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# Corporations

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# CORPORATIONS

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## I. INTRODUCTION

**D**URING this Survey period,<sup>1</sup> the Texas courts<sup>2</sup> again addressed several corporate law issues of significance. Those issues may be grouped into two categories: (1) imposing liability on officers, directors and owners of corporations; and (2) drafting corporate agreements in the context of a corporate acquisition. Section II will address the various theories highlighted during this Survey period on which Texas courts based the imposition of liability on a corporate officer, director or owner. Section III will continue last year's discussion of the issues present in drafting letters of intent as part of the negotiation of a corporate acquisition. Although the 77th Texas Legislature was in session during the Survey period, there were no significant legislative developments in the corporate law area.

## II. IMPOSING LIABILITY ON CORPORATION OFFICERS, DIRECTORS OR OWNERS

As stated in last year's Corporations Survey, Texas courts routinely stress the importance of honoring the corporate form.<sup>3</sup> This Survey period was no exception.<sup>4</sup> Nevertheless, the bulk of Texas corporate law cases decided during this Survey period dealt with efforts by plaintiffs to impose liability on corporate officers, directors or owners; in many cases, for actions taken solely in their capacity as such. Those cases can be divided into four categories: (a) cases involving traditional "piercing the corporate veil" analysis in the context of a tort not associated with a corporate contractual obligation, which will be discussed in Part A of this Section II; (b) cases involving traditional "piercing the corporate veil" analysis in the context of a tort associated with a corporate contractual obligation, which will be discussed in Part B of this Section II; (c) cases not involving "piercing the corporate veil" in which corporate officers or

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1. The Survey period is from October 1, 2000 through September 30, 2001, but includes cases beyond September 30, 2001 to the extent available prior to publication date.

2. Like prior years' Corporations Surveys, for the purpose of this article, "Texas courts" includes decisions by the federal district or bankruptcy courts situated within Texas, by the United States Court of Appeals for the Fifth Circuit interpreting Texas law, and, where appropriate, by the United States Supreme Court. Because the scope of this Article is limited to a survey of Texas corporate law issues, federal cases focusing purely on federal issues affecting the corporation, or federal or Texas cases discussing securities law generally, are not addressed.

3. Glenn D. West, *Corporations*, 54 SMU L. REV. 1221, 1222 (2001).

4. See *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 204-05 (2001) (holding that corporate owner was "distinct" from corporation and they were two separate entities for RICO); *Mitchell v. LaFlamme*, 60 S.W.3d 123, 128 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (reaffirming that "an owner cannot personally recover damages for a wrong done solely to the corporation, even though the owner may be injured by that wrong"); *In re Cap Rock Elec. Coop., Inc.*, 35 S.W.3d 222, 228-29 (Tex. App.—Texarkana 2000, pet. denied) (noting rule that attorney-client privilege continues with acquirer in a merger, but finding that privilege did not continue here because target's post-merger cancellation of regulatory certificates made it more like a liquidated company).

representatives are nonetheless held liable on the theory that they were personally involved in a tort, even though committed solely on behalf of the corporation for whom they were acting, which will be discussed in Part C of this Section II; and (d) cases in which the failure of the corporate officer to clearly identify himself or herself as acting only on behalf of the corporation in entering into an agreement imposed liability on such officer under the principles enunciated during the last Survey period in *Taylor-Made Hose, Inc., v. Wilkerson*,<sup>5</sup> which will be discussed in Part D of this Section II.

Interestingly, none of the cases discussed in Parts B and C of this Section II, many of which clearly involved torts resulting from or connected with contractual obligations of a corporation, addressed the potential applicability of Article 2.21 of the Texas Business Corporation Act,<sup>6</sup> which prohibits imposition of liability on officers, directors or shareholders of a corporation for any contracts entered into by that corporation, or torts resulting from those contracts, unless such officers, directors or shareholders “caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for [their] direct personal benefit.”<sup>7</sup> Not only are Texas courts potentially misapplying Article 2.21 as indicated in the discussion of *Texas-Ohio Gas, Inc. v. Mecom, III*<sup>8</sup> in last year’s Corporations Survey, but they are ignoring it altogether in both the “piercing the corporate veil” cases and the direct personal tort participation cases.<sup>9</sup> Where appropriate we will note the

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5. 21 S.W.3d 484 (Tex. App.—San Antonio 2000, pet. denied), as discussed in West, *supra* note 3, at 1231-33.

6. TEX. BUS. CORP. ACT art. 2.21(A)(2) (Vernon Supp. 2002) [hereinafter “Article 2.21”]. Article 2.21(A)(2) expressly relieves from liability “a holder of shares, . . . or any affiliate thereof or of the corporation” for “any contractual obligation of the corporation or any matter related to or arising from the obligation on the basis that the holder, . . . or affiliate is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory, unless the obligee demonstrates that the holder, . . . or affiliate caused the corporation to be used for the purpose of perpetuating and did perpetuate an actual fraud on the obligee primarily for the direct personal benefit of the holder, . . . or affiliate.” *Id.*

7. *Id.* The Committee states that the amendments to Article 2.21 requiring actual fraud provide the “exclusive” authority for piercing the veil in contract claims. *Id.* cmt. The 1997 amendments require actual fraud for contractual obligations and “any matter relating to or arising from the obligation.” *But see* *Love v. State*, 972 S.W.2d 114 (Tex. App.—Austin 1998, pet. denied) (holding that actual fraud is not required under Article 2.21 for violations of state regulations). While some courts seem to believe that actual fraud also applies to tort claims unrelated to contracts, it appears to these authors that common law principles continue to apply to pure torts that are unrelated to any contractual obligation. *See, e.g.,* *Menetti v. Chavers*, 974 S.W.2d 168, 174 (Tex. App.—San Antonio 1998, no pet.) (stating amendments “blur” the distinction between contract and tort claims); *CMC Steel Fabricators, Inc. v. Harrop Constr. Co., Inc.*, 131 F. Supp. 2d 882, 894 (S.D. Tex. 2000) (stating that 1997 amendment “erased” distinction between contract and tort claims).

8. 28 S.W.3d 129 (Tex. App.—Texarkana 2000, no pet.), as discussed in West, *supra* note 3, at 1226.

9. Of 348 Texas cases discussing veil piercing since 1997, only 10% discussed Article 2.21. The Texas Legislature amended Article 2.21 in 1993 to explicitly provide that it applied to “the alter ego theory, the single business enterprise theory and other similar theo-

potential applicability of Article 2.21 in those cases discussed in Parts B and C of this Section II.

A. PIERCING THE CORPORATE VEIL IN TORT CASES NOT INVOLVING A CONTRACTUAL OBLIGATION

In addition to the well known alter ego theory enunciated in *Castleberry v. Branscum*,<sup>10</sup> Texas courts are increasingly utilizing the single business enterprise theory to disregard the corporate form.<sup>11</sup> The case law is unclear as to whether the theories can be used interchangeably or whether they are separate doctrines.<sup>12</sup> This Survey period contained several opinions discussing the interaction between alter ego and single business enterprise.

