pet. h.); Fin & Feather Club v. Leander, 415 S.W.3d 548, 556 (Tex. App.—Texarkana 2013, no pet.); Metroplex Mailing Servs., LLC v. RR Donnelley & Sons Co., 410 S.W.3d 889, 896 (Tex. App.—Dallas 2013, no pet.); Tryco Enters., Inc. v. Robinson, 390 S.W.3d 497, 508 (Tex. App.—Houston [1st Dist.] 2012, no pet.); Shook v. Walden, 368 S.W.3d 604, 621 (Tex. App.—Austin 2012, pet. denied); Latham v. Burgher, 320 S.W.3d 602, 606 (Tex. App.—Dallas 2010, no pet.) ("[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 West End, Inc. v. Market/Ross, Ltd., 273 S.W.3d 905, 908-09 (Tex. App.—Dallas 2008, no pet.); Solutioneers Consulting, Ltd. v. Gulf Greyhound Partners, Ltd., 237 S.W.3d 379, 387-89 (Tex. App.—Houston [14th Dist.] 2007, no pet.); Menetti v. Chavers, 974 S.W.2d 168, 174 (Tex. App.—San Antonio 1998, no pet.).

[69] TEX. BUS. ORGS. CODE § 21.223(a)(2) (West 2012).

[70] *See, e.g.*, Willis v. Donnelly, 199 S.W.3d 262, 273 (Tex. 2006) (settling the ratification theory); S. Union Co. v. City of Edinburg, 129 S.W.3d 74, 85-90 (Tex. 2003) (settling the enterprise theory). While the cases were percolating in the courts of appeals, commentators felt obliged to tell the courts how to interpret the ambiguous passage. *See* the long list of commentary cited at Ricks, *supra* note 38, at 57 n.177.

[71] TEX. BUS. ORGS. CODE § 21.223(a)(3) (West 2012).

shareholder liability.[72] As a relevance criterion, this qualification is unobjectionable. However, the statute does not phrase the limitation as a relevance criterion, and until a court clarifies it as such, we are likely to see litigation over a host of practices that one party sees as formalism and the other sees as substantive. After all, whether an act is a formalism or substance depends on its and the actor's purpose.[73] The ultimate formalism in the code is the filing of the certificate of formation,[74] yet corporate existence under the law depends on this paper being filed.[75] To the creditor who thought it had obtained a resolution from a board[76] authorizing the transaction that created the debt, the lack of a meeting[77] might be the very basis of a fraud—even an "actual fraud." To a creditor looking for funds that have been commingled, the lack of accounting allows the controlling shareholder to commit fraud. The difficulty in determining what is a formality is perhaps one reason formalities seem to come up in courts' analyses of veil-piercing cases notwithstanding the statute.[78] This statute simply does not say yet what it needs to say; it does not contain its animating principle within its terms.

Moreover, operators of Texas entities who follow the suggestion of the statute may be fooled into believing "formalities"—often requirements of the code or the certificate of formation—are not important. Following the law is always important, however; general prudence suggests counsel should diligently advise that "formalities" be observed. In fact, Texas entities—and shareholders and LLC members—may have to answer for them notwithstanding the TBOC's provision. Under choice of law rules that govern in courts outside the state, the law of the forum state rather than the state of incorporation may govern the veil-piercing issue.[79] Moreover, in federal question cases, federal choice of law principles may

---

[72] *See, e.g.*, Franklin A. Gevurtz, CORPORATION LAW § 1.5.4 (2d ed. 2010); TFH Properties, LLC v. MCM Development, LLC, Order, No. CV-09-8050-PCT-FJM, 2010 WL 2720843, *6-7 (D. Ariz., July 9, 2010) (interpreting Utah's prohibition on the use of formalities in LLC veil-piercing analysis in the following manner: evidence of failure to observe formalities is allowed to show alter ego but could not be the sole basis for veil piercing). The *TFH Properties* analysis makes good sense; it limits failure to abide by formalities to where it is relevant.