1. *Nichols v. Pabtex, Inc.*<sup>13</sup>

In *Nichols*, the plaintiff suffered a foot injury at work and sued his employer and its affiliated companies for personal injury;<sup>14</sup> this situation (involving a personal injury claim as opposed to a tort claim connected to a contractual obligation such as fraud, fraudulent inducement or tortious interference)<sup>15</sup> clearly does not give rise to the potential applicability of Article 2.21 and therefore is correctly dealt with under the traditional common law analysis.<sup>16</sup> Plaintiff alleged both alter ego and single business enterprise to pierce the corporate veil of the sister companies.<sup>17</sup> The defendant moved for summary judgment, urging that there were no issues of genuine material fact, so the district court discussed whether the plaintiff had advanced summary judgment evidence as to the elements of each

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ries" because courts were still applying the *Castleberry* factors. TEX. BUS. CORP. ACT art. 2.21 cmt. (Vernon Supp. 2002).

10. 721 S.W.2d 270 (Tex. 1986). For the peculiar standards applicable to an alter ego claim in a divorce case, see *Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. App.—San Antonio 2001, pet. denied).

11. References to the single business enterprise theory in the veil piercing context have substantially increased in the past 3 years. Of forty references on Westlaw as of January 22, 2002, twenty-two were in the past three years.

12. Compare *Byrne v. Harris Adacom Network Servs., Inc.*, 11 S.W.3d 244 (Tex. App.—Texarkana 1999, pet. denied) (using terms interchangeably) with *Aluminum Chems. (Bolivia), Inc. v. Bechtel Corp.*, 28 S.W.3d 64, 68 (Tex. App.—Texarkana 2000, no pet.) (stating theories are separate).

13. 151 F. Supp. 2d 772 (E.D. Tex. 2001).

14. *Id.* Plaintiff sought relief under the Federal Employers Liability Act, the Safety Appliance Act, the Texas Railroad Liability Act and general negligence.

15. The Committee specifically stated that "[t]he single enterprise theory is another similar theory" to alter ego, so Article 2.21 governs its application to the extent a corporate contract was involved. TEX. BUS. CORP. ACT art. 2.21 cmt. (Vernon Supp. 2002).

16. Except that pursuant to Article 2.21(A)(3), the failure to observe corporate formalities can no longer be used as a factor in "piercing the corporate veil." West, *supra* note 3, at 1227 n.37. See also discussion *supra* note 7.

17. The plaintiff worked for Pabtex, a wholly-owned subsidiary of Southern Industrial Services ("SIS"), which was a wholly-owned subsidiary of Kansas City Southern Lines ("KCSL"), which was a wholly-owned subsidiary of Kansas City Southern Industries ("KSCI"). Kansas City Southern Railway ("KCSR") was another wholly-owned subsidiary of KCSL. *Nichols*, 151 F. Supp. 2d at 775. Plaintiff alleged that Pabtex and KCSR were alter egos or a single business enterprise. *Id.* at 779-80.

theory.<sup>18</sup> Although the case involved affiliate companies instead of the traditional parent-subsidary situation, the court held that traditional veil-piercing analysis still applied.<sup>19</sup>

The alter ego doctrine “allows the imposition of liability of a corporation for the acts of another corporation when the subject corporation is organized or operated as a mere tool or business conduit.”<sup>20</sup> If the corporations act as one entity, separate corporate forms are disregarded to avoid injustice.<sup>21</sup> Reiterating the established factors for determining whether corporations are alter egos, the court emphasized that no single factor is determinative for a sister company analysis.<sup>22</sup> In addition to meeting several of the traditional elements,<sup>23</sup> KSCR had negotiated contracts on behalf of Pabtex, created an executive committee that effectively took management control from Pabtex, and given joint quotes to customers.<sup>24</sup> This evidence was deemed sufficient by the court to raise a genuine issue of material fact with regard to the alter ego claim.

*Nichols* then addressed single business enterprise as distinct from alter ego. Single business enterprise applies “when two or more business entities act as one” by “integrat[ing] their resources to achieve a common business purpose.”<sup>25</sup> Each corporation must be held responsible for the debts of that common purpose to avoid an inequitable outcome.<sup>26</sup> To determine whether the corporations are operating as a single business enterprise, *Nichols* listed several factors examined in *Paramount Petroleum Corp. v. Taylor Rental Center*,<sup>27</sup> including “common employees and offices; centralized accounting; payment of wages by one corporation to another corporation’s employees; common business names; services rendered by the employees of one corporation on behalf of another corpora-

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18. *Id.* at 779-84.

19. *Id.* at 780.

20. *Id.*

21. *Id.*

22. *Nichols*, 151 F. Supp. 2d at 781. Factors include: (1) common stock ownership between parent and subsidiary; (2) common directors and officers between parent and subsidiary; (3) common business departments between parent and subsidiary; (4) consolidated financial statements and tax returns filed by parent and subsidiary; (5) parent’s financing of the subsidiary; (6) parent’s incorporation of the subsidiary; (7) undercapitalization of the subsidiary; (8) parent’s payment of salaries and other expenses of subsidiary; (9) whether parent is subsidiary’s sole source of business; (10) parent’s use of subsidiary’s property as its own; (11) combination of corporations’ daily operations; (12) lack of corporate formalities by the subsidiary; (13) whether directors and officers of subsidiary are acting independently or in the best interests of the parent; and (14) whether parent’s employee, officer or director was connected to the subsidiary’s action that was the basis of the suit. *Id.* Technically, factor (12) should be eliminated because of TEX. BUS. CORP. ACT art. 2.21(A)(3) (Vernon Supp. 2002). See discussion *supra* note 15.

23. *Nichols*, 151 F. Supp. 2d at 784. Pabtex and KSCR had common directors and officers, common stock ownership, common business departments, and shared property and equipment. Further, KSCR controlled Pabtex’s operations through the executive committee, their daily operations were not separately maintained, and Pabtex’s directors and officers acted in the interest of KSCR and KSCI. *Id.*

24. *Id.* at 782-84.

25. *Id.* at 781-82.

26. *Id.*

27. 712 S.W.2d 534, 536-37 (Tex. App.—Houston [14th Dist.] 1986, writ ref’d n.r.e.).

tion; undocumented transfers of funds between corporations; and unclear allocation of profits and losses between corporations.”<sup>28</sup> Applying the same facts used in the alter ego analysis, the district court found that there was a genuine issue of material fact as to whether KSCR and Pabtex operated as a single business enterprise as well as whether the companies were alter egos.<sup>29</sup>

## 2. *Northern American Van Lines v. Emmons*<sup>30</sup>

Unlike the synonymous treatment of alter ego and single business enterprise in *Nichols*, *Emmons* highlighted the different applications of the two theories. Plaintiff was injured by a subsidiary’s moving van—a situation like *Nichols* that does not present the potential applicability of Article 2.21—and sought to hold the parent liable through the alter ego and single business enterprise doctrines.<sup>31</sup> The court of appeals affirmed the trial court’s finding that the companies were a single business enterprise but not alter egos.<sup>32</sup> As in *Nichols*, the court emphasized that the theories were “distinct” and separately analyzed them.<sup>33</sup>

Addressing the alter ego claim, the court reviewed the evidence of the trial and noted the reluctance of courts to disregard the corporate form.<sup>34</sup> Although the subsidiary was undercapitalized and the activities of the parent and subsidiary were not kept separate, *Emmons* found that the facts were not sufficiently exceptional to justify piercing the corporate veil.<sup>35</sup>

Turning to single business enterprise, the court explained the rationale underlying the theory and emphasized its differences with alter ego. First, single business enterprise is based on partnership liability principles and holds corporations liable for their common business purpose.<sup>36</sup> Second, while alter ego usually requires proof of fraud, single business enterprise does not because corporations are simply liable for their joint obligations.<sup>37</sup> These differences explain the court’s holding that the companies were a single business enterprise but not alter egos.