[73] This is why a recent majority opinion could cite in support of veil-piercing that the shareholders "neglected the corporate formality of paying [the corporation's] franchise tax" (an event which is grounds for administrative termination of the corporation by the state, *see* TEX. BUS. ORGS. CODE § 11.251 (West 2012)) only to have the dissent criticize that for relying on a formality. *Cf.* Tryco Enterprises, Inc. v. Robinson, 390 S.W.3d 497, 509 (Tex. App.—Houston 1st Dist.] 2012, pet. dism'd), *with id.* at 525 (Massengale, J., dissenting); *cf. also* Gevurtz, *supra* note 72.

[74] Unbelievably, this is the so-called "formality" at issue in *Scott v. McKay*, No. 12-02-00195-CV, 2003 WL 21998629, *3 (Tex. App.—Tyler Aug. 20, 2003, no pet.) (mem. op.).

[75] TEX. BUS. ORGS. CODE § 3.001(c) (West 2012) ("the existence of a filing entity commences when the filing of the certificate takes effect"). It is possible for a corporation to form *de facto* without a filing, but this requires proof in court of evidence sufficient to show *de facto* formation. *See, e.g.*, TEX. BUS. ORGS. CODE § 3.001(d); Val D. Ricks, *The Revival of De Facto Incorporation in Texas*, 25 CORP. COUNSEL REV. 77 (2006).

[76] Failure to obtain a resolution was deemed a "corporate formalit[y]" that the court then discussed as if it were relevant, notwithstanding its citation to the statute, in *Schlueter v. Carey*, 112 S.W.3d 164 (Tex. App.—Fort Worth 2003, pet. denied).

[77] This is the corporate formality deemed unusable in *Morris v. Powell*, 150 S.W.3d 212, 220 (Tex. App.—San Antonio 2004, no pet.). That the corporation held meetings at a certain office was the fact employed in the court's analysis in *Dominguez v. Payne*, 112 S.W.3d 866, 870 (Tex. App.—Edinburg 2003, no pet.).

[78] *E.g.*, Wilson v. Davis, 305 S.W.3d 57, 71 (Tex. App.—Houston [1st Dist.] 2009, no pet.); Schlueter v. Carey, 112 S.W.3d 164 (Tex. App.—Fort Worth 2003, pet. denied).

[79] *E.g.*, B&H Nat. Place, Inc. v. Beresford, 850 F. Supp. 2d 251, 259-60 & n.14 (D.D.C. 2012) (applying D.C.

dictate that the federal common law of veil-piercing applies,[80] and the federal law may take account of formalities that Texas law does not.[81] So it is possible for the owners of a Texas entity to find themselves liable under the veil-piercing law of another jurisdiction, where formalities matter.[82]

Even more concerning is the application of the "formalities are not considered" principle to the LLC. The likelihood of an unjust or illogical application of that principle is magnified in the LLC context, where the code requires little in the way of formalities. The LLC—"its relations among members, managers, . . . and the company itself," as well as its "other internal affairs"—is governed by agreement.[83] Unlike the corporate code, which as a default requires a board of directors and officers,[84] meetings of board and shareholders,[85] notices of meetings,[86] and the like,[87] the LLC code by default allows members to manage,[88] requires no meeting of members, and in general eschews formality in favor of consent.[89] In this very different