28. *Nichols*, 151 F. Supp. 2d at 782.

29. The identities of KSCR and Pabtex were “blurred . . . beyond distinction” due to unclear allocation of profits and losses between the corporations, KSCR’s responsibility for Pabtex’s accounting, offering of joint proposals to customers where KSCR and Pabtex’s services were indistinguishable, integration of operations, KSCR’s control of Pabtex through the executive committee and common officers. *Id.* at 784.

30. 50 S.W.3d 103 (Tex. App.—Beaumont 2001, no pet.).

31. The accident involved a moving van that was leased by NAVL but used by its subsidiary, NaTex, to make a delivery. *Id.* at 112.

32. *Id.* at 112-13.

33. *Id.* at 119.

34. *Id.* at 120.

35. Courts will usually find that parent and subsidiary corporations are alter egos when “the subsidiary is a sham being used to commit a fraud, avoid financial responsibility, or break the law.” *Emmons*, 50 S.W.3d at 120.

36. *Id.*

37. *Id.*

Using the same *Paramount Petroleum* factors as *Nichols, Emmons* found that NAVL and NaTex had the same employees, NAVL received all of NaTex's profits, the driver of the moving van was supposedly an employee of NaTex but wore a NAVL uniform, and NAVL did "essential administrative functions for NaTex."<sup>38</sup> Since NAVL and NaTex were a single business enterprise, they were jointly responsible for the results of the van's accident.

B. PIERCING THE CORPORATE VEIL IN TORT CASES INVOLVING CORPORATE CONTRACTS (*RIO GRANDE VALLEY GAS CO. v. CITY OF EDINBURG*<sup>39</sup>)

*Rio Grande* involved a number of tort claims arising out of a 1985 natural gas franchise agreement. The city of Edinburg had granted a franchise agreement to Rio Grande Valley Gas Co. ("RGVG") to provide natural gas for its residents in exchange for a percentage of the gross income generated.<sup>40</sup> RGVG was a subsidiary of Valero Energy Corp. ("VEC") and purchased natural gas at a regulated set price.<sup>41</sup> Another VEC subsidiary, Reata Industrial Gas Co. ("Reata"), was able to purchase deregulated gas at a cheaper rate.<sup>42</sup> Reata, therefore, began selling deregulated "spot market" gas to industrial customers in Edinburg at cheaper rates.<sup>43</sup> Reata, on paper, made the gas sales "at designated points of sale outside of the city limits," thereby avoiding paying any franchise fees.<sup>44</sup> Because Reata did not have its own pipelines, it used RGVG and VEC pipelines, which went through the city.<sup>45</sup> When RGVG transferred to Reata some pipelines that lay partly within the city, the city sued RGVG for violating the franchise agreement by transferring the pipes without getting city approval and for using its various affiliates in a fraudulent manner to evade the 1985 franchise agreement.<sup>46</sup>

The jury found that all of the defendant corporations had operated as a single business enterprise and that VEC had used RGVG as a sham to perpetrate a fraud.<sup>47</sup> Based on these findings, the district court held all of the corporations jointly and severally liable for damages assessed against each entity. On appeal, the defendant corporation contended that the questions submitted to the jury were not supported by plaintiff's pleadings.<sup>48</sup> The court of appeals examined whether plaintiff's pleadings met

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38. *Id.* at 121.

39. 59 S.W.3d 199 (Tex. App.—Corpus Christi 2000) *on reh'g in part, rev'd on other grounds sub nom* PG&E Gas Transmission v. City of Edinburg, 59 S.W.3d 225 (Tex. App.—Corpus Christi 2001).

40. *Rio Grande*, 59 S.W.3d at 207.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Rio Grande*, 59 S.W.3d at 208.

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*



the requirements of a “fair notice” pleading<sup>49</sup> and concluded that they did.

The plaintiff’s pleadings had alleged “alter ego” and “joint enterprise liability” as “alternative” theories and did not mention “sham to perpetrate a fraud” or “single business enterprise.”<sup>50</sup> The pleadings did, however, allege “that ‘Defendants acted jointly to conduct the unauthorized deliveries of gas inside Edinburg’ and that ‘the Valero Defendants acted through Reata and RGV[G] to prosecute their own interests and that Reata and RGV[G] were little more than pawns used to effectuate the desires of the Valero Defendants.’”<sup>51</sup>

According to this court, “a sham to perpetrate a fraud” only requires proof of “constructive fraud,” which “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.”<sup>52</sup> Continuing to define terms for the purpose of determining whether the theories pled matched the jury’s findings, the court said that “[t]he ‘single business enterprise’ theory is . . . analogous to partnership principles: that when corporations are not operated as separate entities, but rather integrate their resources to achieve a common business purpose, each constituent corporation may be held liable for the debts incurred by the other component entities in pursuit of that business purpose.”<sup>53</sup> The “alter ego” theory, however, is “separate and distinct.”<sup>54</sup> In contrast to the “single business enterprise” theory, the court said that “[t]he ‘alter ego’ theory applies to disregard the corporate fiction when the corporation is ‘organized and operated as a mere tool or business conduit of another corporation.’”<sup>55</sup> Finally, the “single business enterprise” is also separate and distinct from the “joint enterprise” theory. To prove joint enterprise liability, the plaintiff must prove the existence of a “joint enterprise,” which consists of “(1) an agreement among the members of the group; (2) a common purpose; (3) a community of pecuniary interest; and (4) an equal right to control the enterprise.”<sup>56</sup> In other words, “joint enterprise” liability requires proof of the existence of a joint venture among the various corporate affiliates. As interesting as was the court’s discussion of why the plaintiff’s pleadings provided fair notice of its claim for sham to perpetrate a fraud and single business enterprise—and as unclear as the distinction between alter ego and single business enterprise in the definitions provided by the court—the more interesting issue is why Article 2.21 was not discussed in this context.

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49. *Rio Grande*, 59 S.W.3d at 208. The test is whether “an opposing attorney of reasonable competence, with the pleadings before him, can ascertain the nature and basic issues of the controversy and what testimony will probably be relevant.” *Id.*

50. *Id.* at 208-09.

51. *Id.* at 209.

52. *Id.*

53. *Id.* at 208.

54. *Rio Grande*, 59 S.W.3d at 209.

55. *Id.*

56. *Id.*

The plaintiff's claim in *Rio Grande* was clearly a claim related to or arising from a contractual obligation of a corporation in which the plaintiff sought to impose liability on the "affiliates" of the corporate obligor of that contract on the basis that the "affiliate is or was the alter ego of the corporate obligor, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory."<sup>57</sup> As required by Article 2.21, therefore, plaintiff should not have prevailed absent proof that those affiliates caused the corporate obligor of the contract "to be used for the purpose of perpetrating and did perpetrate an *actual fraud* on the obligee for the *direct personal benefit* of [those affiliates]."<sup>58</sup> There was no such showing in *Rio Grande*. In fact, the only fraud was a "sham to perpetrate a fraud," which as the court noted was a constructive, not actual, fraud. Regardless of whether the theory of liability is alter ego or single business enterprise, if the liability to be imposed arises out of a contractual obligation, Article 2.21 requires an *actual fraud for the direct personal benefit* of the affiliate or owner of the corporate obligor as a precondition to such imposition of liability.<sup>59</sup>

### C. LIABILITY OF OFFICERS FOR KNOWING PARTICIPATION IN A TORT

The fact that a corporate employee is acting solely within the scope of his or her employment when he or she personally commits a tort does not automatically relieve the employee of liability for that tortious act, even though the corporate employer may also be liable for the conduct of its

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57. TEX. BUS. CORP. ACT art. 2.21(A)(2) (Vernon Supp. 2002).

58. *Id.* (emphasis added). "Fraud" requires the following elements be proved: "[1] a material misrepresentation that was false, [2] that was either known to be false when made or was asserted without knowledge of its truth, [3] that was intended to be acted upon, [4] that was relied upon, and [5] that caused injury". *Myers v. Walker*, 61 S.W.3d 722, 728 (Tex. App.—Eastland 2001, no pet.). These same basic elements are required to prove nondischargeable "actual fraud" under the Bankruptcy Code. *In re Rich*, 249 B.R. 709 (Bankr. N.D. Tex. 2000). Under Texas law, "actual fraud" contemplates "intentional breaches of duty that are designed to injure another or to obtain an undue and unconscionable advantage." *Vela v. Marywood*, 17 S.W.3d 750, 761 (Tex. App.—Austin 2000), *pet. denied* 53 S.W.3d 684 (Tex. 2001) (per curiam). "Actual fraud" has also been said to require a showing of "dishonest purpose or an intent to deceive." *In re Monnig's Dep't Stores, Inc.*, 929 F.2d 197, 201 (5th Cir. 1991). Moreover, as noted last year's Corporations article, not only is "actual fraud" required but there is also required to be a showing that the perpetrator of that "actual fraud" did so primarily for the direct personal benefit of that perpetrator. Indirect or incidental benefits are not enough. *West, supra* note 3, at 1230.

59. The federal courts sitting in Texas appear to appreciate the application of Article 2.21 better than the Texas state courts. In *Nordar Holdings*, the district court examined the legislative changes to Article 2.21 and concluded that the statute required a showing of actual fraud both "to pierce the corporate veil on the alter ego theory" and "to disregard the corporate entity under the single business enterprise theory." *Nordar Holdings, Inc. v. Western Sec. (USA) Ltd.*, 969 F. Supp. 420, 422 (N.D. Tex. 1997). Another district court reached the same conclusion in *Olympic Financials*, and held that "joint liability could be imposed only if there is also a finding of actual fraud" under the single business enterprise theory. *Olympic Fin. Ltd. v. Consumer Credit Corp.*, 9 F. Supp. 2d 726, 729 (S.D. Tex. 1998).

employee under the doctrine of respondeat superior.<sup>60</sup> When the tort in question is an intentional tort such as assault,<sup>61</sup> or a negligent tort such as an automobile accident,<sup>62</sup> corporate lawyers seldom question this well-known rule. After all, it is a settled principle of agency law that the agent can be liable for his or her own torts even when acting within the scope of the agency on behalf of the principal.<sup>63</sup> However, when a corporate officer acting on behalf of his or her corporate employer in connection with a transaction is personally sued for fraud, violations of the Deceptive Trade Practices Act, negligent misrepresentation, tortious interference with contract or similar torts arising out of contractual negotiation, there is an immediate reaction by the corporate lawyer that the officer cannot possibly be personally liable because, after all, he or she is acting solely on behalf of the corporation. This is especially true in light of Article 2.21, which strictly limits liability for contracts and torts arising from those contracts,<sup>64</sup> whether the imposition of that liability is sought based on “piercing the corporate veil,” as discussed in Part B of this Section II, or some other theory.

As the Texas cases decided during this Survey period indicate, however, while there is indeed a distinction between torts arising in the context of contractual negotiations on behalf of a corporation and torts arising in other circumstances, the courts continue to return to the old basic rule that “when corporate officers directly participate in or authorize the commission of a wrongful act, even if the act is done on behalf of the corporation, they may be personally liable,”<sup>65</sup> regardless of whether that wrongful act arises in connection with a contractual obligation of the corporation or otherwise.

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60. *Hooper v. Pitney Bowes, Inc.*, 895 S.W.2d 773, 776 (Tex. App.—Texarkana 1995, writ denied). See also *Crescendo Invs., Inc. v. Brice*, 61 S.W.3d 465, 475 (Tex. App.—San Antonio 2001, pet. denied); *Minyard Food Stores, Inc. v. Goodman*, 50 S.W.3d 131, 141 (Tex. App.—Fort Worth 2001, pet. granted).

61. *Rosales v. Am. Buslines, Inc.*, 598 S.W.2d 706, 708 (Tex. Civ. App.—El Paso 1980, writ ref'd n.r.e.).

62. *Chevron U.S.A., Inc. v. Lee*, 847 S.W.2d 354, 355 (Tex. App.—El Paso 1993, no writ).

63. *Leitch v. Hornsby*, 935 S.W.2d 114, 117 (Tex. 1996), as cited in *Keyser v. Miller*, 47 S.W.3d 728, 729-30 (Tex. App.—Houston [1st Dist.] 2001, pet. granted).

64. See discussion *supra* note 7.

65. *Gen. Motors Acceptance Corp. v. Bates*, 954 F.2d 1081, 1085 (5th Cir. 1992), as cited in *King v. Graham*, 47 S.W.3d 595, 610 (Tex. App.—San Antonio 2001, no pet.). See also *Shapolsky v. Brewton*, 56 S.W.3d 120, 133 (Tex. App.—Houston [14th Dist.] 2001, pet. denied) (“It is the general rule in Texas that corporate agents are individually liable for fraudulent or tortious acts committed while in the service of their corporation.”); *Cass v. Stephens*, No. 08-97-00582-CV, 2001 WL 28092, at \*16 (Tex. App.—El Paso Jan. 11, 2001, pet. denied) (“A corporate officer or agent is always primarily liable for his own torts, even though the principal is also vicariously liable . . . [and] regardless of whether he receives any personal benefit from the tortious act.”); *State v. Am. Blastfax, Inc.*, 164 F. Supp. 2d 892, 898, 901 (W.D. Tex. 2001) (officers of corporation held personally liable for violations of the DTPA where the individual officers were the “guiding spirits” or “central figures” in the violations “with their eyes and pocketbooks wide open.”).