---

law to a veil-piercing issue of a corporation formed in Virginia); TAC-Critical Systems, Inc. v. Integrated Facility Systems, Inc., 808 F.Supp. 2d 60, 63-65 (D.D.C. 2011) (same); Harrelson v. Seung Heun Lee, 798 F. Supp. 2d 310, 316 n.4 (D. Mass. 2011) (applying Massachusetts law in the veil-piercing of Arizona corporations); *In re* Botten, 54 B.R. 707, 708-09 (Bankr. W.D. Wis. 1985) (applying Wisconsin law to an apparently non-Wisconsin corporation's veil-piercing because "the rights of third parties are affected"); Multi-Media Holdings, Inc. v. Piedmont Center, 15 LLC, 583 S.E.2d 262 (Ga. App. 2003) (applying Georgia law to the veil-piercing of a Delaware corporation); Cahaly v. Benistar Property Exchange Trust Co., Inc., 864 N.E.2d 548, 558 n.16 (Mass. App. Ct. 2007); UBS Secs. LLC v. Highland Capital Mgmt., L.P., 924 N.Y.S.2d 312 (N.Y. Sup. 2011) (applying N.Y. Law to a Cayman Islands corporation veil-piercing issue); *see also, e.g.,* U.S. v. Clinical Leasing Service, Inc. 982 F.2d 900, 902 (5th Cir. 1992) (applying Louisiana law to a Delaware corporation's veil-piercing because the parties agreed but also citing in justification Restatement (Second) Conflicts of Laws § 306 (1971) ("some other state has a more significant relationship")); Channing v. Equifax, Inc., 2013 WL 593942, *3 & n.1 (E.D.N.C., Feb. 15, 2013); Hitachi Medical Systems America, Inc. v. Branch, 2010 WL 816344, *8 (N.D. Ohio, Mar. 4, 2010) (mem. op.) (reserving the issue and ordering further briefing because the choice of law issue could determine the outcome). The majority of course apply the internal affairs doctrine to veil-piercing issues.

[80] *E.g.*, Brotherhood of Locomotive Eng'rs v. Springfield Term. Ry. Co., 210 F.3d 18, 25-33 (1st Cir. 2000) (applying federal common law of veil-piercing), *cert. denied*, 531 U.S. 1014 (2000).

[81] *See* Alvarez v. 9ER'S Grill@Blackhawk, L.L.C., Civ. A. H-08-2905, 2009 WL 2252243 (S.D. Tex. 2009) (mem. op.). *Alvarez* applied federal single business enterprise theory under the Federal Labor Standards Act to two Texas LLCs engaged in the restaurant business. *Id.* In concluding that the two should be treated as one, the court cited that the two LLCs were organized when a single organizer filed articles of organization for both. *Id.* at *6.

[82] *See* Brotherhood of Locomotive Eng'rs, 210 F.3d at 29 ("Other factors may also be relevant, such as whether the carrier and the related corporation fail to observe separate corporate formalities, or whether the related corporation is undercapitalized.").

[83] TEX. BUS. ORGS. CODE § 101.052(a) (West 2012).

[84] *Id.* §§ 21.401, 21.417.

[85] *Id.* §§ 21.351, 21.409(a), 21.415.

[86] *Id.* §§ 21.353, 21.411(b).

[87] *Id.* §§ 21.302 (board authorization of distributions), 21.367 (proxy voting), 21.372 (shareholder voting list), 21.456 (voting required for fundamental business transactions).

[88] *Id.* § 3.010.

[89] While the code appears to require a governing authority of members to meet, *id.* §§ 101.355-.356, managing members may vote by proxy, *id.* § 101.357(a)(2), and by default action can also be taken with less than unanimous consent, without a meeting, *id.* § 101.358. This contrasts with the corporation, whose directors must deliberate and vote in person and where voting by consent with less than unanimity requires permission of the shareholders in writing in advance.

context, what counts as a formality and what as substance is even more likely to be confused, and the corporate precedents should not control.[90]

In fact, several states' LLC codes provide that failure to observe formalities "is not a ground for imposing personal liability on the members . . . for liabilities of the company."[91] Jurisprudence under these statutes, from other jurisdictions, may be more relevant where LLCs are involved than Texas' own experience under its corporate code, despite the source of Texas' prohibition on the analysis of LLC formalities.

### *4. Reverse Veil-Piercing*

Finally, the corporate statute is inapplicable to reverse piercing claims,[92] and the LLC code's adoption of the corporate statute does not remedy this omission.[93] In a reverse veil-piercing, a corporation is held liable for a shareholder's liability.[94] Reverse piercing can happen to LLCs, too.[95] If the unity of the corporation and the shareholder combined with the commission of some inequitable conduct or constructive fraud is not sufficient to pierce the veil against a LLC member for contractual liability, why should it be sufficient when a creditor of the member seeks to hold the LLC liable for the member's contract debt? And if formalities should not be considered for veil-piercing, why should they be considered for reverse veil-piercing? Courts should tread even more lightly in that circumstance because other creditors with claims against the LLC or the member may exist.[96] Yet in the case of reverse veil-piercing, the statutory limitation, merely an exception to a prohibition on shareholder liability, by its own terms does not apply.

## II. A PROPOSAL FOR FIXING THE STATUTE

Notwithstanding the endless fun I have describing this thicket to my students, they do not enjoy walking through it. We cannot understand the law, and predicting its application is impossible. The best we can discern is a set of arguments: Argue against veil-piercing based on section 101.114 and its reiteration in 101.002. Argue that your LLC-member client cannot be a defendant under 101.113. Argue that if the LLC has already been held liable in a prior suit that the LLC's liability cannot be imposed on the member, under the second half of 101.114. These

---

[90] *Accord* Ribstein & Keatinge, *supra* note 2, § 12.3; Robert R. Keatinge, *et al. The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 445-46 (1992).

[91] 805 ILL. COMP. STAT. § 10-10(c) (2014); Ribstein & Keatinge, *supra* note 2, § 12.3 & n.20.

[92] *See* TEX. BUS. ORGS. CODE §§ 21.223 – 21.226 (West 2012).

[93] *See* TEX. BUS. ORGS. CODE § 101.002 (West 2012).

[94] *See, e.g.*, Wilson v. Davis, 305 S.W.3d 57 (Tex. App.—Houston [1st Dist.] Aug. 14, 2009, no pet.); *see also, e.g.,* Bollore S.A. v. Import Warehouse, Inc., 448 F.3d 317 (5th Cir. 2006) (applying Texas law); Zahra Spiritual Trust v. United States, 910 F.2d 240, 244 (5th Cir. 1990) (applying Texas law); Seghers v. Bizri, 513 F. Supp. 2d 694 (N.D. Tex. Mar. 7, 2007).

[95] *See, e.g.*, In re Moore, 608 F.3d 253, 258-59 (5th Cir. 2010) (applynig Texas law) (holding that reverse piercing claims against a bankrupt debtor's LLC were owned by the trustee and thus transferable by the trustee to another); *In re* Juliet Homes, LP, No. 09-03429, 2011 WL 6817928, at *18-20 (Bankr. S.D. Tex., Dec. 28, 2011) (rejecting motion to dismiss a reverse veil-piercing claim against both several individuals and several entities, including a LLC); Ribstein & Keatinge, *supra* note 2, § 12.3 n.28.

[96] *E.g.*, *In re* Moore, 379 B.R. 284, 294-95 (Bankr. N.D. Tex., Nov. 15, 2007).

all seem like winning arguments until we recall other arguments: Section 101.002, while proclaiming itself subject to 101.114, also imposed on LLCs law that could only apply if 101.114 is not taken at face value. Section 101.114 has never been taken at face value by the courts. Section 101.113 has never been applied. The second part of 101.114 has also never been applied. Now our heads are spinning. If we took all of this language seriously, our heads would continue to spin.

Fixing this twisted area of the law could be relatively simple, but those who have composed it and applied it will have to reach some agreement on basic principles. The first proposition on which those involved should agree is that—

## A. The Possibility of LLC Veil-Piercing Should Be Allowed.

Ultimately, the legislature cannot and should not stop veil-piercing (or a similar remedy) when it is truly appropriate. Moreover, this seems to be nearly universally acknowledged.