### 1. *King v. Graham*<sup>66</sup>

As observed by the San Antonio Court of Appeals, the Texas Supreme Court has previously recognized only two important exceptions to the general rule imposing liability on a corporate officer for knowing participation in a tort on behalf of a corporation: (1) in a negligence case, a corporate officer is not personally liable for negligence committed in the scope of his or her employment on behalf of a corporation “unless he owed an independent duty of reasonable care to the injured party apart from his employer’s duty;”<sup>67</sup> and (2) in a tortious interference with contract case, “a corporate officer or director may not be held liable for inducing the corporation to violate a contractual obligation as long as he or she acts in good faith on the corporation’s behalf.”<sup>68</sup> Concluding that the stated two exceptions are the only exceptions, the *King* court imposed personal liability for malicious prosecution on the officers and directors who personally participated in a corporate decision to send a letter from the corporation to the Sheriff’s Department that resulted in certain individuals being wrongly indicted for theft.<sup>69</sup>

It is not clear that Article 2.21 would have had any applicability here had it been addressed. Although the actions of the officers and directors in accusing the plaintiffs of theft arose from a contractual dispute between the defendants’ corporation and the plaintiffs, the liability sought to be imposed upon the defendants (damages arising from their malicious prosecution) was not liability for the obligations of the corporation arising from that contract.

### 2. *Keyser v. Miller*<sup>70</sup>

The Houston Court of Appeals for the First District determined that a corporate agent was not liable under the Deceptive Trade Practices Act (“DTPA”) for misrepresentations he made solely in his capacity as an agent for the corporation in the absence of a finding that he acted “knowingly.”<sup>71</sup> The court reached this decision notwithstanding that a violation of the DTPA does not require a finding of intent to deceive.<sup>72</sup> Because corporations can only speak through their agents, the court noted that to hold otherwise would result in automatic “DTPA liability for the individual who spoke the words that constituted the misrepresentation, even though the corporation authorized him to make the representation, even though he was not an officer or director of the corporation but was the

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66. 47 S.W.3d 595, 610 (Tex. App.—San Antonio 2001, no. pet.).

67. *Leitch*, 935 S.W.2d at 117, as quoted in *King*, 47 S.W.3d at 610.

68. *ACS Investors, Inc. v. McLaughlin*, 943 S.W.2d 426, 432 (Tex. 1997), as quoted in *King*, 47 S.W.3d at 610. See also *Reyna v. First Nat’l Bank in Edinburg*, 55 S.W.3d 58, 70 (Tex. App.—Corpus Christi 2001, no. pet.); *Pabich v. Kellar*, No. 2-00-105-CV, 2002 WL 287762, at \*5 (Tex. App.—Fort Worth Feb. 28, 2002, no. pet. h.) (unpublished).

69. *King*, 47 S.W.3d at 610.

70. 47 S.W.3d 728 (Tex. App.—Houston [1st Dist.] 2001, pet. granted).

71. *Id.* at 734.

72. *Id.* at 730 (citing *Weitzel v. Barnes*, 691 S.W.2d 598 (Tex. 1985)).

lowest employee, and even though he did not know the representation was false.<sup>73</sup> Again, it does not appear that an analysis of Article 2.21 would have added anything to the outcome of the case, since liability under the DTPA is statutorily imposed and does not arise from the various common law theories listed in Article 2.21.<sup>74</sup>

### 3. *Berens v. Resort Suites-Scottsdale, Inc.*<sup>75</sup>

This fraudulent inducement case directly raises the potential applicability of Article 2.21. Like *Texas-Ohio Gas*<sup>76</sup> discussed in last year's Corporations Survey, however, the court failed to properly address Article 2.21. In *Berens*, the plaintiffs sought to impose personal liability on the president (and owner of all the stock) of a corporate lender without "piercing the corporate veil." The plaintiff had sought a loan from the defendant corporation, Berens Corporation, to refinance a loan on one of the plaintiff's resort hotels.<sup>77</sup> Because plaintiff would get a substantial discount if he repaid the loan prior to December 31, 1994, he entered into discussions in late 1993 with Marc Berens of Berens Corporation to provide the necessary financing.<sup>78</sup> In early 1994, "based upon [Marc] Berens' representations," plaintiff entered into a commitment letter with Berens Corporation pursuant to which plaintiff paid Berens Corporation a commitment fee of \$100,000 and Berens Corporation committed to fund the loan by July 15, 1994, subject to certain conditions.<sup>79</sup> The commitment letter contained an "exclusivity provision" prohibiting plaintiff from seeking alternate financing prior to July 15, 1994, and repeated Marc Berens' representations that Berens Corporation had lines of credit available to fund the loan.<sup>80</sup>

When the loan was not funded by July 15, 1994, plaintiff obtained alternative financing on less favorable terms than under the Berens Corporation commitment letter.<sup>81</sup> Plaintiff then sued Berens Corporation and Marc Berens for fraud and Berens Corporation for breach of contract.<sup>82</sup> Finding for plaintiff, the court concluded that Marc Berens, both "individually and as a representative of the corporation," falsely represented that Berens Corporation was well capitalized and had a line of credit available to fund the loan.<sup>83</sup>

73. *Id.* at 734.

74. See *Love v. State*, 972 S.W.2d 114 (Tex. App.—Austin 1998, pet. denied) (holding that actual fraud is not required under Article 2.21 for violations of state regulations).

75. No. 14-99-00396-CV, 2001 WL 520985 (Tex. App.—Houston [14th Dist.] May 17, 2001, pet. denied) (unpublished).

76. *Texas-Ohio Gas, Inc. v. Meacom, III*, 28 S.W.3d 129 (Tex. App.—Texarkana 2000, no pet.), as discussed in West, *supra* note 3, at 1226-30.

77. *Berens*, 2001 WL 520985, at \*1.

78. *Id.*

79. *Id.* at \*1. Marc Berens was not a party to the commitment letter.

80. *Id.* at \*1-2.

81. *Id.* at \*2.

82. *Berens*, 2001 WL 520985, at \*2.

83. *Id.*

On appeal, Berens Corporation first defended itself by arguing that it had no obligation to fund the loan pursuant to the commitment letter because the plaintiff had violated the “exclusivity provision” by contacting other lenders prior to July 15, 1994.<sup>84</sup> The court quickly dispensed with this argument by noting that because plaintiff had “prevailed under a theory that Marc Berens and Berens Corp. fraudulently induced [plaintiff] to enter into the contract, [plaintiff] was not bound by the exclusivity provision of the contract.”<sup>85</sup> This was true, the court said, because “a party is not bound by a contract procured by fraud.”<sup>86</sup>

Turning to the issue of his individual liability for the fraudulent inducement, Marc Berens argued that he could not be held liable because “there was no proof he was personally liable under a ‘pierce the corporate shield’ theory or that his ownership of all the stock in the Berens Corporation makes it his alter ego.”<sup>87</sup> Further, Marc Berens contended that “all duties and obligations created under the contract were solely between [plaintiff] and the Berens Corporation and . . . he was never a party to the contract.”<sup>88</sup> While all that was true, unfortunately for Marc Berens, the court noted that he was not found liable under an alter ego or “piercing the corporate veil” theory of individual liability; rather, consistent with the well-settled rule of agency described previously, he was found “individually liable because he personally committed fraud.”<sup>89</sup>

Unlike *King* and *Keyser*, *Berens* should not have been decided by simple reference to the general rule that imposes liability on corporate officers who knowingly participate in a tort on behalf of their corporations. Instead, some attention should have been paid to the potential applicability of Article 2.21. Clearly the tort of “fraudulent inducement” alleged in *Berens* arose out of conduct by both a shareholder and affiliate (*i.e.*, its president) of a corporation in connection with a contract entered into by that corporation.<sup>90</sup> The fraudulent inducement claim was clearly “a matter relating to or arising from” the corporate obligation of the Berens Corporation contained in that letter. Furthermore, personal participation by Marc Berens in the “fraudulent inducement” is clearly “an actual fraud” or “similar theory” seeking to impose personal liability as contemplated by Article 2.21(A)(2). As a result, not only should proof of “actual fraud” have been required in order to hold Marc Berens personally liable, but proof that Marc Berens directly and personally benefited from the actual fraud should have been required as contemplated by Article

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84. *Id.*

85. *Id.* at \*3.

86. *Id.*

87. *Berens*, 2001 WL 520985, at \*3.

88. *Id.*

89. *Id.*

90. Indeed, as noted by the Texas Supreme Court during the Survey period in *Haase v. Glazner*, 62 S.W.3d 795, 798 (Tex. 2001); “Fraudulent inducement, . . . is a particular species of fraud that arises only in the context of a contract and requires the existence of a contract as part of its proof.”

2.21.<sup>91</sup>

If the *Berens* court had correctly applied Article 2.21(A)(2), the plaintiff should have been required to prove that Marc Berens used the Berens Corporation “for the purpose of perpetrating and did perpetrate an actual fraud on the [plaintiff] primarily for the direct personal benefit of [Marc Berens].” Instead, the court relied on the old general rule imposing liability on a corporate officer whenever he or she personally and knowingly participates in a tort, even in connection with the execution of a contract solely for the benefit of the corporation and to which the corporation was the party, regardless of whether the officer personally or privately benefited from the fraud.

The continued failure of the Texas courts to recognize and apply Article 2.21 is disturbing. Last year’s Corporations Survey noted that Article 2.21(B) provides that the limitation of liability in Article 2.21(A) is “exclusive and preempts any other liability imposed on a holder . . . or any affiliate thereof or of the corporation for that obligation under common law or otherwise.”<sup>92</sup> But as discussed in Part B of this Section II, Texas courts are routinely referencing common law doctrines and even entertaining new causes of action in the veil piercing context instead of applying Article 2.21.

D. LIABILITY OF OFFICERS FOR FAILING TO SIGN CORPORATE  
CONTRACTS IN A REPRESENTATIVE CAPACITY  
(*CARAWAY V. LAND DESIGN STUDIO*)<sup>93</sup>

As observed in last year’s Corporations Survey, a corporate officer may become liable for the debts of his or her corporation simply by failing to clearly draft the contract so that the corporation is in fact the sole party liable thereon as a matter of contract interpretation. Unlike the theories of “piercing the corporate veil” or “knowing personal participation in a tort,” this means of imposing liability on a corporate officer does not depend on a theory of liability designed to go behind the corporate party to the contract, but relies instead on a simple contract construction to determine who in fact is the intended party or parties to the contract. There is no rule that says a corporate officer cannot assume personal liability for

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91. The Fort Worth Court of Appeals clearly recognized the applicability of Article 2.21 in an analogous situation. In *Pabich v. Kellar*, No. 2-00-105-CV, 2002 WL 287762 (Tex. App.—Fort Worth Feb. 28, 2002, no pet. h.) (unpublished), plaintiff sued defendant for violating the non-compete provisions of his severance agreement with defendant’s corporation and defendant counter-sued that plaintiff was tortiously interfering with his business relationships. Acknowledging that Article 2.21 governed officer liability, the court also recognized that an officer could be held “individually liable for a corporation’s tortious conduct if he knowingly participates . . . or has either actual or constructive knowledge.” But since plaintiff’s tortious claim arose from the settlement agreement, which was a contractual obligation of the corporation, *Pabich* concluded that Article 2.21(A)(2) still controlled. While the court correctly applied Article 2.21, it unfortunately did not further discuss its standards. *Id.* at \*6.

92. West, *supra* note 3, at 1227 (quoting TEX. BUS. CORP. ACT ANN. art 2.21(B) (Vernon Supp. 2001)).

93. 47 S.W.3d 696 (Tex. App.—Austin 2001, no pet.).

his or her corporation's obligations should he or she choose to do so in the contract. This is true, as observed by one court during the Survey period, because the liability of corporate officers for the contracts of their corporations is based on the same law that governs the liability of "agents for private individuals."<sup>94</sup>

A number of cases were decided during the Survey period that followed a similar fact pattern to *Taylor-Made* discussed in last year's Corporations Survey,<sup>95</sup> and which repeated the general rule that while "an agent [*i.e.*, a corporate officer] is not liable for the contracts of his principal [*i.e.*, the corporation], . . . in order to avoid personal liability, an agent has the duty to disclose not only that he is acting in a representative capacity, but also the identity of his principal."<sup>96</sup>

Illustrating these cases is *Caraway v. Land Design Studio*.<sup>97</sup> In *Caraway*, the Austin Court of Appeals held a corporate officer personally liable for a promissory note which read as follows:

In consideration of design services rendered, I(We) *Hugh Caraway*[sic], *International Realty, Inc.* (hereinafter "Debtor") do hereby promise to pay *Land Design Studio* (hereinafter "Creditor"), the amount of \$42,639.82 . . .

\* \*

Hugh L. Caraway (Signature)      9/20/98

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Debtor

Date<sup>98</sup>

Reviewing the express language of the note, the court had little trouble finding Mr. Caraway personally liable. According to the court, "[w]e do not have the instance of a note reflecting the name of the principal only, followed by the signature of a purported representative, but rather we have a note bearing the name of the signing party, Caraway, as one of the principals."<sup>99</sup> Furthermore, the court noted that "the language of the instrument reflects that payment was promised from more than one source . . ."<sup>100</sup> Nevertheless, the court went on to sound the warning issued in last year's Corporations Survey<sup>101</sup> by noting that "Caraway would be in no different position if the note did not bear his name as a principal" because his signature did not clearly indicate his representative

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94. *Burch v. Hancock*, 56 S.W.3d 257, 261 (Tex. App.—Tyler 2001, no pet.).

95. West, *supra* note 3, at 1231.

96. *Bensen v. Live Oak Ins. Agency, Inc.*, 52 S.W.3d 306, 309-10 (Tex. App.—Corpus Christi 2001, no pet.). See also *Ekberg v. Barnes*, No. 03-00-00515-CV, 2001 WL 838427 (Tex. App.—Austin July 26, 2001, pet. denied); *Burch*, 56 S.W.3d at 261; *Fun Motors of Longview, Inc. v. Gantly, Inc.*, 51 S.W.3d 756, 761 (Tex. App.—Texarkana 2001, no pet.).

97. 47 S.W.3d 696 (Tex. App.—Austin 2001, no pet.).

98. *Id.* at 697.

99. *Id.* at 700.