### *1. The Court's Equitable Power to Stop Fraud Requires Veil-Piercing.*

With respect to limited liability companies, veil-piercing law is equitable,[97] meaning that its foundation is in the courts' equitable power to correct the application of a law that would allow the perpetration of a fraud. *Hooks v. Bridgewater* discussed the courts' equitable power:

> It is clear that to warrant equity's 'breaking through the statute' . . . , the case must be such that . . . the enforcement of the statute . . . would, itself, plainly amount to a fraud. This is the basis, and the only basis, for the jurisdiction which courts of equity have assumed in their creation of exception to the statute. When it is considered that the exercise of that jurisdiction results in any case in practically setting the statute aside, certainly there should exist some positive rule which will insure its exercise for only the prevention of an actual fraud as distinguished from a mere wrong, and by which the question of whether [enforcing the statute] would result in such a fraud may be determined so surely as to leave the statute itself, through the exactness of the exception, with some definiteness of operation.[98]

This is the only basis for the numerous equitable exceptions to the Statute of Frauds discussed above in Section I.A. The Statute of Frauds by its terms prevents the enforcement of an oral contract, but the courts pursuant to equitable powers correct the law by making an exception.

The exception to limitations on corporate veil-piercing rests on this power. The language above from *Hooks* could have been written as a justification for section 21.223(b). The veil-

---

[97] *E.g.*, Castleberry v. Branscum, 721 S.W.2d 270, 271 (Tex. 1986) ("when the corporate form has been used as part of a basically unfair device to achieve an inequitable result"), *superseded in part by*, TEX. BUS. ORGS. CODE § 21.223 (West 2012); Tryco Enters., Inc. v. Robinson, 390 S.W.3d 497, 510 (Tex. App.—Houston [1st Dist.] 2012, no pet.) (quoting *Castleberry*, 721 S.W.2d at 273); Shook v. Walden, 368 S.W.3d 604, 611-12 (Tex. App.—Houston [1st Dist.] 2012, pet. denied) ("disregarded as a matter of equity"). When veil-piercing is grounded in equity, many jurisdictions refuse a jury trial right for it. *E.g.*, Sam F. Halabi, *Veil-Piercing's Procedure*, 67 RUTGERS L. REV. ___ (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2490647 (Sept. 2, 2014).

[98] *See, e.g.*, Hooks v. Bridgewater, 229 S.W. 1114, 1116 (Tex. 1921).

piercing limitations in the corporate code meant to limit the courts' veil-piercing activities, and section 21.223(a) is the vehicle for limitation. But section 21.223(b) recognizes that legislation cannot force courts to allow the law to countenance the perpetration of fraud, so there must be an exception to the limitation. The exception is a "positive rule which will insure its exercise for only the prevention of an actual fraud as distinguished from a mere wrong, and by which the question of whether enforcing the statute would result in such a fraud may be determined so surely as to leave"[99] the separateness of corporate entities intact, with some definiteness of operation. In other words, the legislature recognizes in section 21.223(b) that veil-piercing rests ultimately on a moral and jurisprudential obligation of the courts. It could only be limited so far.

The exact same concerns animate the liability of LLC members for LLC obligations. Sometimes, the imposition of liability on a LLC member is the only way to remedy fraud. When it is, following section 101.114 or 101.113 would be to countenance fraud. A court is not required to do this, and a statute authorizing courts to protect fraudulent behavior would be odious.

### *2. Veil-Piercing of LLCs Is the Universal Rule Nationally.*

I have found no dissent from the proposition that the veil of limited liability companies should be pierced given the right circumstances. Though arguments continue about which circumstances are proper, no one now argues for an absolute prohibition; remarkable agreement exists among commentators and cases that if the circumstances demand it members should be liable for the obligations of the LLC.[100] Such uniformity was not foreordained when the Texas LLC code was first passed in 1991,[101] but at this late date an absolute prohibition against veil-piercing of LLCs is a lost battle.

## B. Equity Can Be Described and Contained by Statute.

Historically, when courts have adopted positions in equity that made exceptions to the application of statutes, legislatures have often stepped up to correct the legislation that made possible the circumstances demanding departure from statutory language. Examples of legislative adoption of an equitable position include the doctrine of unconscionability in

---

[99] *Id*. at 128. Peter Oh reports that veil-piercing claims in contract "prevail most often when couched in Fraud. The veil-piercing rate for Fraud exceeds that of any other type of civil substantive claim, in federal or state court as well as across all levels of courts." Peter Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 125 (2010).

[100] *See, e.g.*, Bishop & Kleinberger, *supra* note 46; Ribstein & Keatinge, *supra* note 2, at § 12.3; Miller & Ragazzo, *supra* note 4, at § 20:7; Miller, *supra* note 4, at 416-19; Jeffrey K. Vandervoort, *Piercing the Veil of Limited Liability Companies: The Need for a Better Standard*, 3 DEPAUL BUS. & COM. L.J. 51 (2004); Rebecca J. Huss, *Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age*, 70 U. CIN. L. REV. 95 (2001); Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1 (1997); Robert R. Keatinge, et al, *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 445 (1992); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 403 (1991). Ribstein and Keatinge in particular cite at length cases from around the nation. *See* Ribstein & Keatinge*, supra* note 2, at § 12.3 n.1. (One can search for hours and not find a single dissenting voice.)

[101] 2013 Bill Tex. H.B. 278 (1991).

contracts;[102] statutes authorizing equitable remedies such as injunctions,[103] declaratory judgments,[104] and receiverships;[105] trust law;[106] fiduciary duty law;[107] and the corporate statute allowing veil-piercing notwithstanding limits.[108] No reason exists that legislation could not also establish, structure, and clarify veil-piercing for the LLC.

## C. The LLC Code Can Limit Veil-Piercing in a Simple Way.

An irony exists in a legislative attempt to curb judicial power that itself corrects absurd consequences of legislation. The legal history of veil-piercing in Texas looks like a slow brawl between proponents and opponents of veil-piercing's breadth. The courts took the first swing with *Castleberry*—broad. The legislature struck back with the predecessor of section 21.223—narrow. The legislature took another swing with sections 101.113 and 101.114—so narrow as to be non-existent. The courts swung back with decisions that applied veil-piercing to LLCs, but on the principles set forth in section 21.223—relatively broad. With the latest legislation, both sides are holding on to their opponent—sections 101.113, 101.114, and the preamble to section 101.002 suggesting no veil-piercing should occur; and the rest of section 101.002 and the courts suggesting that veil-piercing should continue on section 21.223 principles. With the two sides' arms tied up, and no referee to separate them, litigants and courts should wonder what will happen next.

But with clarity that no absolute prohibition of LLC veil-piercing should exist and with confidence that the statute can set the boundaries, as does the corporate code, some decisions can be reached.

To start, the statute should discard the absolute prohibition of section 101.114. Courts have both the power and the obligation to disregard it in the proper circumstances, anyway, so the incoherence it brings to the law serves only wishful thinking. Clarifying that it does not preclude veil-piercing would also bring Texas law into line with the rest of the nation. One way to do this would be to adopt the Uniform Act's "solely by reason of being . . . a member" language,[109] which allows the egregious facts of veil-piercing cases to fall outside of the prohibition.

Second, section 101.002's qualifier "[s]ubject to Section 101.114" should be repealed. Section 101.114 is phrased as an absolute prohibition, and that condition renders section

---

[102] *See* TEX. BUS. & COM. CODE § 2-302 (West 2012). For an early example of unconscionability in equity in a contracts case, *see* Luckett v. Townsend, 3 Tex. 119, 131 (1848). The Texas Supreme Court now turns to the UCC's sale of goods provision on unconcionability to give guidance on unconscionability even outside the context of the sale of goods. *See* Venture Cotton Co-op v. Freeman, 435 S.W.3d 222 (Tex. 2014).

[103] TEX. CIV. PRAC. & REM. CODE §§ 65.001-65.045 (West 2012).