100. *Id.* The court specifically noted that "[e]ither 'we' refers to both Caraway and Realty, or exclusively to Realty, which leaves the 'I' to refer only to Caraway. In either event, Caraway assumed liability." *Id.*

101. West, *supra* note 3, at 1232-33.



capacity.<sup>102</sup>

### III. DRAFTING CORPORATE CONTRACTS

Drafting clear documents is crucial in any context. Special issues can arise in the corporate context, however, either because the corporation is a legal person that can only act through its individual agents, because of special rules governing mergers and the assumption of liabilities,<sup>103</sup> or simply because of specialized agreements common to corporate acquisitions. As noted in last year's Corporations Survey, the preliminary letter of intent is a document frequently used to outline the basic terms of a corporate acquisition.<sup>104</sup> In most cases, parties do not intend to be legally bound by a letter of intent until a definitive agreement has been negotiated and executed. Two cases decided by the Dallas Court of Appeals during this Survey period further discussed the binding effect of a letter of intent and the impact of last year's *John Wood*<sup>105</sup> decision.

#### A. *CAVALRY INVESTMENTS, L.L.C. v. SUNSTAR ACCEPTANCE CORP.*<sup>106</sup>

On January 13, 1999, Cavalry sent NationsCredit a letter of intent to purchase the loan portfolio of its subsidiary, SunStar.<sup>107</sup> Making one modification, the Executive Vice President of NationsCredit signed the letter on January 15.<sup>108</sup> The two-page letter included such details as a general description of the portfolio, Cavalry's due diligence requirements, the payment percentage, the funding date, and an exclusivity period for Cavalry until February 19.<sup>109</sup> The letter also specified that "[t]he transaction contemplated hereby will be documented by and contingent upon the execution of a Loan Purchase & Sales Agreement satisfactory to *Buyer* and *Seller*."<sup>110</sup>

During the following weeks the parties negotiated over the draft of the purchase agreement, and Cavalry conducted due diligence of SunStar.<sup>111</sup> On February 19, NationsCredit told Cavalry that it had made too many modifications to the purchase agreement and refused to sign any agreement but the original draft.<sup>112</sup> Cavalry agreed to sign the original and

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102. *Caraway*, 47 S.W.3d at 700.

103. West, *supra* note 3, at 1238-42. For cases discussing Texas law on successor liability during this Survey period, see *Roll v. Tracor, Inc.*, 140 F. Supp. 2d 1073, 1080-81 (D. Nev. 2001); *Shapolsky v. Brewton*, 56 S.W.3d 120, 137 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

104. West, *supra* note 3, at 1233.

105. *John Wood Group USA, Inc. v. ICO, Inc.*, 26 S.W.3d 12 (Tex. App.—Houston [1st Dist.] 2000, pet. denied).

106. No. 05-00-00508-CV, 2001 WL 371545 (Tex. App.—Dallas Apr. 16, 2001, pet. denied).

107. *Id.* at \*1. The portfolio included charged-off subprime automobile loans.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Cavalry*, 2001 WL 371545, at \*1.

112. *Id.*

asked NationsCredit for the amount of the loan portfolio and wiring instructions to finalize the deal.<sup>113</sup> NationsCredit did not respond, and the deal did not close on Friday, February 19.<sup>114</sup> On Monday, NationsCredit informed Cavalry that its exclusivity period had expired, and it was entertaining other offers.<sup>115</sup> Subsequently, NationsCredit sold the portfolio to a third party.<sup>116</sup>

Cavalry sued for breach of contract and other claims.<sup>117</sup> Both parties moved for summary judgment with Cavalry alleging that the letter of intent was a binding contract and NationsCredit arguing that it was not.<sup>118</sup> The district court granted summary judgment in favor of NationsCredit. Finding an issue of fact regarding the existence of the contract, the court of appeals reversed.<sup>119</sup>

NationsCredit argued that the letter of intent was non-binding for three reasons: (1) it lacked a material term (*i.e.*, the definition of what constituted the “portfolio” to be purchased), (2) it lacked consideration, and (3) the “contingent upon” clause evidenced the parties’ intention not to be bound.<sup>120</sup> The court dismissed the first and second arguments quickly, since the parties’ actions evidenced their agreement as to the definition of the portfolio<sup>121</sup> and consideration existed through Cavalry’s due diligence requirements and its promise to pay.<sup>122</sup> For its third argument, NationsCredit relied on *John Wood*, in which a court of appeals held last year that a letter of intent was not binding.

The Dallas Court of Appeals distinguished *John Wood* in several respects. First, *John Wood* had not held that all letters of intent are non-binding. In fact, *John Wood* held that “a letter of intent may be binding even though (i) the parties leave open provisions for later negotiation or (ii) the letter refers to the drafting of a future, more formal agreement.”<sup>123</sup> Second, the letter in *John Wood* specifically stated that it was “nonbinding,” whereas the letter in *Cavalry* did not.<sup>124</sup> Thus, *John Wood* was distinguishable and not controlling in the case at hand.

As further support that the provision making the agreement “contingent upon” the execution of the purchase agreement did not render the letter nonbinding, the court in *Cavalry* referred to the Texas Supreme

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113. *Id.*

114. *Id.*

115. *Id.*

116. *Cavalry*, 2001 WL 371545, at \*1.

117. *Id.* at \*2. Cavalry’s claims also included tortious interference with contractual relations, conspiracy to defraud Cavalry and that NationsCredit and SunStar were alter egos to commit fraud against Cavalry. *Id.*

118. *Id.*

119. *Id.* at \*4.

120. *Id.* at \*6-7.

121. *Caraway*, 2001 WL 371545, at \*6. “[N]othing in the record indicates that any of the parties or parties’ representatives were unclear as to what constituted the ‘portfolio.’” *Id.*

122. *Id.* at \*7.

123. *Id.* (citing *John Wood*, 26 S.W.3d at 19).

124. *Id.*

Court decision in *Foreca, S.A. v. GRD Development*.<sup>125</sup> The letter of intent in *Foreca* included the phrase "subject to legal documentation contract to be drafted by [Foreca's attorney]."<sup>126</sup> The supreme court reversed the appellate court's decision that the phrase was a condition precedent to the formation of the contract.<sup>127</sup> Instead, *Foreca* held that the language was "not conclusive on intent to contract" and "not conclusive on the parties' intent to be bound."<sup>128</sup> Applying *Foreca's* reasoning that intent could not clearly be discerned from the "contingent upon" clause, *Cavalry* said it was a question of fact for the jury to decide and therefore inappropriate for the lower court to have decided it on summary judgment.<sup>129</sup>

B. *GEOPHYSICAL MICRO COMPUTER APPLICATIONS (INTERNATIONAL) LTD. v. PARADIGM GEOPHYSICAL LTD.*<sup>130</sup>

Six months after *Calvary*, the Dallas Court of Appeals decided a similar letter of intent case. In *Paradigm*, the court reversed a summary judgment rendered in favor of Paradigm Geophysical ("Paradigm") in its declaratory judgment action against Geophysical Micro Computer Applications ("GMA").<sup>131</sup> Paradigm had sought a declaration that certain letter agreements between Paradigm and GMA "constituted . . . agreement[s] to negotiate, not . . . binding agreement[s]."<sup>132</sup> The letter agreements consisted of an August 8, 1997, letter from GMA to Paradigm offering to purchase SeisX,<sup>133</sup> and an August 12, 1997, letter from Paradigm to GMA agreeing to the proposal set forth in the August 8th letter subject to certain modifications.<sup>134</sup> Both letters were countersigned by the other party.<sup>135</sup> At the time the letters were entered into, Paradigm was in the process of acquiring CogniSeis, the owner of SeisX.<sup>136</sup> The August 8th letter described the property proposed to be purchased and the purchase price to be paid and was subject to certain due diligence to be performed by GMA.<sup>137</sup> The August 8th letter further provided:

This transaction will be subject to all necessary corporate approvals, on each side of the transaction, such other [government] approvals . . . , satisfactory completion of due diligence and normal representations, warranties and other commercial terms as may be necessary or

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125. *Id.* at \*8 (citing *Foreca*, 758 S.W.2d 744 (Tex. 1988)).