[104] TEX. CIV. PRAC. & REM. CODE §§ 37.001-37.011 (West 2012).

[105] TEX. BUS. ORGS. CODE §§ 11.401-11.414 (West 2012).

[106] TEX. BUS. ORGS. CODE chs. 101, 111, 112, 113, 114 & 115 (West 2012). The early history of trust law's development in equity is reported in David J. Seipp, *Trust and Fiduciary Duty in the Early Common Law*, 91 BOSTON UNIV. L. REV. 1011 (2011).

[107] *E.g.*, TEX. BUS. ORGS. CODE §§ 7.001, 101.255, 101.401, 152.204, 152.205, 152.206 (West 2012).

[108] TEX. BUS. ORGS. CODE § 21.223(b) (West 2012).

[109] *See supra* note 2.

101.002 a contradiction. If section 101.114 was amended so that it was no longer an absolute prohibition, section 101.002 would not need to be subject to it.

Third, section 101.113 should be repealed. It is at best an indirect attempt at regulating veil-piercing via procedure on the off chance that the absolute prohibition of section 101.114 is ineffective. Section 101.113's procedural hurdle is so counter-intuitive that for two decades while the statute sat on the books no court suspected its substance and no lawyer raised it to the court! Direct regulation of the substance of the law is a much better course. Moreover, section 101.113 runs the risk of forcing the courts to allow fraud in the management of the LLC, and courts have an obligation to stop a statute intended to encourage investment and increase business efficiency from having the opposite effect of encouraging fraud.

These changes would go a long way toward fixing the statute. I doubt the remaining problems would warrant mention in print if these were fixed. But as long as we are at it, why not try to mend a few remaining problems?

If section 101.114 is to lose its absolute prohibition, then what form should it take? One possible form is the Uniform Act's, already noted.[110] Another form would be to list exceptions; in other words, capture the equitable position in legislation to give equity effect, structure, and content. The narrowest form this might take is to list the ground of equitable jurisdiction itself:

> *(a)* Except as and *only* to the extent *provided in subsection (b) or that* the company agreement specifically provides otherwise, a member . . . is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.
>
> *(b) A member is liable for the debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court if the member has used the limited liability company to perpetrate a fraud with intent to deceive primarily for the direct personal benefit of the member and against the person to whom the debt, obligation, or liability is owed. A limited liability company shall be liable for the debt, obligation, or liability of a member only on the same principle.*

There are several benefits to this formulation. For instance, it does not use the muddled phrase "actual fraud"; the circularity and ambiguity of section 21.223's use of that phrase is avoided. Second, "other theories" are not mentioned. It is clear that only this narrow case will warrant liability. Third, though formalities are not mentioned, they would only be of use in a veil-piercing case to the extent they are relevant to the issue at hand, which is to the extent that failure to observe them is evidence of the elements of the new section 101.114(b). That is their proper place, in fact. Reverse piercing is also addressed. If this method of direct regulation is chosen, section 101.002 should also be repealed.

---

[110] *See supra* text accompanying note 110.

Perhaps this proposal is too narrow and too broad. For contractual obligations, perhaps it is too broad. The law now requires that litigants satisfy not only this minimal test for equitable jurisdiction, but also the traditional test for veil piercing, from *Castleberry*.[111] Of course, this is easily fixed by including that traditional test, making veil-piercing available as follows:

> *(a)* Except as and *only* to the extent *provided in subsection (b) or that* the company agreement specifically provides otherwise, a member . . . is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.
>
> *(b) A member is liable for the contractual debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court if the member has used the limited liability company*
>
> > *(i) as part of a basically unfair device to achieve an inequitable result, and*
> >
> > *(ii) to perpetrate a fraud with intent to deceive primarily for the direct personal benefit of the member and against the person to whom the debt, obligation, or liability is owed.*
>
> *A limited liability company shall be liable for the debt, obligation, or liability of a member only on the same principle.*
>
> *(c) A member's failure to observe any formality of law or agreement in the operation of the limited liability company is not itself a ground for member liability but may, if relevant, contribute to a finding of unfairness or inequity.*