126. *Caraway*, 2001 WL 371545, at \*8.

127. *Id.* (capitalization changed).

128. *Id.*

129. *Id.*

130. No. 05-98-02016-CV, 2001 WL 1270795 (Tex. App.—Dallas Oct. 24, 2001, pet. denied).

131. *Id.* at \*1.

132. *Id.*

133. SeisX was "a computer software program used in the oil and gas industry to interpret seismic data." *Id.*

134. *Id.*

135. *Paradigm*, 2001 WL 1270795, at \*1.

136. *Id.*

137. *Id.*

required in connection with a purchase and sale transaction of this type. Subject to our mutual agreement otherwise, the final documentation of this transaction will be based upon the agreement set out herein.

...

Our within offer is premised upon your advice that you are not in negotiations with, . . . any other party to . . . transfer [the described assets] and that you will not do so for so long as we are proceeding in good faith towards the consummation of the transaction contemplated herein. Should a final, definitive document not be entered into between Paradigm and GMA (with both parties negotiating in good faith towards such end) within 31 days of the closing of the asset purchase transaction between Paradigm and Cogni[S]eis, the obligations of Paradigm and GMA hereunder shall terminate.<sup>138</sup>

Following the execution of the "letters of intent," GMA issued a press release announcing that it had entered into a "Letter of Intent" with Paradigm, which stated in part:

The transaction will be subject to all necessary corporate and regulatory approvals, satisfactory completion of due diligence, normal representations, warranties and other commercial terms as may be necessary or required and *negotiation* of a definitive purchase and sale agreement.

...

[T]here can be *no assurance* that GMA's acquisition of SeisX will close under the terms of the Letter of Intent or at all.<sup>139</sup>

Immediately following Paradigm's acquisition of CogniSeis on October 14, GMA requested lists of the SeisX property acquired as contemplated by the "letters of intent."<sup>140</sup> It took almost a month for Paradigm to get the required list to GMA and it was incomplete.<sup>141</sup> Since the "letters of intent" expired 31 days after Paradigm acquired CongiSeis and the agreed list was not delivered until November 10, Paradigm agreed to extend the termination date of the "letters of intent" to December 1.<sup>142</sup> GMA delivered a draft asset purchase agreement to Paradigm on November 28.<sup>143</sup> Thereafter on December 2, Paradigm notified GMA that the "letters of intent" were terminated.<sup>144</sup> Finally, on July 9, 1998, the Board of Directors of Paradigm "disapproved and rejected the 'contemplated' transaction."<sup>145</sup>

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138. *Id.*

139. *Id.* at \*2.

140. *Paradigm*, 2001 WL 1270795, at \*2.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Paradigm*, 2001 WL 1270795, at \*2. The Board approval requirement was a separate issue in this case because (a) it presented the issue of whether the Board had in fact approved the transaction and then later repudiated it; and (b) it presented the issue of whether it is possible to have a binding agreement (because it in fact does not impose a definitive agreement on either party) if it is subject to obtaining approval and there is no obligation to in fact obtain such approval. As to the first issue, the court decided there was

Paradigm sued GMA for a declaratory judgment that the “letters of intent” were not a binding agreement and moved for summary judgment.<sup>146</sup> After the district court granted Paradigm’s motion for summary judgment, GMA appealed.<sup>147</sup> The court of appeals reversed the trial court, because it found that a fact issue existed as to whether the parties intended to be bound by the “letters of intent.”<sup>148</sup>

According to the court, to form a binding agreement the parties must agree on the essential terms of the contract, but non-essential terms may be left open for further negotiation, because “[i]t is only when an essential term of a contract is left open for future negotiations that there is no binding contract, only an agreement to agree.”<sup>149</sup>

Examining the “letters of intent,” the Dallas Court of Appeals in *Paradigm* found that they contained both “essential” and “definite” terms and, therefore, created an “enforceable agreement.”<sup>150</sup> However, as in *Cavalry*, the court decided that the “letters of intent” were not clearly binding as a matter of law based on *Foreca*.<sup>151</sup> The court in *Paradigm* held that the language in the “letters of intent” did not clearly express the intent of the parties to be bound with the result that it was a question of fact for the jury.<sup>152</sup> Unlike the letter of intent in *John Wood*, the letters in this case “do not explicitly say that the parties do not consider the letter of intent binding.”<sup>153</sup> The court rejected Paradigm’s final argument that GMA’s press release expressing “no assurance” was clear evidence of the parties’ intent not to be bound by finding that the statement was taken out of context.<sup>154</sup>

*Cavalry* and *Paradigm* serve as clear reminders of the need to be explicit as to the nonbinding nature of a letter of intent. In both cases, the appellate court reversed the trial court’s decision that the letter of intent was not binding by finding a fact issue regarding the intent of the parties. Texas law permits agreements that are subject to definitive documents to

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a fact issue as to whether approval had in fact been obtained and then later repudiated only after the litigation started. As to the second issue, the court found that the requirement that the parties “negotiate in good faith” satisfied the mutuality requirement for a binding agreement because the good faith negotiation requirement required the parties to proceed in good faith to obtain that approval. *Id.* at \*6-7.

146. *Id.* at \*2.

147. *Id.*

148. *Id.* at \*5.

149. *Id.* at \*3.

150. *Paradigm*, 2001 WL 1270795, at \*4 (the “letters of intent” included the identification of “the asset to be sold, its price and adjustments to the purchase price, royalties, a method to calculate the closing date, and the payment and financing terms.”) *Id.*

151. *Id.* at \*5 (referring to *Foreca, S.A. v. GRD Dev. Co.*, 758 S.W.2d 744 (Tex. 1988)).

152. *Id.* *Foreca* held that similar language did not definitively express the intent of the parties to be bound because the provision could be interpreted as a “condition precedent to the formation of a contract or merely a memorial of an already existing contract.” *Foreca*, 758 S.W.2d at 746.

153. *Paradigm*, 2001 WL 1270795, at \*5.

154. *Id.* The statement was included in a paragraph explaining that the deal was contingent upon Paradigm’s acquisition of SeisX, which required regulatory approvals “beyond GMA’s control.” *Id.*

be binding even if no definitive agreements are ever executed, as long as the essential terms are set forth in the preliminary letter agreement.<sup>155</sup> In fact, it appears there is a presumption that the parties intended a preliminary letter agreement to be binding if the essential terms are present and there is no explicit statement that the preliminary letter was not binding. As demonstrated in *Cavalry* and *Paradigm*, a provision making the letter of intent contingent upon a future agreement is not an explicit statement that the letter of intent is not binding. For the courts to find the letter of intent nonbinding, the letter must clearly state so.

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155. See, e.g., *Foreca, S.A. v. GRD Dev. Co.*, 758 S.W.2d 744 (Tex. 1988).