Knowledgeable readers will recognize the language from the Texas Supreme Court's latest pronouncement of the standards for shareholder liability for a corporate debt,[112] with an added sentence to deal with formalities. That should suffice to counter the objection; the case law fills out the meaning of the general test. The only exception is that this proposal handles the law of formalities as a relevance question, which it should be.[113] This would be more reflective of current corporate law, but requiring plaintiffs to show both (i) and (ii) has always seemed redundant to me. Subsection (ii) is the more difficult showing, and if subsection (ii) is shown, the courts should pierce regardless of whether (i) is true, so it would be appropriate to drop (i) and allow contractual and non-contractual liability to be regulated somewhat differently.

---

[111] *See, e.g.*, *supra* note 97.

[112] SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 451 (Tex. 2009) (*citing* Castleberry v Branscum, 721 S.W.2d 270, 271 (Tex. 1986)).

[113] *Contra* TEX. BUS. ORGS. CODE § 21.223(a)(3) (West 2012). The difference, of course, is that here proof of failure to observe formalities is allowed if that is actually relevant to prove the case. The proposal tries to eliminate the confusion inherent in 21.223(a)(3) as currently worded.

Some may feel the proposal too narrow with respect to tort and other non-contractual liability. After all, the corporate statute treats shareholder liability for torts differently from contractual liability; imposition of tort liability requires proof of traditional judge-made veil-piercing law (minus failure to observe formalities),[114] while contractual liability requires the same proof plus a showing that the shareholder used the corporation "for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of" the shareholder.[115] It is possible to subject tort liability to the same criteria as contract liability.

But that may be too narrow. Is fraud the only possible absurd consequence of an absolute prohibition on LLC veil-piercing? I do not know, and I suppose reasonable minds may differ. After all, the tort victim is seldom able to calculate the risk of dealing with the LLC in a manner similar to one who enters into a contract with it. Tort victims do not choose their status at all. Setting up a LLC with little or no capital in order to use it to commit torts with impunity is malicious or recklessly abusive in a manner similar to using the entity to perpetrate an intentional fraud, but it is not necessarily an actual fraud. If the legislature feels that tort liability veil-piercing against LLC members should more resemble the corporate context, then the proposal could be modified to include that substance, so that another recommended proposal looks like this:

> *(a)* Except as and *only* to the extent *provided in subsection (b) or (c) or that* the company agreement specifically provides otherwise, a member . . . is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.
>
> *(b) A member is liable for the contractual debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court if the member has used the limited liability company to perpetrate a fraud with intent to deceive primarily for the direct personal benefit of the member and against the person to whom the debt, obligation, or liability is owed. A limited liability company shall be liable for the debt, obligation, or liability of a member only on the same principle.*
>
> *(c) A member is liable for the non-contractual debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court if the member has used the limited liability company as part of a basically unfair device to achieve an inequitable result.*
>
> *(d) A member's failure to observe any formality of law or agreement in the operation of the limited liability company is not itself a ground for member liability but may, if relevant, contribute to a finding of fraud, unfairness, or inequity.*

---

114 *See, e.g.*, TEX. BUS. ORGS. CODE §§ 21.223(a), 21.224 (West 2012).

115 *Id.* § 21.223(b).

With regard to tort liability, I see little difference between the position of the LLC member and the corporate shareholder, or at least none that makes the law difficult to apply as it does in the contractual liability context given the language and conceptual structure of section 21.223.

With these larger issues addressed, I will conclude by urging action. I have shown, I hope, that the statute must be improved, and that it can be. No doubt more could be said on these issues; surely others will contribute. I mean here only to describe the problem and point toward a simpler, more internally consistent solution. In its current state, the Texas law of veil-piercing for LLCs does not need further description. It does not deserve further description. It deserves to be changed.